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The role of sustainable finance to fight poverty and inequalities

Origins of SRI

The concept of sustainable finance revolves around the provision of finance to investments taking into account environmental, social and governance considerations, commonly referred to today as ESG. Sustainable and responsible investment ("SRI") is the backbone of sustainable finance as it represents its enabler for players in the financial markets. SRI is a long-term oriented investment approach which integrates ESG factors in the research, analysis and selection process of securities within an investment portfolio. It combines fundamental analysis and engagement with an evaluation of ESG factors in order to better capture long-term returns for investors, and to benefit society by influencing the behaviour of companies. The concept of SRI has evolved over the years, moving from being a purely ethical reflection on the economy to a revenue generating investment strategy. In fact, religious movements, such as the Quakers, already in 1758 used the concept of SRI to prevent the members of its religious group to be involved in the slave trade. After them, also John Wesley, one of the founders of Methodism, recognised the extent to which the use of money was the second most important subject of New Testament teachings. Also in Europe there has been a rich wave of religious-based activism which saw the launch of specific investments funds based already on ethical and social considerations.

SRI in numbers

Today, the SRI industry has become a fully-fledged part of mainstream finance and it has been integrated by investors who intend to incorporate ESG considerations in their investments. On a global scale SRI has grown exponentially, the size of AuM devoted to SRI has grown from 18 Tr USD in 2014 to 31 Tr in 2018, where 31% of this share alone is in Europe. Several exogenous elements have played a role in determining this important growth, which meant recognizing the value of "investing for good" as a profitable strategy as well. The political push from regulators and the dire straits of our climate, crystallized in the mind of the international community during the Paris Accord in 2015 another important catalyst has been the strong voice of our Pope Francis, who already back in 2014 made a clear link between investors profit and solidarity as he spoke before a Conference in front of an audience about ethical investing. On that occasion, the Pope talked about 'impact investors' who focus on improving communities, reducing poverty and limiting social inequality, with the help of financial institutes, all while keeping in line with the social doctrine of the Church. Already then, the Pope took the chance to criticize the way in which some financial markets are shaping the destiny of entire communities, instead of serving their needs. Focusing too much on a self-serving financial system, instead of working towards a financial system capable of serving the needs of the economy and embed social and environmental principals.

Catalysts for change

The recent Vatican document *Oeconomicae et pecuniariae quaestiones* (Considerations for an Ethical Discernment Regarding Some Aspects of the Present Economic-Financial System), takes strong positions on shareholder risk, subprime mortgages, derivatives, credit default swaps, interbank loans (LIBOR), shadow banking systems (think, cryptocurrency), and

offshore tax havens. The document in particular has some strong words of encouragement for those who engage in SRI, emphasising the importance that even small individual investors have and their potential to move the needle in the 'good' direction. The Third Vatican Conference on Impact Investing held in Rome last year, was another concrete example of how religious communities intend to use finance to help the poor and other people in need. Impact investing has increasingly began to feature prominently as part of the mission of the Catholic Church. Very much in line with the words and will expressed in *Laudato Si*, the Church is acknowledging how choosing investments that are consistent with the Catholic ethics is in line with its ambition and a valuable tool to accomplish much of its mission.

The European Commission has been doing much to help this shift, setting up working groups to tackle specific challenges of our financial system and in that respect, more accountability and transparency in order to allow for more investors to choose sustainability as their investment target. In fact, for too long, the myth of poor performance has hampered sustainable investing, whereas we are at a time when not only institutional but also retail investors can and should be empowered to make this choice.

Impact investing and SDGs

One of the most talked about forms of SRI which has grown with a CAGR of 52% in the last 6 years, is in fact impact investing, which combines a positive impact to the commitment to return, rendering this the key characteristic of this investment approach. Its key requirements are:

- ✓ **Intentionality:** the intention of an investor to generate a positive and measurable social and environmental impact;
- ✓ **Additionality:** fulfilling a positive impact beyond the provision of private capital;
- ✓ **Measurement:** being able to account for -in a transparent way- of the financial, social and environmental performance of investments.

At global level there are 114 bn of USD devoted to this investment strategy alone.

Never like today, have our planet and society faced interconnected challenges. Great pressures on our environment and social infrastructure have stemmed from an economic system measured solely by output and growth. Countering these challenges requires a radical transformation. We must facilitate a transition toward a sustainable system that respects ecological balance and works for the benefit of all. We also must ensure that we give investors the possibility to direct their investment choices towards tackling and solving these challenges. Officially known as 'transforming our world: the 2030 agenda for sustainable development', the SDGs were established in September 2015 and signed by 193 countries to define worldwide sustainable development priorities, set to be achieved by 2030. The 17 goals and 169 sub-goals are interlinked and equally important and call for close and active cooperation between all stakeholders. The SDGs offer a framework that allows companies and governments demonstrate how they help to advance sustainable development, by minimising negative impact and by maximising positive impact on planet and society.

