

Sustainable Finance

Rising Concerns about Climate Change

Humanity has gone from 1 billion people in 1800 to 4 in 1975 and 8 in 2023. Result of huge technological, financial and industrial development around the globe since the Industrial Revolution. But those transformations were only possible thanks to one thing: Energy.

And this energy, well we found it in multiple forms but the main ones used were fossil fuels (gas, coal, petroleum, etc...) with all sharing three main specific characteristics :

They are fossil fuels and their formation takes millions of years.

They contain carbon which when burned releases energy in the form of heat that can be used for electricity generation, heating, powering vehicles,

They produce greenhouse gases when burned.

And, you know, more people, more technology and industry development, means more energy consumption which also means more carbon burned and finally more greenhouse gases (GHG) in the air. Basic maths.

[twitter.com/ScottDuncanWX/Climate change from 1880-2022](https://twitter.com/ScottDuncanWX/Climate%20change%20from%201880-2022)

It was in 1987, during the Montreal Protocol that we first restricted the use of certain products, mainly chemicals, to prevent damaging the ozone layer. Then followed several Governmental meetings and reports that were not very useful, as any commitment was made by the government to develop public policy that was aligned with those problems. We had to wait until 2021, at the COP21 that was held in Paris, to see countries commit themselves to long-term goals and persistent evaluation with more transparency toward reducing GHG emissions to limit the global temperature rising 2 degrees Celsius this century and providing necessary financings to developing countries to mitigate climate change.

Finance and Climate: is it a good combination?

When it comes to finance, the association with climate change might initially seem incongruous, considering that finance has historically driven rapid economic development, enabling companies to expand and, inadvertently, contribute to pollution. The question arises: how can finance contribute to a future rooted in low or zero-carbon emissions while respecting the environment?

One answer lies in the fundamental principle of finance: the creation of long-term value. Can companies or countries sustain growth and generate value for their shareholders (in the case of companies) or citizens (in the case of countries) if they persistently pollute and harm their natural resources?

The fundamental shift is in recognising that sustainable practices and environmental responsibility are essential components of long-term value creation in the financial world. By aligning financial strategies with environmental preservation, finance can play a pivotal role in shaping a future that is both economically prosperous and ecologically sustainable.

Sustainable Financial: Regulation and Innovation

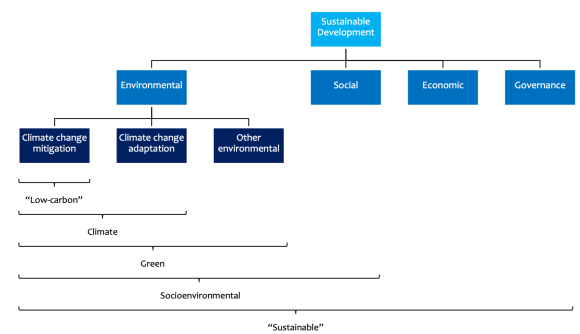
Climate Finance, Green Finance, Sustainable Finance ? Here some clarity:

- **Climate Finance** is a subset of environmental, or green finance and aims to support the public or private sectors to address climate change through mitigation or adaptation.

- **Green Finance** or environmental finance is a part of sustainable finance and includes climate finance but excludes social and economic aspects. Green finance takes into consideration environmental objectives such as whether the investments would preserve biodiversity and water and marine resources, prevent pollution, boost the circular economy, or ;support climate change mitigation and adaptation.

- **Sustainable finance** is the broader concept that includes not only green investments but also social, economic and governance characteristics (ESG) issues and risks, to increase long-term investments in sustainable economic activities and projects.

Exhibit 3: A simplified schema for understanding broad terms



To prevent greenwashing, regulators are increasingly integrating frameworks like SFDR (Sustainable Finance Disclosure Regulation) and TCFD (Task Force on Climate-related Financial Disclosures) into their regulatory standards.

SFDR, or Sustainable Finance Disclosure Regulation, is a European Union regulation aimed at promoting sustainability and transparency in the financial sector. The regulation therefore requires financial market participants and financial advisers to disclose certain information about the environmental and social impacts of their investment products. Under SFDR, investment products are categorised into three principal articles:

Article 6 applies to products that do not promote environmental or social characteristics. These products don't have sustainable investment objectives, and their managers are not required to consider adverse sustainability impacts in their investment decisions.

Article 8 products are those that promote environmental or social characteristics. These products have sustainable investment objectives, and their managers are required to disclose how those characteristics are met. For Article 8 products, the disclosure requirements are more stringent than those for Article 6 products.

