

NORDIC WORKING PAPERS

Greening the financial system

Nordic experiences and the way forward

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GREENING THE FINANCIAL SYSTEM

Nordic experiences and ways forward

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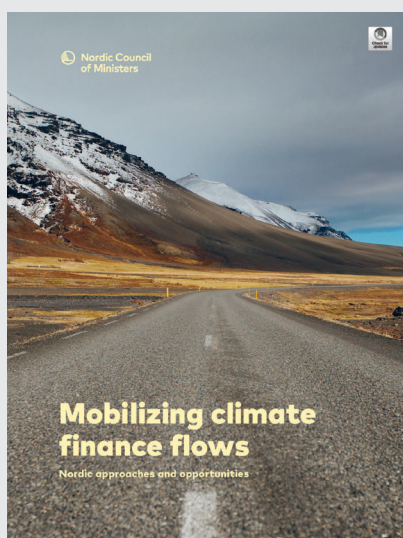
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Highlights

The massive need for climate-related investments is evident in our post-Paris world, but the recent IPCC report significantly added to the sense of urgency of mobilizing more private finance to support climate change mitigation and adaptation.

The Paris Agreement, as well as the UN 2030 Agenda for Sustainable Development, aim at a fundamental transition of societies and stress the importance of collaboration between governments, the private financial sector and other non-state actors in mobilizing the required resources for a sustainable future. In developing countries only, new investments worth 2.5 trillion USD are needed on an annual basis every year until 2030 in order to achieve the sustainable development goals.



Nordic countries have amongst other contributed to strengthen the enabling environments for climate resilient development and mobilizing private climate finance in emerging markets.

Mobilizing climate finance flows Nordic approaches and opportunities TemaNord, ISSN 0908-6692 ; 2017:519. <http://norden.diva-portal.org/smash/get/diva2:1086204/FULLTEXT02.pdf>

In the past years, Nordic countries have been a major contributor of climate finance, with their contribution amounting to almost 10% of total climate-related Official Development Assistance (ODA) provided by developed countries.

In recent years, Nordic actors have also been able to illustrate leadership in mobilizing private finance for climate compatible investments with, for example, Nordic joint finance institutions and development finance institutions (DFIs) contributing to this progress.

However, there is considerable room for improvement and upscaling. Rather than everyone learning by doing on their own, there is much to be said for engaging and sharing knowledge amongst actors and stakeholders.

This issue brief highlights some of the good practices and lessons learned by the Nordics and suggests potential ways forward to jointly raise up to the massive challenge.

It reviews Nordic experiences in light of the recent global agreements and commitments, with a particular view on how the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and the on-going EU work on sustainable finance can help accelerate action.

There is an urgent need for consistent, reliable and comparable climate-related information for various participants in the financial markets that allow to rapidly improve how climate risks are assessed, priced and managed. Supported by improved disclosure, investors will be able to make more responsible capital allocations and lenders, insurers and underwriters will be able to better evaluate their sustainability risks and exposure over the short, medium and long-term. Nordic finance sector stakeholders, including private and public stakeholders, broadly welcome the recommendations from the TCFD. However, the readiness as well as capacities to implement the suggested action still vary widely within and between finance sectors in Nordic countries.

The TCFD recommendations are structured around four thematic areas that represent core elements of how organizations operate (source TCFD available at <https://www.fsb-tcfd.org/>)

Governance	Strategy	Risk Management	Metrics & Targets
Disclose the organisation's governance around climate-related risks and opportunities	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material	Disclose how the organization identifies, assesses, and manages climate-related risks	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

This issue brief provides examples of actions by selected Nordic finance sector forerunners that are addressing climate risks proactively. Potential ways forward for the Nordics and their partners are also suggested.

[The issue brief has been produced by Gaia Consulting Oy (Mikko Halonen and Henrik Sjöblom) as part of the Nordic Public-Private Platform on Mobilization of Climate Finance, an initiative by the Nordic Council of Ministers (NCM), with the aim to share Nordic lessons learned and best practices. The initiative has brought together leading Nordic actors through four thematic issues groups and has been implemented and facilitated by South Pole (lead) in collaboration with Gaia Consulting Oy and Climate-KIC.]

