Sustainable Banking Network

NECESSARY AMBITION:

How Low-Income Countries Are Adopting Sustainable Finance to Address Poverty, Climate Change, and Other Urgent Challenges

June 2020

Executive Summary

Investigation of National Approaches to Sustainable Finance in International Development Association (IDA) Countries – An SBN Task Force Report

Sustainable Banking Network

IFC International Finance Corporation WORLD BANK GROUP

Creating Markets, Creating Opportunities

Executive Summary

Building sustainability into financial systems not only helps manage environmental, social and climate risks, but also de-risks markets to enable greater investment flows and deepened financial market development

SBN IDA member countries face unique constraints due to the size and maturity of their markets, yet they have demonstrated high levels of ambition and good progress in developing systems that support the adoption of sustainable finance. Of the 11 low-income (IDA) countries within SBN – Bangladesh, Cambodia, Ghana, Honduras, Kenya, the Kyrgyz Republic, Lao PDR, Mongolia, Nepal, Nigeria, and Pakistan – four are in the 'Advancing' stage of their sustainable finance journeys, according to the 2019 SBN Global Progress Report, namely Bangladesh, Kenya, Mongolia, and Nigeria. This means they have i) introduced national policies or industry frameworks to promote sustainable finance, ii) are actively raising awareness and building capacity on this topic in their markets, and iii) are taking steps to ensure implementation and behavior change by financial institutions. In doing so, they are leading alongside peers from higher-income countries.

Sustainable finance has emerged as a pathway for IDA countries to de-risk investments and enable the financial flows needed to support climate action and sustainable development. IDA countries face acute environmental and social challenges and their governments have limited resources to address these challenges, both in terms of financing and enforcement capacity. SBN IDA members fully understand these challenges and are committed to action, particularly through the development of sustainable financial systems that can de-risk investment and unlock finance flows for climate and sustainable development priorities. National sustainable finance frameworks are made up of policies, regulations, guidance, and programs that promote higher standards of environmental and social (E&S) risk management by the financial sector while stimulating investment in green and inclusive sectors. These interventions thereby also secure enhanced credibility and lower risk for local financial institutions looking to attract international capital and position the financial sector to help address environmental and social challenges through scaled-up investment.

SBN IDA countries recognize that transitioning to sustainable financial systems is critical to their futures. IDA countries face similar environmental, social, and development challenges to higher-income countries, but they feel the costs and impacts of these challenges more intensely. Some SBN IDA countries face immediate and significant impacts from climate change, pollution, biodiversity loss, and social inequality, all of which require urgent responses. All SBN IDA countries are preparing for massive climate change impacts in the coming decades. Embedding effective management of sustainability factors within their financial sectors is therefore crucial to achieving broader development goals, both within and beyond the financial sector. However, these countries often have weaker institutional and financial sector capacity, which makes implementing sustainable finance frameworks more challenging. At the same time, local financial institutions often underestimate the benefits of sustainable finance or are wary of its perceived regulatory burdens. Support from development finance institutions (DFIs) and investors therefore remains essential to integrating sustainability into financial systems.

Sustainable finance frameworks provide an opportunity for IDA countries to increase their market resilience and unlock new green and inclusive investment opportunities. In a 2018 report, "Climate Investment Opportunities in Cities - An IFC Analysis",[1] IFC estimates a cumulative climate investment opportunity of $29.4 trillion across six key sectors in emerging market cities through 2030 – including green buildings, electric vehicles, public transport infrastructure, climate-smart water, renewable energy, and municipal solid waste management. Additional opportunities, not included in the study, include utility scale renewable energy and sustainable agriculture. IDA countries can take advantage of the relatively early stages of their financial systems to embed sustainability into the cores of their operating models in alignment with global good practices. Early action on sustainability can support these countries as they address crucial development challenges. By de-risking investments and enabling flows into new green and inclusive sectors and asset classes, sustainable finance can help unlock significant investment opportunities. This can have a major impact on the ability of these countries, with assistance from DFIs, both to meet climate ambitions and drive sustainable development.

With these opportunities in mind, this landmark report and its eight country profiles provide the first investigation into IDA countries' unique implementation of sustainable finance frameworks.

