Discussion Paper on Sustainability and the Role of Financial Institutions

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Subject

Financial institutions are banks, insurance companies, and institutional investors. Their contributions to sustainable development can basically be distinguished in two broad categories: through their internal operations, and through their core business of financial services to their clients and investments in companies and projects. There can be no doubt however, that - at least potentially - the most important contribution of the financial sector to sustainable development concerns the latter, due to its control over the essential resource of the market economy: money. The workshop should deal with the contributions of the financial sector to sustainable development, the state of the art in these fields, and feasible improvements on the short and the long term.

Banks

The following issues can be distinguished concerning their core business in relation to sustainable development:

1. Environmental risk management with respect to credits and investments,
   a. financial consequences of environmental mismanagement, first to the companies themselves and - in case of imminent bankruptcy - to their banks as well.
   b. the potential loss of (market) value of securities due to environmental deterioration (in case of foreclosure),
   c. lender (or investor) liability.
2. Environmental related market opportunities,
   a. environmental related services to corporate clients in general industrial sectors (environmental investments),
   b. specialisation to sectors of development and production of environmental technologies,
   c. specialisation to environmental related sectors, such as environmental services, application of environmental technologies, nature production, (sustainable) energy, (sustainable) agriculture.
3. Public affairs and corporate image.
   a. Risks of damage to public image due to involvement in notorious unsustainable practices,
   b. Endorsement of environmental charters (ICC charter, CERES principles, UNEP statement by banks),
4. Ethical banking.

Insurance companies

The following issues can be distinguished concerning their core business in relation to sustainable development:

1. Climate change and increasing damage through meteorological abnormalities (floods, hurricanes, droughts).
2. Environmental damage due to unforeseen events (accidents) covered by regular insurance policies.
3. Gradual environmental damage (third party and first party) covered by special environmental insurance policies.

Institutional investors

Several approached may be distinguished of investment in selected companies and projects on environmental related criteria:

1. Active involvement through the exercise of shareholder power.
2. Active involvement through the provision of capital on favourable conditions.
3. Passive involvement by offering ethical sound investment opportunities to (private) savers and investors.
4. Obtaining tax reductions for private savers and investors (in the Netherlands).
5. Environmental performance as indicator of long term returns on investment.

Observations

1. Financial institutions are getting more aware of involved in environmental issues, while most of them are mainly driven by opportunistic considerations or economic rationality (which may be benevolent to sustainable development).
2. In general banks tends to downplay the threats and opportunities related to environmental issues, and are reluctant to interfere in the internal operations of corporate clients (tradition and competition), while insurance companies seem to impose more severe conditions and to exercise more control to avoid environmental related damage (but not in the open).