Nordic pension funds breaking new ground

Several Nordic pension funds have taken a proactive role in climate compatible investing, hence going beyond stepwise divesting from fossil fuels. They are setting more comprehensive targets for sustainability investments, including investing in renewable energy and seeking for ways to align their portfolios with science-based climate targets. While this is also noted in several international assessments¹, there is considerable room for improvement and for raising the bar more widely amongst Nordic pension funds.

"If you want to get things done – aim at something concrete! The carbon footprint of our listed equity and credit holdings will be halved and our strategic sustainability investments will be doubled, to over SEK 20 billion (around USD 2 billion) by 2018."

Peter Lundkvist
Senior Strategist and
Head of Corporate Governance,
Swedish pension fund AP3

For example, AP3, which is part of the national pension system in Sweden, stresses the importance of taking a holistic perspective on sustainability – looking at all categories of risk – as well as setting ambitious sustainability targets on a portfolio level. Similar approaches can be found amongst other Nordic forerunners that have set clear quantitative targets e.g. for divesting from fossil fuels, investing in green bonds and for active corporate stewardship with the aim to promote long-term sustainability.

A number of Nordic institutional investors are also entering private equity and project financing in developing country markets, for example, through partnerships with DFIs,

which can show a solid track record in responsible and profitable investments in emerging markets. For example, the collaboration by the Norwegian pension fund KLP with the Norwegian DFI (Norfund) or with Climate Investor One (a blended finance, capital-recycling facility), showcase possibilities to mobilize climate-related finance at scale to emerging markets. Similarly, the partnership between the Danish DFI (IFU) and Danish pension funds, showcases how the climate, and more broadly the SDG funding gap, can be narrowed – assuming key concerns related to strategy, governance, risk management as well as metrics have been properly addressed. Evidently, depending on, amongst other, the mandates of financial sector actors as well as legislation in investor host countries and partners countries invested in, the most suitable investment vehicles, profit and risk sharing mechanisms have to be tailored.

While these Nordic experiences showcase that pension funds can be one of the key actors in addressing the sustainable finance gaps, active sharing of lessons learned should continue through Nordic and internal for a. There is a clear need to speed up alignment of investments with not only a 2°C climate-related scenario, but rather a 1.5 °C scenario. The race for the first pension fund to disclose its 1.5°C climate-related scenario that reveals the accompanied physical and transition risks, and, in particular, the investment opportunities is open!

¹ See e.g. Asset Owners disclosure project, AODP GLOBAL CLIMATE INDEX 2018 / PENSION FUNDS

Green bonds – beyond a drop in the bond ocean

The Nordic financial sector has been a pioneer in developing the green bond concept and market, with SEB as well as the European Investment Bank and the World Bank being the first ones to issue green bonds in 2007-2008. Since then, the growth of the green bonds as an instrument to raise funding for projects with environmental benefits has been rapid, with a diversification of issuers and countries entering the market, and often over-subscription being the case. In 2017, global issuance of green bonds surpassed the mark of USD 150 billion. While green bonds make up only a fraction of the global USD 100 trillion+ bond market, green bonds have considerable potential – in various manners – to serve the required transformation in the finance sector.

Numerous Nordic actors are contributing to this change. The International Finance Institution of the Nordic-Baltic countries (NIB), which finances projects that help ensure sustainable growth, launched its NIB Environmental (Green) Bond in 2011 – referred to as NEB. The NEB framework, updated in 2018, is subject to a second opinion from Cicero and compliant with the Green Bonds Principles (GBP).

In addition to NIB and SEB, many other Nordic finance institutions, such as Nordea and Danske Bank are actively engaging in the green bonds market. Numerous Nordic public sector issuers have become frequent promoters of green bonds, increasing the issuer base and bringing depth to the universe of investable green bonds ². As the first Nordic government green bond is yet to be issued, prominent Nordic politicians have stated that it is a matter of time, not 'if'.

While there is still diversity in the measuring of environmental results and impacts achieved, increasingly, the monitoring and reporting is linked to the Sustainable Development Goals (SDGs). Current reporting, with a bulk of green bond impacts being linked e.g. to SDG 6 (clean water and sanitation), SDG 7 (affordable and clean energy), SDG 11 (sustainable cities and communities) and SDG 13 (climate action) reveals the need for a diversity of financing instruments to secure funding for all SDGs.

