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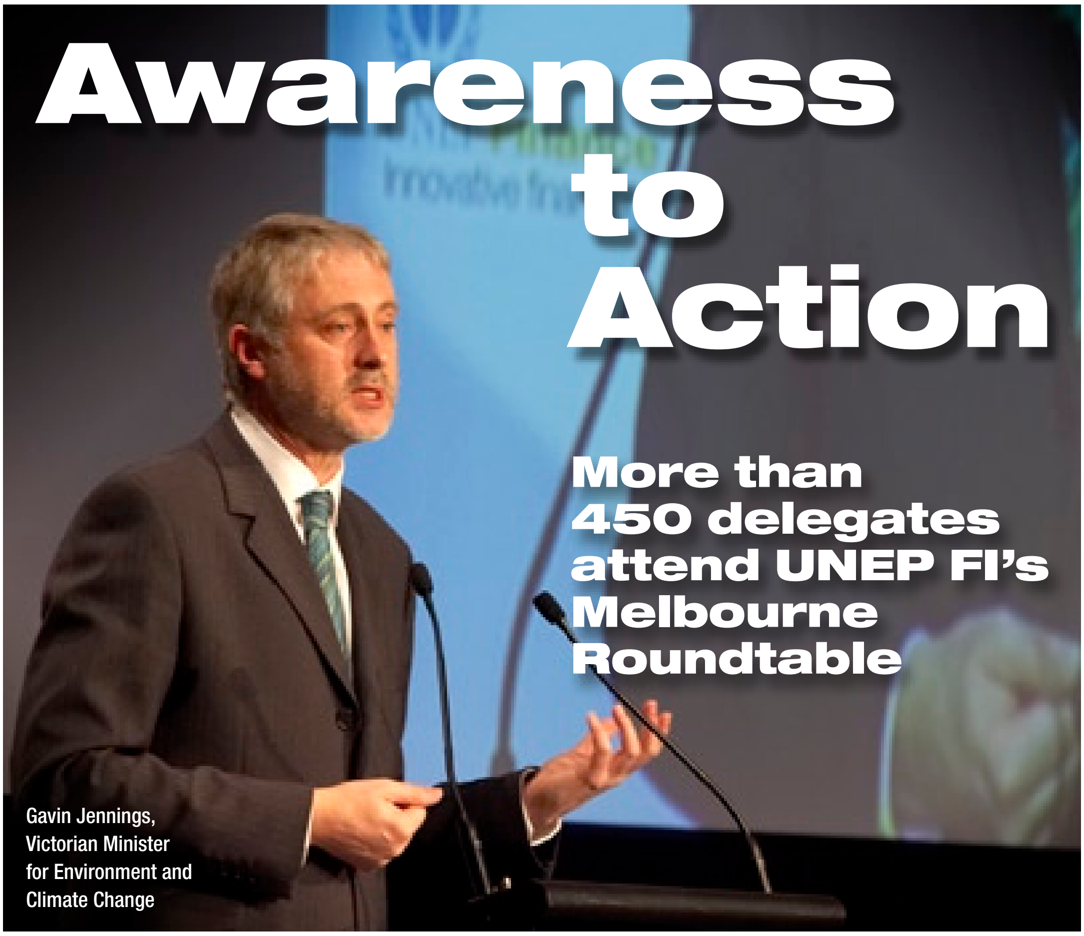
UNEP Finance Initiative
Innovative financing for sustainability

Briefing

UNEP Finance Initiative news from Australasia

Awareness to Action

More than 450 delegates attend UNEP FI's Melbourne Roundtable



Gavin Jennings, Victorian Minister for Environment and Climate Change

Financial institutions and investors controlling trillions of US dollars can transform the world's future markets and help to mitigate the global environmental crisis if they back the ideas, technologies and companies that are in the vanguard of sustainable development.

And there is a growing urgency to introduce Environmental, Social and Governance (ESG) principles into the mainstream operations of financial institutions worldwide.

Those were the two principal messages conveyed to around 460 delegates attending the "Awareness to Action" Roundtable, the biennial gathering of bankers, insurers and finance services industry delegates, staged by the United Nations Environment Programme Finance Initiative (UNEP FI) in Melbourne on 24–25 October 2007.

The Roundtable's two days of working sessions attracted 285 delegates from Australia and 171 delegates from 34 overseas countries, ranging from South America and Africa to the United States.

Delegates could attend any of four plenary sessions, 20 workshops and a number of significant product and report launches.

Presiding at the opening ceremony was Martin Hancock, Chief Operating Officer – Westpac (London) and Chair, UNEP Finance Initiative, accompanied on the podium by Sylvie Lemmet, Director, UNEP Division of Technology, Industry and Economics (DTIE). Representing the Victorian Government was the Minister for Environment and Climate Change, Mr Gavin Jennings MLC (photo, above). >

Speakers and moderators at the Roundtable were drawn from all areas of the financial services community and included:

- **The Rt. Hon. Michael Moore**, Former Director-General World Trade Organisation and Former Prime Minister of New Zealand
- **Mary Robinson**, former President of Ireland and UN High Commissioner for Human Rights (video-link)
- **Xavier Desmadryl**, Global Head of SRI Research – HSBC Investments
- **Rachel Kyte**, Director, Environment & Social Development Department, International Finance Corporation (video-link)
- **Steve Gibbs**, CEO, Australian Reward Investment Alliance
- **Leo Johnson**, Co-founder and Partner, Sustainable Finance
- **Bien Subiantoro**, Director, Commercial & Syariah Banking – PT Bank Negara Indonesia
- **John Kalfayan**, Senior Manager for Technical Services – World Council of Credit Unions (WOCCU)
- **Christopher Wells**, Environmental Risk Manager for Latin America – ABN AMRO Banco Real (video-link)
- **James Cameron**, Founding Partner, Climate Change Capital and Chairman, Carbon Disclosure Project
- **Dr Matthew Kiernan**, Founder and CEO of Innovest.

Other distinguished delegates included **Prof. Li Junfeng**, Deputy Director General of Energy Research Institute and Secretary General of China Renewable Energy Industries Association; **Renjie Li**, President of the Industrial Bank of China; and **Nobuyuki Hirano**, Director of the Bank of Tokyo Mitsubishi UFJ.

Melbourne provided a focus on Asia Pacific

Melbourne was chosen as the site for the Roundtable because Australian financial institutions have been at the forefront of integrating sustainability aspects into financial products and services over a number of years. EPA Victoria, a UNEP FI partner based in Melbourne, has coordinated Australasian UNEP FI activities since 2000. In the last few years, UNEP FI has been increasing its worldwide membership, with a focus on the Asia Pacific.

In 2004, financial institutions from the Asia Pacific constituted 12 percent of all UNEP FI signatories; in 2007 the number stood at 30 percent. Staging the Roundtable in Melbourne allowed UNEP FI to further raise its profile in the region and attract a large number of delegates from Asia-Pacific countries.

This increase in membership is tangible evidence of how financial institutions are increasingly eager to learn how they can develop and adopt sustainable finance principles.

Challenges

The Roundtable's discussion agenda addressed the world's unprecedented environmental degradation – most notably climate change – and confirmed that dealing with these issues through sustainable development initiatives and Responsible Investment is the great moral, social, financial and economic imperative of our time.