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[1] Source: IFC. 2018. "Climate Investment Opportunities in Cities - An IFC Analysis." Available here: https://www.ifc.org/wps/wcm/connect/topics_ext_content/ ifc_external_corporate_site/climate+business/resources/cioc-ifc-analysis.
To estimate investment opportunities, IFC took a sampling approach and studied 15 to 18 benchmark cities across the emerging markets. It then scaled regional estimates by using projected urban populations in 2030 to reach an aggregated global figure.

How have SBN IDA countries developed and promoted sustainable finance frameworks?

Several SBN IDA countries have developed strong and creative responses to the challenges of implementing sustainable finance frameworks. Commonly cited challenges include low levels of awareness and capacity among both SBN member institutions – financial sector regulators and banking associations – and local financial institutions when it comes to designing and implementing sustainable finance frameworks.

What factors have spurred countries to develop sustainable finance frameworks?

National commitments and pressing environmental and social challenges have been the key drivers for sustainable finance initiatives in SBN IDA countries. Three-quarters of SBN IDA members surveyed noted that a supportive policy environment is an effective driver of sustainable finance, including national commitments to the Sustainable Development Goals (SDGs) and the Paris Agreement on Climate Change. Similarly, government and industry-level recognition of critical environmental and social challenges has driven progress, particularly in countries with more established sustainable finance frameworks. Such countries typically cited more factors across both the market and policy domains as drivers of sustainable finance development, suggesting that these countries benefit from broad-based support for progress.

What approaches do SBN IDA countries adopt in developing sustainable finance frameworks?

Similar to other SBN countries, there have typically been two paths selected by SBN IDA countries in developing national sustainable finance frameworks: regulator-driven and industry-driven. In the former approach, regulators have drafted and launched sustainable finance policies and guidelines in consultation with the financial sector. Implementation has been led by central policy actors, with varying degrees of monitoring and enforcement. In contrast, under the industry-driven approach, banking associations have received mandates from their members to develop sustainable finance frameworks, such as voluntary principles and initiatives. These banking associations have drafted sustainable finance frameworks, often in collaboration with a working group of bank representatives. In this approach, adoption and implementation of a sustainable finance framework has typically been voluntary, industry-driven, and gradual. In all cases there tends to be a convergence toward a public-private partnership approach over time, thereby achieving greater buy-in across the financial sector.

Despite different paths, SBN IDA members have faced strikingly similar challenges on their journeys but have responded creatively to overcome them. Typical challenges include capacity constraints, limited national expertise, financial institution perceptions about trade-offs between profits and sustainability, and concerns about compliance burdens. However, SBN IDA members have demonstrated a range of approaches to addressing these concerns and barriers.

What are SBN IDA members' priorities as they continue to develop sustainable finance frameworks?

SBN IDA members' top priorities for future action are i) promoting green finance such as green bonds and green loans; ii) developing sustainable finance roadmaps, and iii) supporting implementation. Three-quarters of SBN IDA members identified the promotion of green finance instruments as a priority, with a green bond program considered a key next step. Half of surveyed members indicated that a next priority was to develop a national sustainable finance roadmap to support broad-based sustainable finance adoption, including both improved E&S risk management by financial institutions and innovation to unlock sustainability-focused lending and investment. Similarly, half of respondents also plan to continue developing additional tools and resources such as guidelines and checklists to support sustainable finance implementation.

Practical approaches to key challenges in implementing sustainable financing frameworks

Pathways to developing environmental and social risk management

Improving environmental and social risk management (ESRM) by financial institutions has been a core component of the sustainable finance frameworks of SBN IDA countries. This has included developing ESRM policies and guidelines for their financial sectors in line with international good practices such as the IFC Performance Standards, and providing support to local financial institutions to implement ESRM practices. These countries can further boost their implementation of ESRM by drawing on available international resources and experiences, and can leverage broad stakeholder engagement to promote shared commitment, understanding, and implementation among financial institutions. Countries may also want to take a stepwise approach to ESRM, expanding the focus or depth over time to support institutions as they develop capacity and adapt to new requirements.