A tremendous amount of financing is required to realise the Sustainable Development Goals. Investment in infrastructure development alone—a key bottleneck to economic transformation and sustainable growth—faces financing needs at the global level of 5 Tr USD to 7 Tr USD per year. These investments are expected to open up 12 Tr USD of market opportunities as well as create 380 million new jobs. Currently, private investment accounts

for up to half of total infrastructure spending of 1 Tr USD to 1.5 Tr USD a year. Conversely, almost 100 Tr USD of funds are managed by institutional investors in OECD countries, and as we have seen, only a minor percentage of this is today invested in sustainable assets. Green, Social and Sustainability Bonds, as traditional financial instruments with an emphasis on sustainability, are helping to channel investment to sustainable infrastructure, essential services, and beyond. These instruments have begun to unlock increased investment from bond investors.

Green, Social and Sustainability Bonds are any type of bond instrument where the proceeds will be exclusively applied to eligible environmental and social projects or a combination of both:

- Green Bonds are any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance projects with clear environmental benefits and which are aligned with the four core components of the GBP.
- Social Bonds finance projects that directly aim to address or mitigate a specific social issue and/or seek to achieve positive social outcomes, especially but not exclusively for a target population(s).
- Sustainability Bonds are any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance a combination of green and social projects and which are aligned with the four core components of the GBP and/or SBP.

Green, Social and Sustainability Bonds are regulated instruments subject to the same capital market and financial regulation as other listed fixed income securities.

The Global Impact Investing Network reported that 60% of impact investors stated that they actively track or plan to track the financial performance of their investments with respect to the SDGs. In addition, surveys of investors revealed that the SDGs are clearly emerging as the dominant framework around which to organize investing for impact. Many surveyed indicated that stakeholders were explicitly pressing them to consider the SDGs in the investing process. Investors that had been investing for impact prior to the SDGs indicated that they saw a growing necessity to report and frame their activities around the SDGs.

Key players

Development agencies are an example of essential players able to fast-forward sustainable development and do that through investments. I would like to cite the World Bank whose work is entirely anchored to two goals: ending extreme poverty and promoting shared prosperity in a sustainable manner. A key priority for the WB's engagement in the capital markets is to build strategic partnerships with investors to raise awareness for the role of private sector financing in sustainable development. A great supporter and investor in the SDGs, the WB has catered for annual issuance to the tune of 40-50 bn USD in bonds towards the Goals. After launching the first green bond ever back in 2008, the WB has continued to issue bonds with a diverse span of goals ranging from the Pandemic Bond in 2017 (to support emergency financing facility) to a Sustainable Development Bond for water and Ocean Resources in 2018, which also saw the launch of their 10-year anniversary green bond. 2019 has opened with a new social impact bond, the WB has launched in collaboration with the Women and Small Industries Development Bank of India (SIDBI), along with some ten leading wealth managers and corporates, to help rural women in some of India's poorest states to set

up or scale-up their own enterprises. This is a first example ever that a social impact bond will connect investors with rural women entrepreneurs.

Challenges ahead

Yet, despite the hype, impact bonds are fewer and smaller than momentum would suggest. The impact bond market remains small and these remain highly niche products with a 3.7 Mil USD average upfront capital investment. The extent to which such models are scalable, represent value for money or are a good idea relative to more traditional financing approaches can be confusing. Challenges ahead include the ability to generate capital across the risk/return spectrum and suitable exit options, and investors also highlight the need for a common understanding and segmentation of impact investing market. Significant work has been done to create uniform measurement and reporting standards for impact investing funds through the development of the Global Impact Investing Ratings System (GIIRS). This is meant to help intermediaries and investors benchmark and monitor fund performance, evaluate investment opportunities, and reduce transaction costs involved with due diligence and marketing. While GIIRS has focused on the more traditional impact investing asset classes, if it were expanded to include Social Impact Bonds (SIB programs), service providers, and/or funds, it could help make SIBs a more easily targeted asset class for fund managers. While many intermediaries view their return data as proprietary, the lack of transparency will make it difficult for investors to evaluate the risks and opportunities involved with investing for instance in SIB funds. Product diversification is also key, and there is a need to focus on a diverse range of product opportunities. It is important for SIB fund managers to offer and open the market to different types of investors with different constraints or investment goals. Finally, the importance of clarifying fiduciary responsibility mandates for liability-constrained institutional investors to allow for more investments in SIB funds. This could significantly enhance the SIB fund market's access to capital and bring the oversight and expertise of sophisticated investors to the market.

Policy makers have an important role in this system as they play a more significant role as conveners to improve data-sharing agreements between government agencies at the national and subnational level in order to reduce transaction costs, build expertise across governments, and facilitate efficient deal flow. They can also help by increasing support and investment for capacity building on the state and local level in order to make potential outcome funders more comfortable working with SIBs.

Conclusions

I started by highlighting the role of SRI as part of the sustainable finance as an ideology to foster more investment in favour of sustainable developments. Today, there are concrete opportunities for finance to support the socio-economic needs that are ever more pressing for our generations and the future ones. Though SRI seems to be making its mark in today's financial system, more needs to be done to ensure the proper transition, both environmental and social, takes place. Today seems to be an excellent time to change that and we hope that sustainable finance will give a renewed opportunity to create more opportunities for the most needy and helpless.