The Roundtable reached general agreement that, although an increasing number of companies are now converting their awareness of sustainable development into action, UNEP FI's greatest ongoing challenge is the mainstreaming of the sustainable development ethos across the broad spectrum of the financial services and interconnected capital markets community.

UNEP FI affirmed a commitment to assist financial institutions to move from awareness of sustainable development into an action phase, whereby financial institutions need to adopt innovative financing for sustainability through the introduction of Responsible Investing and Environmental Social and Governance (ESG) principles into their day-to-day business practices.

The latter report discusses the misconception that responsible investment leads only to underperformance and also that various factors such as managerial skill, investment style and time period are all integral to investment performance.

According to Jane Ambachtscheer, Global Head of Responsible Investment – Mercer's Consulting Business, the report shows that the investment community is taking first steps towards making ESG considerations more mainstream.

A changing world

The Roundtable heard an overview of the powerful mega-trends of society that are rapidly becoming the deep roots of business risk and prosperity. These trends present amazing new business opportunities, according to Steve Gibbs, CEO of the Australian Reward Investment Alliance.

Discussing the 10 mega-trends that would dominate the 21st century, Mr Gibbs said that population growth meant the planet was "hitting its limits". The century would be defined as the century of resource scarcity – a scarcity of clean air, clean water and arable land to grow food, trees and fuels.

Several keynote speakers identified an urgent need to price these natural resources, both to encourage more sustainable consumption and to avoid waste.

Delegates heard about several sustainability issues confronting investors, including climate change, water shortages, the rise in pandemics, the end of cheap oil, product safety in emerging nations, and the scarcity of all natural resources in the face of a ballooning population.

Emerging markets

The Roundtable heard that more than 3 billion people live in emerging markets – many without access to basic financial services.

Chris Wells from ABN Amro identified two lessons from emerging markets:

1. there are definitely financial risks in emerging markets and often these stem from environmental risks, and
2. there is a high rate of co-incidence between companies with environmental problems and those with financial problems.

On the positive side, first movers in emerging markets are also poised to gain long term branding benefits, with carbons emissions trading a major opportunity for the Australian sector.

Environment and climate change

From around the world, the Roundtable heard real examples of how UNEP FI signatories are turning awareness of sustainable development into action.

The Roundtable found that there is a disconnect between the longer-term issue of climate change compared with the short-term judgments that a lot of asset managers make. There remains a challenge to get asset owners and asset managers to take climate change into account.

Four key conference outcomes

as nominated by Martin Hancock, Chair of UNEP FI

Martin Hancock, Chair of UNEP FI, welcomes delegates to the Roundtable

First, the 2007 Roundtable clearly demonstrated the transition from "Awareness to Action" of sustainable development. The Carbon Disclosure Project Report, the Demystifying Responsible Investment Report and the new Responsible Investment slide show were not just information – they will all play a valuable role in transforming the way financial institutions think and hopefully do business, and how our global financial and capital markets work.

Second, the extensive range of sustainability issues that financial institutions now face from different parts of the world, and are expected to understand and deal with, are a tremendous challenge. Working groups within the UNEP FI are working exceedingly hard to address these challenges. UNEP FI has actually raised the bar and UNEP FI will continue to provide leadership on sustainability issues for the finance sector. It will empower its members with the means to identify and address environmental and social risks and opportunities in their operations. UNEP FI can help its members deal with this complexity through the development and provision of practical and pragmatic guidance, as well as engineered training courses.

Third, UNEP FI enjoys a unique positioning, which greatly assists it to promote sustainable development and bring about desired financial and environmental reforms. It has a foot in both the multilateral world that is the United Nations, and another within the financial services sector and capital markets community. This allows UNEP FI to see early-emerging developments and priorities in public policy that will affect the operating context for financial institutions worldwide. Whether this occurs in the environmental or social areas, it provides a critical early insight into coming changes, and is a unique advantage of UNEP FI.

Fourth, the vibrancy of the UNEP FI Regional Taskforces network is tremendous, especially in Africa, Latin America, North America and certainly Asia, which accounts for about 30 percent of our membership now. This indicates the growing interest and importance of sustainable finance and responsible investment worldwide. However, it is clear that different regions have a variety of challenges and sustainability priorities. Future investment in, and support for, the regional taskforces is critical to the overall growth and future success of UNEP FI.

Keynote speakers from the host nation indicated that while Australian customers wanted to support the environment, they weren't yet prepared to do so at premium costs.

Environmental, Social and Governance (ESG) issues

Banking delegates informed the Roundtable that for ESG to be truly mainstream, it must relate directly to investment returns.

Speakers at an open debate on climate change and investment agreed: "Only when an institution believes that climate change is within their fiduciary duty to address, will it move to have that tough conversation with the asset manager. The challenge is to communicate the urgency of the issue to the asset manager – every sector could be affected by climate change or carbon risk – so research and feedback from the sales side is so important."

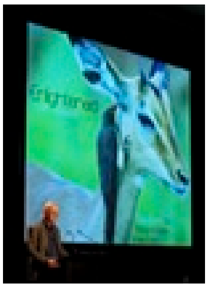
Human rights

The Roundtable heard that free markets and sustainable development are essential for the preservation of human rights. The financial sector has great influence in this area, because the lenders of money have the power to deny loans to those who would infringe human rights.

Speaking on a video-link, Mary Robinson, former President of Ireland and UN High Commissioner for Human Rights, said businesses have a key role to play in ensuring appropriate human rights standards are maintained. >

Roundtable Highlights

Highlights from the Roundtable's various sessions and workshops included:



The launch of a new slide show, *Enlightened Self-Interest*, which outlines 10 powerful mega trends that should be considered by investors in their investment decisions, and that is available to use by application

The launch of *Demystifying Responsible Investment Performance – A Review of Key Academic and Broker Research on ESG Factors*, a significant, joint report of the UNEP FI Asset Management Working Group and Mercer

An online toolkit, launched at the Roundtable, has been developed through UNEP FI to provide front-line lenders with the tools to identify potential human rights risks. The toolkit provides guidance and information on specific sectors such as child labour in the textile sector, while highlighting relevant laws, standards and initiatives.

The way forward

Participants in the Roundtable's many workshops identified many problems for sustainable finance – and some solutions – on the way forward.

Reliable data – and more of it – is one of the keys to sustainable finance, as are open and transparent markets.

With the growth of the sustainable banking market, consumers are placing increasing scrutiny on green credentials and financial institutions around the world are increasingly responding to the surging market for sustainable retail banking products, according to Roundtable participants. In many regions around the globe, consumer awareness is ahead of supply of sustainable retail banking products.

The Roundtable heard that although insurance companies are experts in pricing risk, the challenge for the insurance sector is to drive the monetization of risks – to bring forward future risks in terms of today's dollars.

Also, as markets do not generally value the service provided by ecosystems, many speakers argued government assistance is needed to create institutions that would enable transactions in environmental services to take place.