Promoting green finance

Green finance, including climate-focused lending and investment, is a priority for SBN IDA members and a key driver for the development of sustainable finance frameworks. Some SBN IDA countries have already started developing enabling frameworks for green finance, such as definitions of eligible sectors and projects (taxonomies), and incentives for green lending and investments. The countries most advanced in terms of sustainable finance overall – Bangladesh, Kenya, and Nigeria – have also tended to be the most advanced in terms of green finance, indicating that some of the policy foundations of sustainable finance enable green finance opportunities. Providing resources and capacity building to promote green finance has proven to be an effective approach. Countries have also benefitted from engaging all stakeholders to help tailor policies and schemes, and from developing definitions and standards for green projects and green financing that are meaningful and actionable for national stakeholders. These can build on international support and resources, such as existing good practice examples and templates, to accelerate initial action. Working toward international alignment is also recognized as a strategy that can facilitate cross-border investment and collaboration.

Leveraging sustainable finance frameworks to support broader development objectives

Financial inclusion

Most SBN IDA members have prioritized financial inclusion within sustainable finance frameworks. Financial inclusion increases household resilience and reduces poverty. Yet it is lacking in many IDA countries due to demand barriers, such as limited financial literacy, and supply challenges, such as geographic remoteness. Financial inclusion is therefore a typical priority focus area for IDA countries. As a result, most SBN IDA members consider financial inclusion to be an essential component of their sustainable finance frameworks. In practice, however, measures to promote financial inclusion have often been conducted on a standalone basis and have not been integrated into broader efforts to create a sustainable finance system.

SBN IDA members implement both 'supply-side' and 'demand-side' approaches to support financial inclusion. Regulators and banking associations can integrate supply-side measures alongside sustainable finance mandates to boost support for financial inclusion. In particular, mandates and support for expanding access, targeting priority and vulnerable groups, and expanding the range of services provided within sustainable banking approaches can boost financial inclusion. Outreach, communication, and education efforts for sustainable finance can be easily combined with efforts to increase financial literacy and awareness. Indeed, efforts to increase broader awareness and literacy may also boost the effectiveness of awareness raising for green and sustainable finance.

Agriculture and SME finance

While SBN IDA members have implemented a number of support measures to facilitate the flow of credit to the agriculture and SME sectors, including lending to women-owned businesses, these have not been comprehensively integrated into sustainable finance frameworks. Yet efforts to expand finance to these sectors through regulatory standards or sectoral targets could leverage synergies and integration with sustainable finance. Examples include the tailored ESRM guidelines developed in Mongolia and Nigeria for the agriculture sector. Developing sector-specific guidelines in this way is more common among SBN IDA members and may indicate that the financial sectors in these countries need specific guidance to address environmental and social issues in priority sectors due to capacity constraints. Sustainable finance frameworks could also encourage banks and financial sector institutions to engage with agricultural and SME businesses to improve the sustainability of their businesses and thereby increase their capacity to receive credit.

Next steps and a toolkit for supporting sustainable finance in IDA countries

A continued need for international support

Despite the clear progress among many SBN IDA countries in developing and implementing sustainable finance frameworks, further action and additional international support are needed to de-risk markets through sustainable finance and enable green investment at scale. SBN IDA members have demonstrated innovation in designing efficient and effective approaches that respond to the realities of local institutions and promote buy-in through collaboration and stakeholder engagement. SBN IDA countries have also leveraged sustainable finance frameworks to address broader development challenges and have provided additional support, guidance, and incentives to their financial sectors to support these activities. Nevertheless, continued support is needed from the international community—and DFIs and investors in particular—to help SBN IDA countries implement sustainable finance, de-risk markets to enable greater investment flows, and strengthen financial institutions to realize new investment opportunities.

IFC has identified over $29 trillion in green and climate investment opportunities in emerging markets up to 2030, and commercial banks will play a key role in funding these opportunities, mostly through debt financing. To do so, it is estimated that banks would need to grow the share of climate-related investments in their total loan portfolios from the current 7 percent to at least 30 percent by 2030 (see Annex). To scale this line of business, both banks and banking regulators need support and guidance. Capacity building and practical tools will also be needed to assist IDA countries in developing and implementing sustainable finance frameworks. This report suggests three areas for SBN to provide future support to IDA countries.

