

the review

PROVIDING INSIGHT AND ANALYSIS FOR FINANCIAL SERVICES PROFESSIONALS

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CHARTERED INSTITUTE FOR
SECURITIES & INVESTMENT

TEN YEARS ON FROM
THE CRASH, HOW HAS
THE SECTOR CHANGED?

IN SEARCH OF RETURNS
ON INVESTMENT IN
DIGITALISATION

LEARNING FROM
THE LIBRARY
OF MISTAKES



The lifelong learner

WE MUST ALWAYS BE LEARNING,
SAYS NEW CISI CHAIRMAN
MICHAEL COLE-FONTAYN MCSI

FOCUS ON CLIMATE: TRANSITIONING TO A SUSTAINABLE ECONOMY

PROFESSOR MICHAEL MAINELLI, EXECUTIVE CHAIRMAN OF Z/YEN GROUP; AND **MIKE WARDLE**, HEAD OF INDICES AT Z/YEN GROUP, LOOK AT HOW FINANCIAL SERVICES CAN ALIGN MORE CLOSELY WITH THE PARIS AGREEMENT AND THE SUSTAINABLE DEVELOPMENT GOALS

The Global Green Finance Index (GGFI) project was launched in spring 2017, with the first publication in spring 2018, not just to measure how 'green' financial centres are, but to help catalyse growth in this sector, improve policymakers' understanding of what makes a financial centre 'green', and shape the financial system to support sustainability goals.

Professor Michael Mainelli, Chartered FCSI, says: "Success measures' suffer from the complexity of measuring not what level of success was achieved, but what level of success should have been achieved. GGFI allows us to see how a centre would fare without a strong reputation, based on just fundamentals. GGFI hopes to provide continuous index improvement by including hypotheses about success backed by instrumental factors to measure them."

This article includes references to endnotes. The full list can be found online at cisi.org/rofmq4-18

THE CHALLENGE

Atmospheric concentrations of greenhouse gases have risen precipitously since the beginning of the Industrial Revolution. For carbon dioxide, the average concentration has increased from 282 parts per million (ppm) in 1800 to 412ppm in 2017.

The last time CO₂ levels were this high was the middle Pliocene, 3.6 million years ago. During this period, global temperatures were 2°C to 3°C higher than today.¹ Forests grew in the Arctic² and global sea levels were 25 metres higher than today.³

Inertia built into climatic systems means there is a lag between rising CO₂ concentrations and the impact on global temperatures. The full impact of carbon emissions today will not be felt for half a century.⁴ However, if all known reserves of fossil fuels were burnt, average global temperatures would rise by 10°C,⁵ rendering 99% of life on Earth extinct.

To survive, society not only has to transition economic growth onto a low carbon path that keeps temperature increases below 2°C; it must also adapt infrastructure and services to cope with the impacts of climate change.

THE ROLE OF FINANCIAL SERVICES

The financial sector is a critical means for price signals, regulation and civil society pressure to create and direct financial capital to more or less sustainable economic activity.

International and regional financial institutions, finance ministries and central banks all have crucial parts to play in achieving the goals set out in the Paris Agreement and the Sustainable Development Goals.⁶

Financial services affect development paths in three main ways:

- pricing assets and exercising ownership
- pricing risk
- flows of finance.

Policymakers, finance ministries, regulatory agencies and central banks have an enabling role in ensuring adequate transparency and governance, providing a level playing field and ensuring a stable policy environment in which long-term investment can take place.

ARE FINANCIAL SERVICES LIVING UP TO THE CHALLENGE?

Pricing assets and exercising ownership

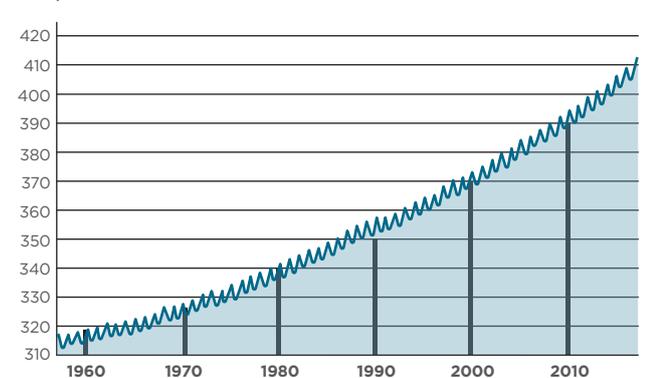
It is estimated that worldwide, 20% of all funds are now managed on socially responsible investment (SRI) principles.⁷ Globally, there are now US\$22.89tn of assets being professionally managed under responsible investment strategies,

an increase of 25% since 2014.⁸ Impact investment funds grew from US\$25.4bn to US\$35.5bn between 2013 and 2015. Pressure is ramping up on

// WORLDWIDE, 20% OF ALL FUNDS ARE NOW MANAGED ON SRI PRINCIPLES //

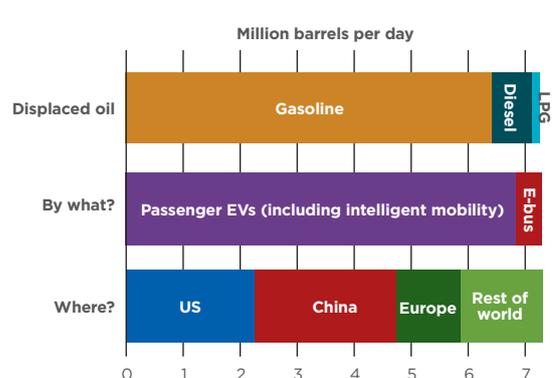
businesses. The Carbon Disclosure Project now collects information on climate risks and low carbon opportunities from the world's largest companies on behalf of over 650 institutional investor signatories with a