Key outcomes

In his summing up of the final Plenary Session, Martin Hancock, outgoing Chair of the UNEP Finance Initiative, said that "the current business-as-usual model is definitely not an option. In the two days of this Roundtable, we have taken some long strides in the journey from Awareness to Action, but we have got a lot further to go."

Priorities

The speed with which people have signed up to the UNEP FI's Principles for Responsible Investment is an indicator that the financial services community is indeed moving into an action phase.

The next stage is for UNEP FI to help develop the metrics, the processes, and the procedures to embed those principles into the fund managers' and pension fund managers' operations.

UNEP FI in 2007 has a membership of almost 180 global financial institutions, all with different sets of problems. For example, clean water and water scarcity is not a problem in Europe. In Australia and parts of Africa, it is a recurring problem.

UNEP FI must now take all the different elements from its global membership and develop a program that, ideally, helps everybody. It must take into consideration the work-streams, develop more tools, more capacity building and do out-reach to other regions that are experiencing particular environmental issues.

This will facilitate the entire world finance community coming together to consider how a global environmental and social agenda might be put in place.

The next UNEP FI Global Roundtable will be held in Africa in 2009.

The future role of UNEP FI

In the words of Achim Steiner, Executive Director of the United Nations Environment Programme:

"We cannot underestimate the influence of financial services and the potential impact of the world's most powerful private institutions on delivering a more intelligent management of the environment and its nature-based assets."

"Climate change is one area where UNEP FI has taken a leading role, launching the first global statement by the financial services sector on climate change on World Environment Day 2007.

"In the coming years, the sector will be judged on how its core business rolls out financial products that allocate capital and fully integrate environmental and social factors.

"Along with other UN efforts, UNEP stands ready to work with banks, insurers and investment companies to make sustainable development the key to long-lasting and future success."

UNEP Executive Director calls for more intelligent management of the environment

"Climate change is one area where UNEP FI has taken a leading role, launching the first global statement by the financial services sector on climate change"

In his message to "Awareness To Action" UNEP FI Global Roundtable delegates, Achim Steiner, United Nations Environment Programme (UNEP) Executive Director and UN Under-Secretary-General, pointed out that it had been 15 years since 28 banks and their $2 trillion in assets gathered in New York to sign a UNEP commitment to sound environmental management.

This was subsequently presented to the historic 1992 Rio de Janeiro Earth Summit a week later. Since then, the commitment between UNEP and those original 28 banks has grown into a unique public-private partnership with almost 180 banks, insurers and asset managers from 38 countries, known as the UNEP Finance Initiative.

"In the transformational years since UNEP FI began, financial services and capital markets have operated in a rapidly changing and globalised economy that has delivered the hope of prosperity for more people but at the same time has intensified our collective environmental and social challenges," said Mr Steiner.

Real and present dangers

"The threat of climate change impacts, the struggle to protect fragile ecosystems, and the understanding of the economic and social impacts of urban and industrial pollution, are embedded in the global public perception as real and present dangers.

"Those attending the UNEP FI Global Roundtable in Melbourne have explored the urgent need to align the environmental and economic priorities in our globalised economy, and the critical part played in this process by the worldwide financial services sector and our interconnected capital markets.

"Nor should we forget the fundamental importance of the assets that intimately support our financial institutions, economies, capital markets and ultimately all life on Earth."

UN Millennium Goals

"Without the aligned support of the finance and investment sectors, we cannot hope to attain the UN Millennium Goals of alleviating poverty, helping countries develop sustainably, protecting the environment and providing health and education. >

Highlights of a growing awareness

- **More than 230 institutional investors from 30 countries, representing USD 10 trillion in assets, now back the Principles for Responsible Investment – the PRI – launched by former United Nations Secretary General Kofi Annan in 2006.**
- **The strong participation in the PRI sends the clearest of signals to the broader investment community and capital markets that environmental, social and governance considerations have to be part of mainstream business and investment considerations.**
- **More than 50 banks representing more than 85 per cent of global project finance have signed the Equator Principles, a voluntary code giving best practice guidance to banks financing extractive industry, infrastructure, industrial and transport projects, amongst others, that top USD 10 million.**
- **UNEP FI's insurance group is developing a set of Principles for Sustainable Insurance to mirror those provided by the PRI for the investment community. The principles will reflect broader sustainability issues to assist in the development of risk-mitigating and risk- transferring products that address both the challenges and opportunities of sustainable development.**

"At the same time, there is increasing scrutiny of companies and investments for their environmental, social and human rights values. Several recent cases show the increased risks to a company's reputation – and indeed bottom line – when they do not manage these issues effectively. In a global market where information flows instantaneously, there are now few places to hide.

"So, what can financial institutions do?" asked Mr Steiner.

"The UNEP FI partnership is one step to help companies understand the opportunities for new investments, and the risks of inaction.

"Climate change is one area where UNEP FI has taken a leading role, launching the first global statement by the financial services sector on climate change on World Environment Day 2007, immediately before the meeting of G8 Heads of Government in Germany.

"The UNEP FI declaration states that without immediate action to create a low carbon economy, the world could experience annual economic losses as high as USD 1 trillion by 2040."

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Climate change – a core business issue

Along with grave social and environmental harm from climate-related disasters, the statement says climate change "could result in a reduction in global GDP equivalent to the economic impacts of the 20th century's major conflicts…"

"Signals move markets and the signal the UNEP FI global statement made to fellow institutions is that climate change is a core business issue that cannot be ignored by any serious institution," said Mr Steiner.

Sustainability will not happen overnight

"The examples of change within financial services are encouraging although placing sustainability in the mainstream of the sector will not happen overnight and will be forged over many years and decades ahead.

"The sector's role in aligning environmental and economic values will be an important factor determining the pace at which this fundamental transformation of our markets and the way we do business takes place," added Mr Steiner.

A sea change in thinking among banks

Financial institutions around the world are increasingly responding to the surging market for sustainable retail banking products.

"There's a real sea change in what's going on right now in the corporate mindset," said Katie Sullivan, an associate at ICF International.

Ms. Sullivan said institutions of all sizes are beginning to see sustainable products as essential profit areas, pushing products aggressively rather than as experiments or 'whims'.

In many regions around the globe, consumer awareness is ahead of demand, said Tony Innes, Deputy Executive of Savings & Loans Credit Union.

Demand is highest among retirees and school leavers, said Mr Innes. "People coming out of school are expecting us to be doing this."

But government initiatives are also key creators of this consumer demand, according to the Sustainable Retail Banking Workshop. In the United States, the number of banks offering 'green' mortgages tripled after its government made climate emissions commitments last year.

Consumers have good intentions and want to be green but need incentives to do so

But while Australian customers want to support the environment, they aren't yet prepared to do so at premium costs.

"People have good intentions, but we need to create the incentives," Mr Innes said. "A lot of customers want to help the environment but can't afford to pay extra."

"Greenwashing" Won't Work

First movers in emerging markets are also poised to gain long term branding benefits, with carbon emissions trading a major opportunity for the Australian sector.