1. **Provide targeted capacity building and technical assistance to SBN IDA members to help them develop and implement sustainable finance frameworks.** The SBN IDA Task Force could focus efforts on mobilizing and designing tailored capacity building and technical assistance to support SBN IDA members to implement the best practice solutions summarized in this report. The Task Force can also encourage SBN members to engage in peer-to-peer knowledge sharing and technical support activities.

2. **Develop additional technical resources to support SBN IDA members.** Building on the set of tools and case studies captured in this report, additional technical resources could include templates, operational guidelines, and other materials, which would enable SBN IDA members to fully benefit from international best practices and enable them to focus their efforts on tailoring the available resources to the domestic context, rather than developing tools and approaches from scratch.

3. **Targeted and in-depth research into the challenges and priorities identified by SBN IDA members.** The Task Force should conduct further research into the interrelatedness between different environmental and social challenges and the financial sector, which would help integrate activities to address these challenges into sustainable finance development.

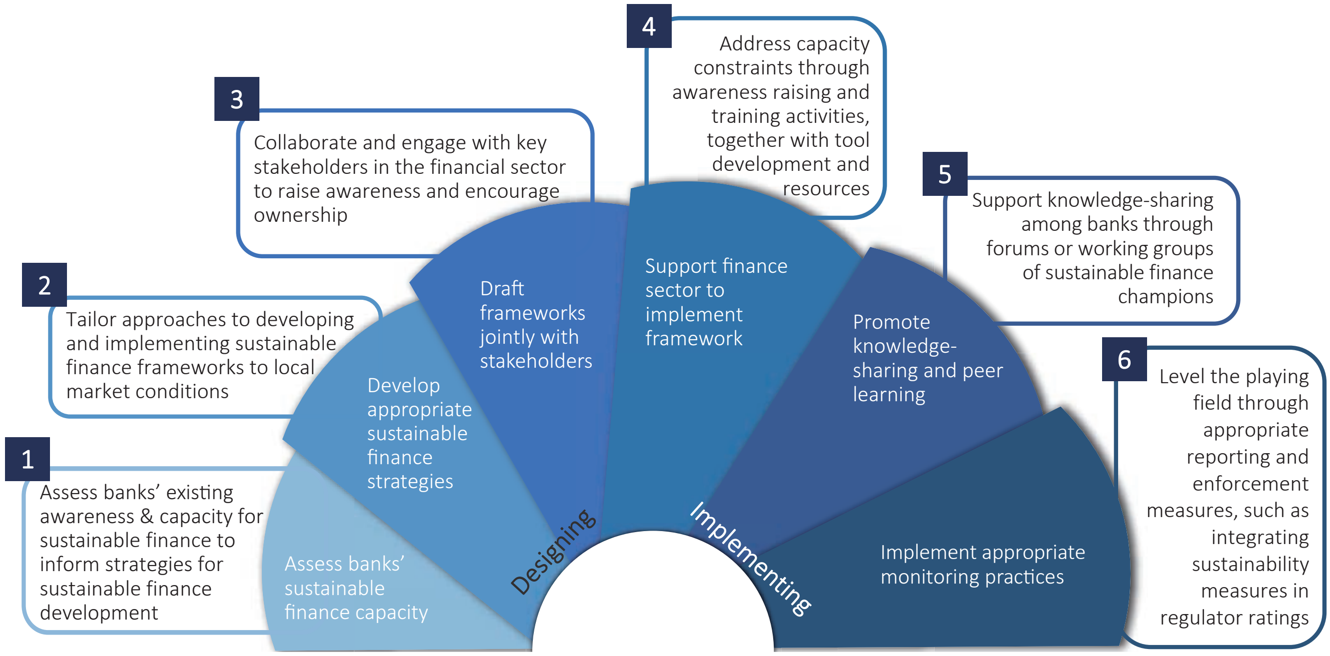
Initial tools to guide design and implementation

As a first step, the following high-level planning tools were developed based on the findings of this report and the eight associated Country Profiles (Bangladesh, Cambodia, Ghana, Kenya, Kyrgyz Republic, Mongolia, Nigeria, and Nepal). They reflect solutions and approaches tested by IDA countries to develop and implement sustainable finance frameworks.