Article 9 of SFDR applies to products with sustainable investment objectives. These products have a specific environmental or social objective, and their managers are required to disclose how those objectives are achieved. Article 9 products have the highest level of transparency requirements.

The Financial Stability Board (an international body that monitors and makes recommendations about the global financial system) created the Task Force on Climate-related Financial Disclosures (TCFD) to improve and increase the reporting of climate-related financial information. To accomplish this goal, TCFD has developed a reporting framework based on a set of consistent disclosure recommendations. These guidelines are intended for companies to ensure transparency regarding their climate-related risk exposures, providing valuable information to investors, lenders, and insurance underwriters.

These regulations aim to establish a meaningful and practical framework for the finance industry to coordinate efforts toward sustainable growth while preventing deceptive greenwashing practices. By doing so, these regulations provide clear guidelines for financial institutions, enabling them to align their objectives with sustainability goals. Consequently, investors gain a transparent understanding of which products genuinely support a sustainable future, allowing them to make more informed and responsible investment choices.

It has enabled the creation of innovative sustainable products that align financial investments with environmental, social, and governance (ESG) objectives, promoting a greener and more socially responsible future. These financial instruments include among others:

- **Green Bonds:** debt securities issued by governments, municipalities, or private institutions to finance environmentally friendly projects. The funds raised through green bonds are specifically allocated to initiatives such as renewable energy projects, energy efficiency improvements, clean transportation, and other eco-friendly endeavours. Investors in green bonds contribute to projects that directly address climate change and promote environmental sustainability.
- **Social Bonds:** are similar to green bonds but focus on funding projects with positive social impacts. These projects often include initiatives related to affordable housing, healthcare, education, and community development. Social bonds provide financial support to organisations

and projects that aim to improve social welfare and address societal challenges. Investors in social bonds play a vital role in advancing social equity and supporting underserved communities.

- **Sustainability Linked Bonds:** Sustainability Linked Bonds (SLBs) are unique financial instruments where the issuer commits to specific sustainability performance targets. If the issuer meets these predefined targets, the bondholders receive a financial reward, such as a coupon rate adjustment. SLBs incentivize companies to improve their sustainability practices, encouraging them to reduce carbon emissions, enhance energy efficiency, or achieve other measurable ESG goals. These bonds provide a direct link between a company's sustainability performance and its financial obligations, aligning economic success with environmental and social responsibility.

These innovative products not only attract socially conscious investors but also drive positive change by directing funds towards projects and initiatives that contribute to a sustainable and equitable future. Through the issuance and investment in these instruments, financial markets are increasingly becoming powerful catalysts for environmentally friendly and socially beneficial endeavours.

Why is it important? Analysis of recent IPCC reports

As per the IPCC, developing countries will require \$127 billion annually by 2030 and \$295 billion yearly by 2050 to cope with the impacts of climate change. However, the funding allocated for adaptation purposes amounted to only \$23 billion to \$46 billion between 2017 and 2018, comprising merely 4% to 8% of the total climate finance tracked. Still, the IPCC finds that with adequate support, existing and easily accessible adaptation solutions can build resilience against climate-related risks and, in many cases, deliver wider sustainable development advantages.

In the last IPCC report the urgency to fight climate change has never been clearer. With global warming already at 1.1 degrees Celsius, we are witnessing unprecedented climate changes, including rising sea levels and extreme weather events. These changes have severe impacts on people and ecosystems, leading to water scarcity, disease spread, reduced agricultural productivity, and forced migrations. Even efforts to limit warming to 1.5 degrees Celsius won't ensure safety for all. Urgent adaptation measures are essential, yet funding falls significantly short, especially for developing countries. Irreversible losses, such as coral reef destruction and coastal communities' displacement, emphasise the need for immediate action. To limit warming, global greenhouse gas emissions must peak before 2025, demanding a rapid shift away from fossil fuels and systemic transformations across society. Carbon removal, increased climate finance, and ensuring a just transition are primordial.

The need for financing is as urgent as huge, and requires both public and private contribution. Governments and international financial institutions must collaborate to mobilise the necessary funds, honouring their commitments to support developing nations in their climate adaptation efforts. Private sector engagement is equally crucial, with businesses investing in sustainable technologies, resilient infrastructure, and environmentally responsible practices.

Only through concerted global efforts and substantial financial commitments we can hope to safeguard communities and ecosystems from the escalating impacts of climate change.

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