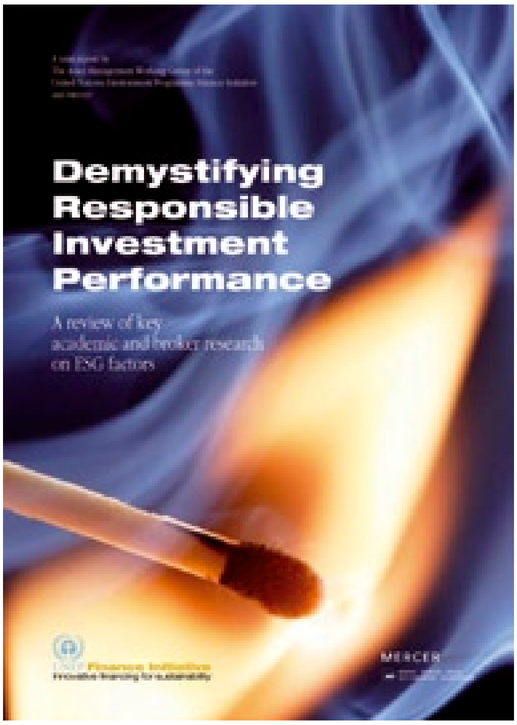
But with the growth of the sustainable banking market, Ms. Sullivan warned that consumers are placing increasing scrutiny on "green" credentials.

"If you're going to invest in an offset program for a car loan or a credit card, make sure the offsets are verified by a third party. I can't re-iterate enough that the benefits must be real, or it will come back to haunt you," she said.

Environmental, social and governance factors can improve investment portfolio performance

The Roundtable saw the launch of the performance report *Demystifying Responsible Investment Performance*, a review of key academic and broker research on Environmental, Social and Governance (ESG) factors, which was sponsored by HSBC, one of the world's largest banks.

The report is the product of a strategic alliance of more than 15 strategy managers – and includes 20 academic studies and 10 broker studies. It covers a range of varied research methods, regions and approaches, while looking at the overall state of ESG integration.



A key finding is that portfolio results usually improve when investors considered ecological and human rights issues.

"The report shows that the investment community is taking the first steps towards making ESG considerations more mainstream," said Jane Ambachtsheer, Global Head of Responsible Investment, Mercer.

"The question that we get from clients time and time again is 'Is this going to hurt returns?' I point out that ESG integration doesn't have to negatively impact performance. And integration of ESG into investment can help you to manage risk."

The report found that the idea that responsible investment leads only to under-performance is a misconception, and that various factors such as managerial skill, investment style and time period are all integral to investment performance.

Evidence suggests that there appears to be no detrimental effect on performance from taking ESG factors into account in the investment management process.

Pursuit of profit continues to override ESG

Eurizon Capital Fund Manager Gianluca Manca, Head of Global SRI Equities, spoke of the difficulties companies have in putting into perspective "the efforts of today for the benefits of tomorrow."

"While it is generally accepted that ESG issues have a material impact on companies' valuations, there does not yet seem to be a unique way to determine the value of such impact," said Mr Manca. "The pursuit of profit continues to override the ESG consideration."

Mr. Manca also showed some examples of new methodology that can be used to calculate brand values, taking into account ESG factors.

Jean Philippe Desmartin, Head of SRI Research, Oddo Securities, explained how he would integrate ESG research into his evaluation models.

"Many investors have a 'one day/one loss' view – it is a real revolution to talk about even one year, and 25 years," said Mr Desmartin.

He listed the three evaluation methods he uses when learning from new research – ESG Key Performance Indicators, ESG events, and monetary value (both top and bottom line).

ESG education is under-represented at universities

Dr Hendrik Garz, Executive Director of West LB AG, described the materiality – a "very abstract concept" – of ESG factors, observing that while it is incredibly hard to deliver concrete proof of ESG performance, he believes that it is not absolutely necessary to do so.

"The most efficient approach to changing behaviour is education. ESG education is under-represented at universities, but the next generation needs the philosophy and the tools of ESG being taught to them," said Dr. Garz.

Download *Demystifying Responsible Investment Performance* at www.unepfi.org

Mike Moore salutes globalisation and the emergence of the Asia-Pacific age

“A reputation is vulnerable. It’s hard to win. It’s easy to lose... Business and government must conduct themselves in a more ethical and transparent manner. Virtue will be prized and rewarded”

In the Roundtable’s plenary session “Awareness to Action”, keynote speaker Michael Moore, former Director-General of the World Trade Organisation and former Prime Minister of New Zealand, offered both a spirited defence of “that much abused word” globalisation and a plea to stand staunch in favour of those market mechanisms which have delivered so much to us in the last 50 years.

He stressed that governments matter and optimism and globalisation will drive sustainable finance in the years ahead. Open and transparent markets are needed for sustainable finance, and competitive trade agreements are crucial for effective and efficient operation of markets.

Mr. Moore said that the last 50 years have been the most successful in human experience and the last 10 years have produced more global growth than any other decade in human history. Life expectancy has increased by 20 years and infant mortality rates have dropped by two-thirds.

History demonstrates that when living standards rise, so do people’s expectations of society and their demands upon it. Mr Moore said that the greatest threat to the environment was poverty.

He strongly endorsed the emergence of an Asia-Pacific age, as demonstrated by the escalating economic power of China and India.

“Nowadays there are only two classes of people – those who are talking about China and India and those who are not,” said Mr Moore.

“Thanks to the wonders of compound growth, if China can maintain the growth of the past 25 years, in another 16 years its average income will equal Portugal’s and South Korea’s and in another nine years equal the Americas.”

And China and India are now dragging Africa along, according to Mr Moore. Africa has missed out on the globalisation of the past 50 years, but there are now positive signs that sub-Saharan Africa is integrating into the world economy.

Impressive successes of globalisation, competition and the free market system

- South Korea’s GDP per capita did not reach $100 until 1963 – since then, life expectancy has risen from 54 years to 73 years, and infant morality has dropped from 8.0 per cent to 0.8 per cent.
- In China, up to 400 million people have been lifted from extreme poverty in 30 years.
- Given projections of Chinese growth, which gives them a per capita consumption equal to the US by 2031, China would then consume two-thirds of the world’s grain, and its paper consumption would double the world’s output.
- 20 years ago, China was self-sufficient in oil; it will soon be the world’s largest importer.
- 30 years ago, China shunned foreign investment, now she is the biggest recipient of it.
- Japan and Korea now trade more with China than the US.

Michael Moore addresses Roundtable delegates

Of the 20 fastest-growing economies in 2006, five are in Africa, and three are in the top 10. Africa's exports to China have increased 40 per cent per year since 2002.

Freeing up trade curbs domestic giants, by exposing them to competition. Closed domestic markets, where nationally famous companies "cosy up" to governments, are more likely to harbour monopolies than open ones.

"Even though many global companies are getting bigger, it does not necessarily give them more clout. It's the absence of competitors, not size that gives companies power," said Mr Moore.

"Open markets make life difficult for cosy, crony capitalists with businesses purchasing privileges from politicians against the interests of workers and consumers."