These recommendations can be applied not only by SBN IDA countries, but also other SBN members and all emerging economies looking to develop sustainable finance frameworks and embed them in national financial systems.

Drawing on the SBN IDA country experiences, the follow six best practices emerged as being associated with effective design and implementation of a sustainable finance framework.

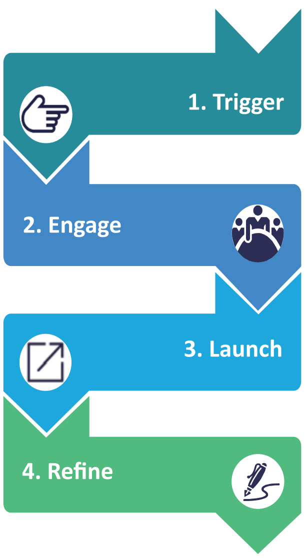
Figure ES1: Six best practices for developing sustainable finance in IDA countries



Source: SBN IDA Diagnostic Survey responses

The figure below provides common steps to develop and implement a national sustainable finance framework, with specific actions identified at each stage. The proposed actions can be taken in a different order depending on existing networks, institutions, drivers and priorities in place.

Figure ES2: Common stages and steps for developing and implementing sustainable finance frameworks



1. Trigger

- Synergy with the relevant national policy/strategy (e.g., commitment to the SDGs, the Paris Agreement on Climate Change, etc.) and awareness building on sustainable finance in the public and private sectors
- Identification of a lead organization (selection of the framework development approach, e.g., regulator-driven or industry-driven) and key stakeholder mapping
- Collaboration with leading international development partners and standard setters
- Signaling the intention and determination to develop sustainable finance framework

2. Engage

- Seek broader support from public and private sectors, secure support and commitment from the key stakeholders
- Formation of a working group with representatives from the key stakeholders and drafting of the sustainable finance documents reflecting the country's priorities and needs
- Multi-stakeholder consultation and technical discussion, including domestic and international partners/stakeholders, to discuss and finalize the documents, potentially with public comment period

3. Launch

- Launch of the sustainable finance document including supporting guidelines and tools
- Information dissemination both locally and internationally

4. Refine

- Development and issuance of other additional documents on data collection, monitoring, and reporting, and continuous improvement of existing documents
- Gradual behavior change in the financial sector

Capacity Building

Source: SBN IDA Diagnostic Survey responses and SBN Global Progress Report

The following strategies have been used by IDA countries to overcome common challenges they have faced in developing sustainable finance frameworks. The relevance of the practices to a specific country depends on that country's stage in its sustainable finance journey. Figure ES 3 summarizes these practices.

Figure ES3: Best-practice solutions to overcome common challenges related to developing and implementing sustainable finance frameworks

Challenges	Solutions
• *A failure by banks to recognize the value of sustainability* and *prioritize sustainability over short-term profits*;	• *Sensitization activities within financial institutions*, to convince banks of the importance of sustainable finance and the benefits of adopting sustainable finance approaches.
• *Capacity constraints* within financial institutions that limit their engagement with and/or ability to implement sustainable finance approaches;	• *Capacity building with financial institutions,* through training of bank staff and developing additional resources to support the implementation of sustainable finance frameworks.
• *Limited national expertise* to lead and inform the sustainable finance process;	• *Knowledge sharing and peer learning*, through technical assistance within the SBN network and international exchange visits.
• *A wariness among banks of additional regulatory burdens* from aligning with sustainable financing frameworks;	• *Encouraging industry ownership of sustainable finance frameworks,* engaging with banks in the process of developing sustainable finance frameworks and, where appropriate, using a phased approach during the implementation of sustainable finance frameworks.

Source: SBN IDA Diagnostic Survey responses

Access the SBN Necessary Ambition Report and associated Country Profiles at: www.ifc.org/SBNnecessaryambition

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