"Green bonds have been a valuable instrument for raising financial sector sustainability awareness and directing finance to projects with measurable environmental benefits."

Samu Slotte
Head of Sustainable Finance,
Danske Bank

² Several Nordic public sector issuers jointly launched a 'Position Paper on Green Bonds Impact Reporting' in October 2017.

"We must use the momentum to expand the green bond market while harmonizing key concepts and terminology, developing standards and measurement and aiming at more transparent communication about additionality/benefits of green bonds."

Jukka Honkaniemi
Senior Banker, Head of Sustainability
SEB

Hence, it is not surprising, that in addition to the recommendations by TCFD, on-going EU-level work concerning EU's action plan on financing sustainable growth, is closely followed by all Nordic finance sector stakeholders. In May 2018, the Commission adopted a package of measures implementing several key actions announced in its action plan. The package includes, amongst other taxonomy-related work, to develop a proposal for regulation to establish a framework to facilitate sustainable investment. The proposed regulation should establish the framework for a

unified classification system (or taxonomy) on what can be considered environmentally sustainable economic activities. Nordic stakeholders generally agree that this is an important step in the broader effort to channel investments into sustainable activities.

Opportunities for accelerated action – Nordic perspectives

During 2018, the Nordic initiative '*Nordic Public-Private Platform on Mobilization of Climate Finance*', has engaged numerous Nordic finance sector actors through workshops, webinars as well as thematic work in four issue groups covering various opportunities to help mobilise private finance for climate action. During this work, new opportunities to accelerate mobilisation through improved sharing of good practices, sharing of experiences as well as joint learning have been identified.

Taking note of the TCFD recommendations as well as on-going EU work on sustainable finance, amongst other, the below opportunities and suggestions for potential next Nordic steps were raised.

The Nordics could jointly show global leadership by spearheading climate-related scenario work aligned with a 1.5°C target, as urged in the recent IPCC report. Several Nordic actors have expressed a readiness for joint scenario work and the promotion of a more long-term investment approach. Building on an ecosystem of already existing Nordic finance actors, including joint Nordic finance institutions as well as traditionally smooth science interfaces with political and economic decision-making, Nordic finance sector stakeholders have the potential to help demystify climate scenarios and become forerunners in forward looking, decision-relevant climate scenario analysis.

The Nordics could help gear the discussion towards the opportunities in addressing climate risks proactively and holistically, while understanding the urgency to ensure that the most vulnerable are protected against the already on-going climate changes. A recent study by the Global Commission on the economy and climate finds that climate action could deliver at least USD 26 trillion in economic benefits through 2030. While climate risk management will require avoiding non-sustainable investments and divesting, it is crucial to harness the strength of the financial sector in producing truly green and SDG aligned revenues.

The Nordics could jointly contribute to awareness raising and competence building amongst politicians, legislators, regulators as well as private stakeholders, to strengthen the enabling environment for the required finance sector sustainability transformation. The Nordics should make use of this momentum – with voluntary TCFD recommendations being broadly embraced, EU work on sustainable finance gaining speed and emergence of multiple other market initiatives and partnership on sustainable finance – and ensure that the required awareness and competence is developed, in dialogue between key stakeholders. As the Nordic countries are generally well respected for delivering on their ODA commitments, the Nordics should also continue their support to strengthen the enabling environments also in emerging and developing markets, to ensure that the transformation is a global one, in line with our common commitment to the SDGs.

Naturally, any and all of the suggested measures should link with relevant on-going national, Nordic and international efforts and initiatives, to ensure potential synergies are harnessed and duplication is avoided.



Nordic Council of Ministers is the official body for intergovernmental cooperation in the Nordic region. It seeks solutions with visible positive effects for everybody who lives in the Nordic countries.

Implementing partners of the Nordic Public-Private Collaborative Platform for Mobilization of Climate Finance:



South Pole offers a full spectrum of sustainability solutions to both public and private clients. We are proud to support notable organisations in taking meaningful steps to improve their performance and to reduce their negative impact on the environment, affected communities and the climate.



Gaia is a consultancy for sustainable business. We help our clients become more competitive with responsible business that respects the environment. Sustainable business means efficiency, reduced risks and more opportunities. It's all about producing more from less.



Climate-KIC is a European knowledge and innovation community, working to accelerate the transition to a zero-carbon economy.