Translating awareness into action

Explaining how the insurance sector is translating awareness into action, Mr Michael Hawker, CEO, Insurance Australia Group, listed eight areas of activity:

- **Risk Modelling – eg. of climate change, by working with organisations such as the CSIRO and the Bureau of Meteorology**
- **Educating the community – such as founding the Business Roundtable on Climate Change**
- **Assisting in the formation of public policy – advising governments on how to mitigate risk (e.g. in Victoria, some $3-billion needs to be spent on flood levees)**
- **Changing the price of risk – by offering premiums that will change according to the risk appetite of customers**
- **Reducing (the sector's) carbon footprint – in air travel, automobile fuel, paper and energy, with the aim of becoming carbon-neutral in 5 years time**
- **Working with suppliers – in order to understand carbon issues throughout the supply chain**
- **Working with communities – what the sector can do in terms of community grants**
- **Investments – insurance companies invest some $21-trillion in investment funds per year**

Mr. Hawker said that the insurance sector is driven by how it can best reduce risks for the community but that it was very difficult to evaluate the impact of future costs. The challenge was to drive the monetization of risks – the need was to bring forward future risks in terms of today's dollars.

Virtue will be rewarded – businesses and government must conduct themselves in a more ethical and transparent manner

During his address, Mike Moore offered the following blunt advice to governments and corporations:

"Has globalisation led to a world run by logos? Is this dangerous? What is a brand but a reputation? All a brand represents is the goodwill and trust stored up over years of success.

"I think the opposite will happen to what some activists fear. A reputation is vulnerable. It's hard to win. It's easy to lose. Corporates live in a world of free information, populated by investigative journalists, NGOs, and opportunist politicians on the prowl for a headline.

"Business and government must conduct themselves in a more ethical and transparent manner. Virtue will be prized and rewarded. Companies will have to explain themselves.

"It's little different to Victorian England. They had their flash, huge mansions, and thought things were great. But it was no good being the richest guy in Manchester with the biggest house, if the cleaner and the cook came in and brought influenza or some other disease with them. The Victorians responded by inventing municipal socialism, public goods, clean water and public sewerage.

"We have to do this on a global basis in the 21st century, because we can't live alone in isolation from the influences of others, whether good or bad."

Global markets must learn to price and value biodiversity and ecosystem services

While ecological balance is one of the key pillars of sustainable development, global financial markets have yet to come to grips with pricing and valuing biodiversity and ecosystem services.

"Only when we understand the tangible and material economic benefit of these eco-system services will the market-place begin to internalise these impacts in its decision making"

Introducing the open debate on "The Natural Dividend: Financing Ecosystem Services," moderator Richard Burrett, Head of Sustainability, Group Public Affairs with ABN AMRO Bank N.V., said that while the business world had an effect on eco-systems, it also relied on their regulatory services (such as climate, flood control and waste treatment) and their provisioning services (such as fresh water and food).

"These are services for which no price has historically been paid, but their degradation comes at a significant cost," said Mr Burrett.

"Only when we understand the tangible and material economic benefit of these ecosystem services will the marketplace begin to internalise these impacts in its decision-making," he said.

Risk of market exclusion is very real

Commenting on whether biodiversity was a risk or an opportunity to financial organisations, Annelisa Grigg, Director for Corporate Affairs, Flora and Fauna International, said it was not just a risk to project finance, but also to fund management, trade finance, corporate loans and investment banking.

Investment returns could be affected by a number of factors, including: access to land (development permits and community consents to operate could be affected by a company's poor handling of biodiversity and ecosystem services issues); security of supply (as ecosystem services decline, raw materials will become more expensive and less available); and access to markets (this could be restricted through a failure to meet major customer demands for sustainably sourced products).

"The risk of market exclusion is very real, and growing across a range of industry sectors," said Ms Grigg.

Risk management must prepare for external shocks

Simon Petley, CEO of EnviroMarket, said regulators internationally were looking at the issue of direct and indirect degradation of ecosystems, particularly where the "supply of nature" was important for agriculture and tourism.

"If nature stops supplying the services, businesses will take an expense hit on the bottom line," said Mr Petley.

Risk management included looking at alternative sources of supply, and being prepared for external shocks if natural services were lost.

Government needs to facilitate environmental services transactions

Speaking as an institutional investor, Bob Welsh, CEO of VicSuper, said an organisation could make money with biodiversity offsets in either a voluntary market or a regulated market – if such a market existed.

An investor could purchase a habitat, restore it if it had been degraded, and then manage it. The habitat's biodiversity benefits or offsets provided an offset service, and a fee could be charged for establishing the offset service and managing it in perpetuity.

"Biodiversity offsets could become part of a global market if we had a common metric," said Mr Welsh.

But markets did not generally value the service provided by ecosystems, so the assistance of governments was needed to create institutions that would enable transactions in environmental services to take place.

A major barrier to incorporating environmental issues into investment decisions was short-term investment measurement timeframes.

Workshop cautiously advocates mandatory regulation

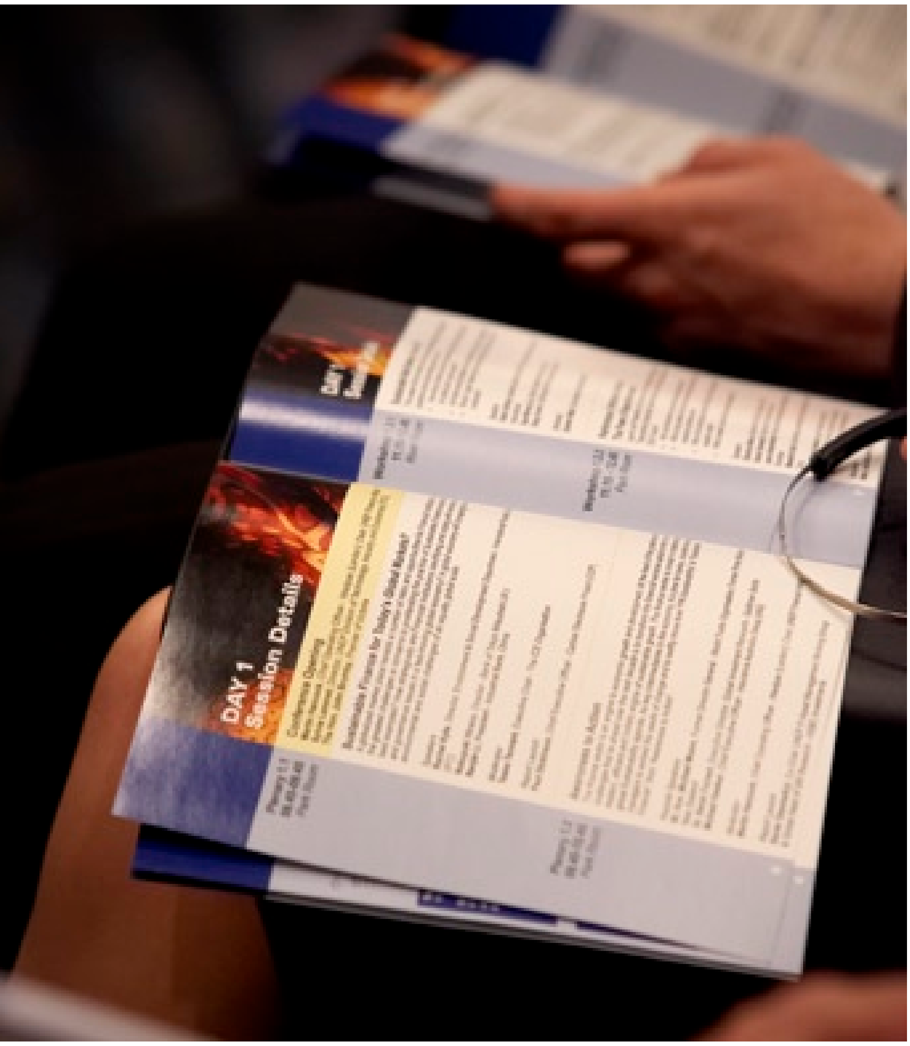
Effective regulation depends on continuously improving market and business understanding, agreed a Roundtable Workshop.