CHART 1: MONTHLY CARBON DIOXIDE CONCENTRATION
Parts per million



Source: <http://scrippsco2.ucsd.edu>

CHART 2: OIL DISPLACED DUE TO ELECTRIFICATION IN 2040



Source: Bloomberg New Energy Finance

CHART 3: GROWTH OF FOSSIL-FUEL DIVESTMENT

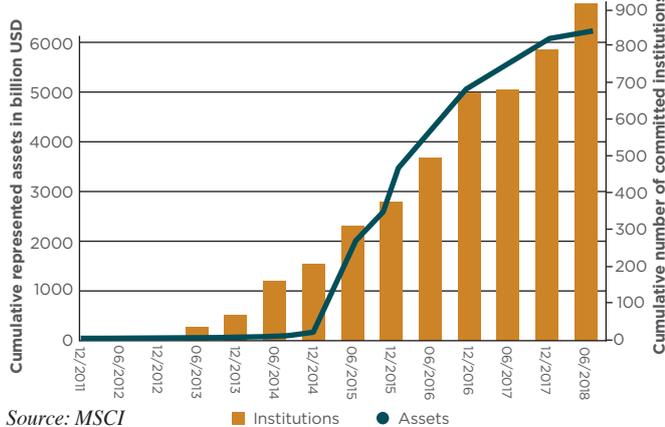
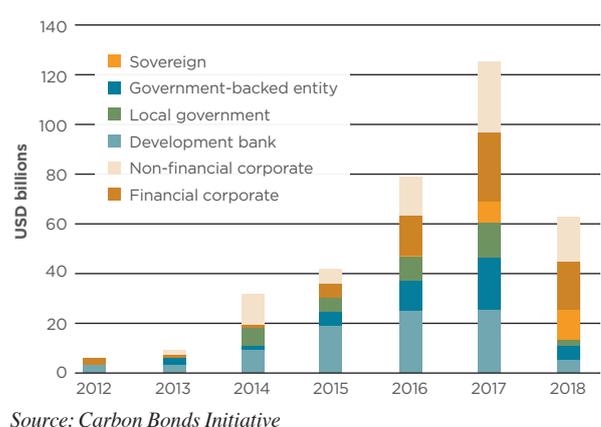


CHART 4: FLOWS OF FINANCE



combined US\$87tn in assets. Shareholder activism is also increasing, with pressure being placed on fossil fuel companies for disclosure of risks associated with 'stranded assets'.⁹

Pricing risk

Climate concerns and technological changes are creating new pricing risks, dramatically illustrated by the collapse in value and bankruptcies of several US coal companies in recent years.¹⁰ Overcapacity, the rise of electric vehicles,¹¹ stranded assets and pricing issues are still major risks for fossil fuel and related industries.¹²

It is no surprise that stock exchanges around the world are embracing market transparency on climate and other impacts – 23 stock exchanges currently incorporate reporting on environmental, social and governance (ESG) information into their listing rules and 15 provide formal guidance to issuers.¹³

ESG analytics has long been a key tool for specialist SRI funds. Increasingly, it is being used in relation to mainstream investment analysis and is becoming a factor used by rating agencies.¹⁴

Momentum is growing on disinvestment and structured disinvestment, with a number of high-profile sovereign funds cutting their holdings in fossil fuel companies.

Flows of finance

The global growth of green bond markets has played a significant role in raising the profile of green finance. Globally, 14 stock exchanges now have dedicated segments for green or

sustainable bonds,¹⁵ and there has been strong growth in the issuance of green bonds – with 2016 seeing the issuance of the first sovereign green bonds.

FINANCIAL CENTRE LEADERSHIP

While national policymakers seek to capitalise on what is perceived as a new market opportunity, through a variety of national programmes, for financial centres the emphasis is very much on

// FOR FINANCIAL CENTRES, THE EMPHASIS IS ON COLLABORATION, COOPERATION, SHARING OF BEST PRACTICE //

collaboration, cooperation and the sharing of best practice. Initiatives such as Financial Centres for Sustainability,¹⁶ the Sustainable Stock Exchange Initiative¹⁷ and UNEP FI¹⁸ continue to provide

valuable resources which are encouraging the growth of the green finance sector.

A MOUNTAIN YET TO CLIMB

The transition to a green economy, required if the world is to meet the targets laid down in the Paris Agreement and avoid catastrophic climate change, is a huge global investment opportunity: the International Energy Agency (IEA) estimates that US\$26tn of additional investment is needed just in renewables and energy efficiency between 2015 and 2040 to achieve the 2°C target – around US\$1tn a year – not including the large amounts needed for climate mitigation.¹⁹

However, green finance has a long way to go if it is to penetrate and displace the enormous amounts of finance for carbon intensive activities, or 'brown finance'. In 2016, global climate finance flows were

US\$383bn, less than half the US\$1tn a year needed under the latent IEA estimate.²⁰ Only 5–10% of bank loans are 'green'²¹ (based on data from the few countries where national definitions of green loans are available), and 'brown' finance flows all massively overshadow green finance even in the public sector: G20 countries alone received US\$72bn in annual public financing for fossil fuel energy between 2013 and 2015, and only US\$18.7bn for clean energy.²²

In 1960, the carbon intensity of the world's GDP was 1,000 gr CO₂ per dollar. By 2000, this had dropped to 500 gr CO₂ per dollar. By 2010, this had reduced to 400 gr CO₂ per dollar. Despite this rapid progress, if we are to have any hope of attaining the Paris target of limiting global warming to 1.5°C, the carbon intensity of GDP must be below 60 gr CO₂ per dollar by 2050.

The progress made by the centres listed in the Global Green Finance Index is heartening, but there is a mountain yet to climb.

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