Perspectives for Promoting a More Sustainable Latin American Financial Sector

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Overarching Goals

• Promote a more sustainable form of development in Latin America
  – Poverty reduction
  – Better management of natural resource base
  – New opportunities for wealth creation

• Involve the financial sector in promoting a more sustainable form of development in our Region
Context: Limited SD Action

- Little awareness of opportunities
- Immature regulatory systems
  - decent laws, weak institutions
- Fiscal and monetary policies create perverse incentives
- Lack of business sustainability skills
- Extremely high cost of understanding market trends and accessing markets
- Financial sector policies, practices and regulatory systems deter SD investment
Drivers

- Trade integration (with world)
  - raise environmental and social standards
  - more “strings attached” to major financial flows (WB, IDB, OPIC, Equator Principles, etc)
- Rapid urban growth
- New market dynamics favor what Latin America has to offer
  - tourism
  - agriculture
  - energy
  - genetic information
- Recognition that resources have a limit
- Nascent mainstream interest
L.A. Financial Markets

- Commercial banking
- Stock markets
- Asset management=pension funds
- Microfinance (formal and informal)
- No venture capital
- Few investment funds
Equity Markets

- Only three “large” markets (SP, BA, MX)
- Immature
- Highly concentrated
- Not very transparent
- Companies closely held => minority shareholder interests and rights
- Represent trivial part of region’s total finance
Pension Funds

- Long tradition of public funds
- New development is private funds (last 3 to 8 years)
- Large amounts of excess liquidity ($10 to 20 billion?)
- Most investment in government bonds (90%?)
- Little talk of SRI filters (or even “standard” investments, like forestry)
- Regulatory problems (banking oversight)
- Perverse results in destination of investment
Commercial Banks

• Backbone of financial system
• 80% of all financing?
• Very “traditional” operations
• Almost all will face future “client crisis”
• Tightly regulated, few degrees of freedom

• Generally unaware of sustainability trends
• Increasing interest in environmental and social risks (this group, others)
• SRI action MUST BE in this sector
Critical Importance

• THE dominant source of capital for foreseeable future
• Huge client base
• Intermediate almost all project finance
• Consensus of segment can change regulatory structures
• Long-term strategic interest
  – Risk management
  – Pending client crisis
  – Increasing international competition
Microfinance

• Conceptual Issues
  – MF is assumed to be inherently “sustainable”, Is it?
  – Little is known about needs, in general, or in sustainability.
• LA is one of only two successful MF regions (other is South Asia)
• Opportunity to merge sustainability into poverty alleviation?
Findings of Study

- Some exciting things happening
- General level of activities is very low
- Underperformance vs. interests
- Surprising gaps (MNCs, risks)
- Excellent opportunities
  - client reorientation
  - new products
- Major information gaps
Environmental Risk Perception

- 62% have no analysis
- Only 39% check legal compliance
- Only 25% does credit committee see issue
Figure 10
Comparative analysis – environmental management controls

<table>
<thead>
<tr>
<th>FACTOR</th>
<th>World</th>
<th>Latin America</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Policy Of Environment</td>
<td>69%</td>
<td>66%</td>
</tr>
<tr>
<td>Manager/Department In charge of Environmental issues</td>
<td>30%</td>
<td>11%</td>
</tr>
<tr>
<td>Analysis and Monitoring Of environmental performance</td>
<td>57%</td>
<td>11%</td>
</tr>
<tr>
<td>Objetivos específicos de desempeño ambiental</td>
<td>75%</td>
<td>28%</td>
</tr>
</tbody>
</table>
How Latin American Banks Create “Green Value”

1) Risk reduction
2) Orienting toward new clients
3) Relations with multilateral and international institutions
4) Internal efficiency
5) New products
Winning Strategies

• Information and awareness
• Much to learn from leading banks in US and Europe, particularly in risk area
  – yet the specifics are different and local
• Evaluation and possible reorientation of client base
• Explore new products (new or redesign)
Regulatory Issues

• Awareness
  – Superintendents
  – Boards
  – Technical staff
  – Advisory Boards

• Collateral

• Separation of banking and pension oversight (rules, institutions)
Pension Funds

- Awareness of sustainability issues
- Best practices in incorporating sustainability
  - Screens/filters
  - “Sustainable investments”
- Separation of banking and pension oversight (rules, institutions)
- Help in design of products?