Despite confidentiality risks, corporate responsibility reporting would benefit most from mandatory regulation

But the Workshop also found that with products rapidly evolving, regulation must be constantly updated to avoid irrelevance.

The discussion, led by a panel of global industry leaders, addressed the risks and benefits of voluntary and mandatory regulation. Voluntary standard charters have been adopted in over fifty countries, but only a handful of companies are signatories in each market.

"We're trying to do all the right things but there's only so far you can go through a voluntary system," said Paul Hilton, Director of Advanced Equities Research at Calvert Group.



US companies slow to sign up

In the United States, five financial companies are signatories to the Equator Principles and only a handful to the PRI and UNEP FI statements.

"They're big names but it's not that many when you think about it," said Mr Hilton. "Voluntary measures just aren't good enough because too few banks are involved."

Despite confidentiality risks, corporate responsibility reporting would benefit most from mandatory regulation, the panel decided.

"Otherwise, how can you make a comparison around companies?" said Rob Tacon, Head of Risk Reporting at Standard Chartered.

"Current consumer regulation of reporting suffers from a 'Catch-22' situation," said Mr Hilton.

"It can only happen when the market understands the risks of non-disclosure – and that only happens with disclosure."

Voluntary codes come first, legislation follows

But voluntary measures are the critical precursors, shaping the conditions and systems for later mandatory regulation, the panel agreed. It warned against hasty government regulation, saying success often depends on taking time to observe the longer effects of voluntary regulation.

Global regulation must also account for market variations, with government and voluntary codes harder to enforce in emerging markets such as India, Brazil and China.

In China, understanding of regulation is "non-existent"

In China, western understanding of regulation is "non-existent," said Mizuho Corporate's Osamu Odawara.

"There's the expectation that regulations are rigged, so Chinese banks won't agree to regulate," he said. "And without NGOs and a vibrant media, who will enforce accountability?"

Around the globe, the immediate future may see tighter regulation of voluntary codes.

"The Equator Principles may soon remove signatories who don't meet reporting standards for eighteen months," said Mr Odawara.

"The Equator Principles and other voluntary codes need to move on again. It is time for them to evolve."

Western banks now strive to include environmental and social factors into their general credit risk factors

"Credit is the process whereby a person who cannot pay gets another person who cannot pay to guarantee he can pay."
Charles Dickens

The "Best in Class: Environmental and Social Credit Risk" Workshop session explored credit risk management by banks and financial institutions (FIs) with regard to environmental and social risk factors.

Session moderator Chuck Berger opened the discussion with a quote from Charles Dickens: "Credit is the process whereby a person who cannot pay gets another person who cannot pay to guarantee he can pay."

The speakers discussed to what extent FIs should base their credit risk assessment on issues that are not overtly financial – such as the potential impact on the environment, and consequently on the FIs' reputations.

Working for an investment bank with public shareholders, owned by 62 countries, Anne Maria Cronin, Principal Environmental Specialist for the European Bank for Reconstruction and Development (EBRD), spoke of her company's aim to promote environmentally sound and sustainable development, despite a popular view that "sustainability is seen to actually slow down development."

The case of Rabobank

Daniela Mariuzzo is CSR Manager of Rabobank Brazil, the largest agricultural bank in the world, and the biggest financier of soil and plantations. Mariuzzo acknowledged that Rabobank Brazil has been accused of destroying the Amazon and other tropical rainforests.

Several years ago, the Financial Times accused the bank of destroying Amazonian biodiversity.

In 2005, after Rabobank Brazil began to offer financial products directly to farmers, and as slave labour issues became increasing factors in the struggle to maintain the bank's reputation, Rabobank started a CSR Risk Management program, which is now integrated into all its activities.

Importance of environmental and social criteria

Takejiro Sueyoshi, Special Advisor to UNEP FI in the Asia Pacific region, told the session: "As the number two GDP country in the world, Japanese FIs have a big social responsibility."

Sueyoshi discussed the importance of real and complete integration of CSR codes in all loan procedures on a daily basis. He also mentioned that by reducing interest rates and offering more favourable loan conditions to clients who are, for example, more energy efficient, FIs can encourage better CSR practice from their clients.

Gavin Murray, Director of Institutional and Corporate Sustainability, ANZ, told the session that while every wholesale transaction is screened against environmental and social criteria, "it is not yet at the point where we are turning down transactions because they fail to meet certain criteria."

Four key areas which are barriers to better CSR

Speaking on behalf of Barclays, Chris Bray, Head of Environmental Risk Management, addressed the following:

- **First, the issue of transparency, highlighting the public expectation that FIs should be publishing and disclosing the results of their social and environmental risk assessments. "We have a duty of confidentiality to our clients – we can only encourage clients to be more transparent," he said.**
- **Second, he discussed a major reason that banks do not go further in environmental diligence – "We are in the business of managing our own risk. We are not, and cannot act as, regulators for a democratically elected government."**
- **Third, Mr Bray conceded that as highly competitive businesses, responsible banks face competition from other banks who attach no importance whatsoever to environmental and social considerations.**
- **Fourth, he mentioned the issue of Carbon Intensity, saying that while there is a large amount of public demand and support for Carbon Intensity measurement and results, it is an incredibly difficult thing to assess.**

"These are the four real difficulties that we face in achieving 'Best in Class'," said Mr Bray, referring to the title of the Session.

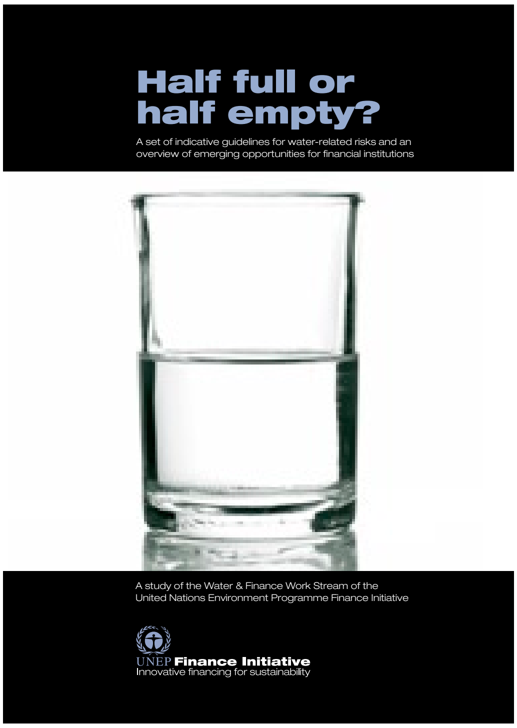
The world underestimates the magnitude of water supply and infrastructure challenges

"We face a water scarcity crisis of equal or greater impact in some countries than climate change"

With a staggering number of people in the world still without basic water and sanitation services, the urgent need for new infrastructure and improvements to existing infrastructure was brought sharply into focus during "Blue Oil – Water and Finance?", part of the UNEP FI Open Debate Series.

Introducing the open debate, Gary Miller, Senior Vice President and Co-Chair of IPWA – OMI Inc, said the magnitude of the challenges of water had been underestimated.

It could be difficult to motivate funds into this sector, and while significant achievements had been made with some projects, political hurdles and red tape often frustrated project progress.



"We need better alignment with organisations to get water projects through, so we can get better quality water services and sanitation services to people around the world," Mr Miller said.

Andrew Pidden, Chief Investment Officer of Clean Resources Asia, said his company's investment funds in water and waste management had grown rapidly, due to investor pressure for dedicated water funds in the Asia Pacific region. Clean Resources Asia had added waste management to its funds, because it couldn't separate water supply and water clean-up from the business of ensuring that pollution wasn't corrupting the water supply in the first place.

Water pricing

The pricing of water as a resource had to take into account the cost of delivery and the condition of the water, for example, whether it was polluted or sourced from ever-decreasing ground aquifers. But the price of supply hardly ever seemed to be the direct result of the cost of supply, because of government-imposed tariffs.

"There is a massive disconnect between the price that people expect or want to pay for water in the Asia Pacific, relative to the difficulty of supplying it. We feel that situation is deteriorating, and as long as it deteriorates you risk over-exploiting the pure water sources that are available, and leaving yourself a bigger problem to clean up," said Mr Pidden. While water tariffs in cities were increasing, they still did not reflect the cost of the infrastructure, he said.

Global investors eager to invest in water/waste

Asked how to get more finance from the private sector to improve water infrastructure around the world, Mr Pidden said there was lots of appetite from global investors to invest in the water/waste space globally. There was recognition that this was a constrained, critical resource, but the real problems were that water historically in any country had been a utility-style investment with low volatility yield and lower risk.

There were few water utilities companies available for public investment, and primarily the story was built around water technology and water project companies. In China, the water project companies were very volatile in the way they were executing. "There's not great clarity at times about the actual returns you're receiving from the project you're investing in, and there have been some quite alarming announcements and results that have created the perception of high volatility in that space."

Many of these companies were reasonably young, and management had little experience of the way investors liked to be informed about problems and issues that could affect the profitability of the company.

> *Continued on page 14*

Water scarcity: an environmental crisis

James Pittock, the outgoing Director of WWF's Global Freshwater Programme, said the water scarcity crisis was also a crisis for the environment. Freshwater systems were amongst the most bio-diverse on earth, but had been severely damaged by human impact.

"We face a water scarcity crisis of equal or greater impact in some countries than climate change," Mr Pittock said. "Much has been made of the impact of climate change on freshwater in terms of water supply and sanitation, but unless our societies can get better governance of our river systems, we are not going to achieve goals of better water supply and sanitation or have a healthy freshwater environment, and we won't have energy and food."

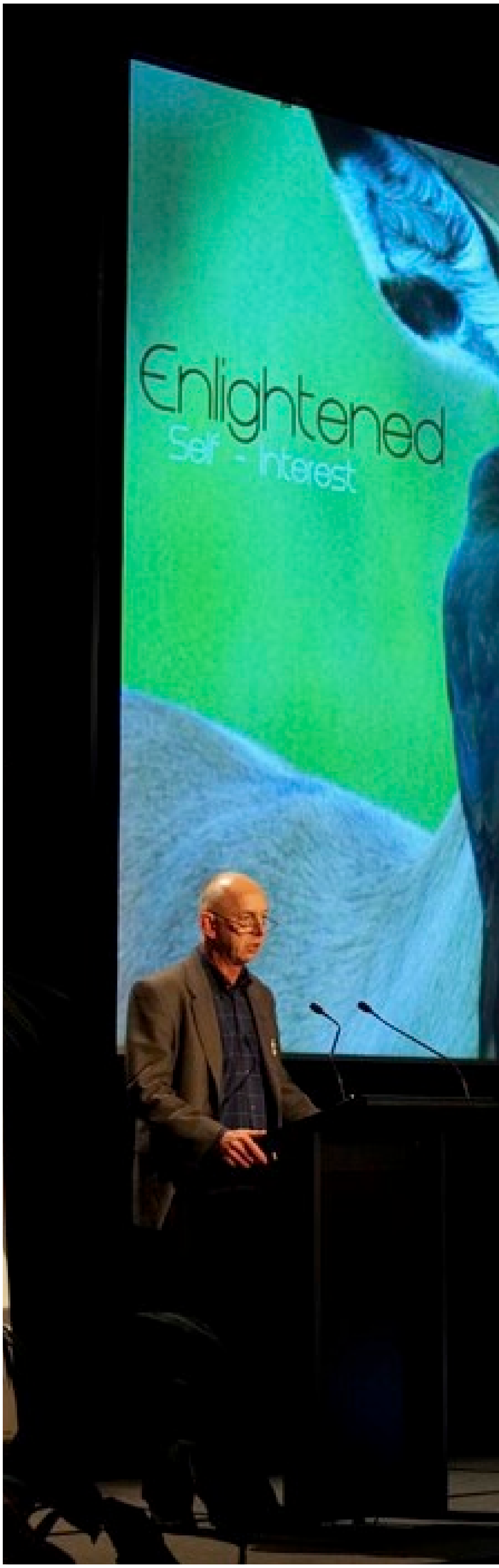
Mr Pittock said that when WWF and its NGO partners studied the question of government prioritisation of the supply of water and sanitation services, they looked at the 30 least developed countries that had the lowest rates of water service delivery to their people.

"Half Full Or Half Empty" Guidelines

Of the developing country governments, only two had prioritised water and sanitation for financing from the international community. Large scale engineering infrastructure projects took priority. One of the key reasons was that responsibility for water was often scattered between different ministries, which had not "got their acts together" to influence their finance ministries and governments.

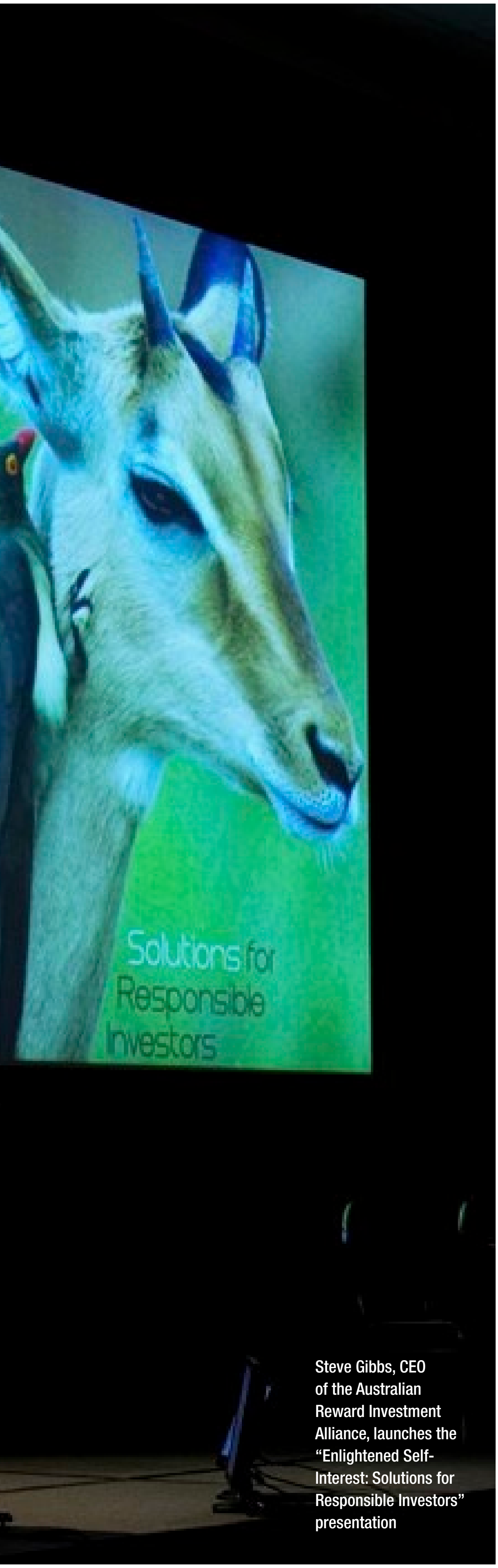
Following the open debate, a new set of guidelines for water-related risks and an overview of emerging opportunities for financial institutions were launched. *Half Full Or Half Empty*, a study by the Water and Finance Work Stream of UNEP FI, examines the drivers of water-related risks and opportunities and looks at exposure to risk by sectors. It also gives a framework for water-related risk management, and risk management guidelines for project finance, corporate finance and asset management. Growing areas of opportunity in innovative water technologies and water services are also identified.

Download the water guidelines at www.unepfi.org.



New megatrends lead to both investment risks and new opportunities

Powerful new megatrends in socio-political issues are rapidly becoming the deep roots of busness prosperity. These trends are sounding serious alarm bells about risks, but at the same time are presenting "amazing" new opportunities, according to Steve Gibbs, Chief Executive Officer of the Australian Reward Investment Alliance.



Steve Gibbs, CEO of the Australian Reward Investment Alliance, launches the "Enlightened Self-Interest: Solutions for Responsible Investors" presentation

Mr Gibbs was launching a comprehensive new presentation titled "Enlightened Self-Interest. Solutions for Responsible Investors".

The presentation was created by the Responsible Investment Association Australasia (RIAA) to promote the sustainable investment message to superannuation trustees, analysts, fund managers and others in the investment sector. It will be available for use by anyone wishing to educate and influence others on these issues and application is through RIAA.

Mr Gibbs said investors were facing a whole new range of issues that were unfamiliar, volatile and complex, including:

- Climate change,
- Water shortages,
- The rise in pandemics,
- The end of cheap oil,
- Product safety in emerging nations,
- Failures of governments on a massive scale and
- The scarcity of natural resources in the face of a ballooning population.

"These issues have a cost, and some of the world's largest financial institutions want to find out exactly what those costs are," Mr Gibbs said.

"We think of responsible investment in the context of risk, so we look at ESG (environmental, social and governance risks) from a risk perspective. If a company isn't managing those risks in an appropriate way, then that poses a risk to our long-term investment in that company."

Discussing the 10 megatrends that would dominate the 21st century, Mr Gibbs said that population growth meant the planet was "hitting its limits", and the next century would be defined as the century of resource scarcity.

> **"We think of responsible investment in the context of risk, so we look at ESG (environmental, social and governance risks) from a risk perspective. If a company isn't managing those risks in an appropriate way, then that poses a risk to our long-term investment in that company"**

Hidden treasure

Understanding and managing risk in emerging markets

In countries where 70 per cent of the population has their hands on just 10 per cent of the wealth, it's not surprising that a key challenge for emerging markets is access to financial services.

Participants in the Roundtable heard that more than 3 billion people live in emerging markets – many without access to basic financial services.

A key challenge for emerging markets is how to reach the majority of the population over sustainable finance and investment opportunities, when they are not included in financial services.

The answer is microfinance

The answer, according to Daniella Mariuzzo, CSR Manager, Rabobank, is microfinance. For years, microfinance has firmly been within the realm of NGOs – but not any more.

According to Justin Smith, Head of Governance and Sustainability at South Africa's Nedbank, emerging markets such as South Africa provide a great many opportunities, but there are still significant challenges ahead. While the South African market is not developed from a business perspective, it has a well-developed finance sector. This sector has witnessed a change in consumer demand, which is driving an increase in ethical investment.

In a nation like South Africa, where there are great opportunities in renewable energy, particularly solar power, Mr Smith says that it's frustrating that 95 per cent of the power still comes from coal. The lack of investment in alternative infrastructure is a major challenge. So too, is the lack of Government enforcement of policy. Mr Smith says that companies have the responsibility to direct corporate behaviour and multilateral development banks have the responsibility to enforce behaviour.

Environmental and financial problems are most likely linked

Chris Wells from ABNAmro, commented that banks in his region are now positioning themselves in the corporate and environmental responsibility arena.

ABNAmro has recognised that society is changing, and therefore banks are changing. A major challenge for traditional financial institutions is understanding risk in emerging markets. Traditional models are not geared around the issues facing emerging markets. So banks are increasingly reliant on informal regulators, such as labour unions and NGOs to guide investment.

After more than five years looking at environmental risks, Mr Wells said that they have identified two lessons: first, that there are definitely financial risks in emerging markets and often these stem from environmental risks; and second, that they have observed a high rate of co-incidence between companies with environmental problems and those with financial problems.

Chances are, if a company has environmental problems, they will also have financial problems. Mr Wells observed that if you have good management, including environmental management, then "you are doing everything right."

Partnerships have success in promoting sustainability in emerging markets

Toshiro Nishizawa, Deputy Director General, JBIC Institute, Japan Bank for International Cooperation, said his bank has responded to climate change by increasing investment in cross-border transactions, particularly those in emerging markets.

Co-financing and partnerships are business models that seem to be successful in promoting sustainability in emerging markets, particularly in India. This approach is helping to deepen and broaden awareness.

Responding to the need for greater awareness around environmental and social risk in emerging marketplaces, such as Africa, Latin America and South East Asia, UNEP FI now offers signatories e-learning tools, such as the Environmental and Social Risk Analysis E-Learning Programme.

EPA VICTORIA

Victoria The Place To Be

EPA Victoria is an independent statutory body charged with the protection of the Victorian environment. EPA signed a Memorandum of Understanding (MOU) with UNEP in 2000 to coordinate and promote its Finance Initiative activities in Australasia to ensure that Australasian financial institutions are assisted in managing their environmental issues. Learn more about EPA at www.epa.vic.gov.au/bus/UNEP/default.asp.

If you would like to submit an article, receive a copy of the Briefing or learn more about UNEP FI's Australasian activities then please contact us on the details below.

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