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“Financing a green recovery, and maintaining momentum for green finance and investment”

SUMMARY

Discussions during the 7th OECD Forum on Green Finance and Investment focused on priorities to finance a green recovery and maintain momentum for green finance and investment. Key messages included: the imperative of an inclusive and green economic recovery; the role of the public sector in shepherding private investment through well-articulated policies that commit to economic prosperity while preserving biodiversity and combating climate change; the need to improve market integrity and transparency, including through convergence in green finance definitions and better data disclosure; risks of underinvestment in critical green infrastructure; and opportunities presented by the shift to a sustainable and equitable economic model.

Key Messages across the Four Days of the Forum

- The world is currently in the midst of three planetary crises: climate, nature and biodiversity; pollution; and waste. Though many commitments have been made to address these challenges, the pace is insufficient.
- The COVID-19 pandemic provides a unique, once-in-a-generation opportunity to reset our economic model and its objectives.
- We have already built the capital stock that will breach the warming targets. This is really the last chance we have to sort out fossil fuel and agricultural subsidy systems.
- To develop effective solutions, it is important to understand the horizontal, cross-cutting nature of climate change in the context of economic policy. It is also important to spur more innovation.
- The interlinkages between climate change, nature loss and human health need to be better appreciated. We need to stop funding activities that have precipitated the current crises.
- To support the transition we have to put a much greater focus on activities other than those that are clearly green today. These account for the bulk of our economic activity, all of which need to transition with a broader plan in mind.
- While sustainable finance has developed and investors have taken some steps, these are not nearly enough. There is a lack of transparency, pension funds continue to invest in assets that will become stranded, and though digitalisation is welcome, there is an imminent need to develop a regulatory architecture that works for the people and the planet.
- Recovery measures to address the ongoing pandemic need to be job-rich and protect the most vulnerable.
- Subnational governments need to be at the forefront of sustainable recovery efforts. They have a more intimate understanding of needs and are better positioned to transform crises such as COVID-



19 into learning opportunities to bring about positive local climate action. We have an historic opportunity to align large-scale economic stimulus packages with climate goals, but this will require leadership from subnational governments.

High-Level Plenary: Challenges and Opportunities for Green Finance post COVID-19

- The ongoing pandemic presents a once-in-a-generation opportunity to rethink and reset our economic model and its objectives. COVID-19 has taught us that we need to be more agile in tackling threats in plain sight.
- Everyone now firmly agrees that we can deliver economic prosperity while protecting the environment. Recovery efforts must be centred on two priorities: (i) protecting the vulnerable and combatting inequality; and (ii) getting on track to a 1.5-degree world. We must combat inertia and incumbency.
- It is critical to better understand the interlinkages between climate, nature and human health and divert financing from activities that harm us. Traditional measures like GDP are no longer fit for purpose. We need better system indicators.
- Achieving progress requires political willingness, leadership and better governance structures. In the same way that financial stability units were established within finance ministries in the aftermath of the global financial crisis (2008), we need to install climate policy units in finance ministries to manage the challenges and threats we face.
- Recovery packages of unprecedented amounts have been announced by several countries with many more in the pipeline. It is too early to say that all of the money has gone to fossil fuels. Many countries are still in the rescue phase and we are poised to see more money flow to cleaner sectors.
- Accelerating the transition is about risk-adjusted returns. Policymakers can increase the returns by either increasing the risks of environmentally harmful activities or decreasing the risks of clean innovation.

High-level plenary: How to ensure the financial system helps deliver a green recovery (including jobs, low-carbon growth, and environmental resilience)?

- More needs to be done to ensure that the global financial system is resilient to systemic shocks like pandemics and climate change. The financial system needs to consider adverse impacts that financial decisions can have on people and the planet.
- As a first step, it is essential to acknowledge that 'green' is not just carbon, that 'climate' is not just carbon. Biodiversity prevention is a critical component and not a luxury item. We need to understand the distinct characteristics of issues beyond climate. To develop an effective systemic response, we need to get to where the problem is and not focus on easy solutions. Solutions in the financial sector may have to front-run the environmental and other regulatory measures in many countries including emerging economies.
- An important lesson from the global financial crisis (2008) is that silos in policymaking must be avoided. It is critical to take a 'whole of government' approach in developing effective responses to the current crisis.



- The ongoing pandemic presents an opportunity to accelerate sustainable finance and retool the financial system. Sustainable investments both on the public and private side can be expedited by the government. We need to eliminate fossil fuel subsidies on one hand while increasing green subsidies and green fiscal tax breaks on the other.
- Financial institutions need to better manage their ESG related risks and seize opportunities presented by the transition. They must go beyond climate. Today we understand well how climate risk translates to financial risk and how to manage and supervise it. However, the same mechanisms hold true for biodiversity loss as well. Supervisors and central banks have a critical role to play here and need to incorporate this new thinking in their supervisory activities.
- Another lens to evaluate a sustainable financial system is to consider how the investment supply chain is evolving in the context of sustainable finance. The climate crisis and long-term value generation are fundamentally connected but this has not necessarily trickled down the entire investment supply chain.
- Increasing number of investors are trying to move beyond being 'future takers' to becoming 'future makers'. Any good investor considers material risks and opportunities. With the introduction of more mandatory reporting, taxonomies and coordination across markets, it is easier to be a future taker. However, more and more investors are trying to be future makers by pushing the implementation of the Paris accord through their activities.
- Investors can be effective in aligning the financial system with the Paris accord through rebalancing their portfolios and voting for resolutions supporting climate action. Most progressive institutional investors are now using their shareholdings to reorient the banking sector towards sustainability. Banks and their boards can move very fast when they get unambiguous signals from their shareholders. However, despite rising acknowledgement within the financial community, investors are not seeing enough market signals from policymakers.
- Managing the transition is a critical and often overlooked component of the conversation around a sustainable financial system. A binary approach is likely to be unhelpful -- we cannot get rid of all emissions-intensive assets. It is crucial to focus on and shepherd sectors and activities that fall in the grey zone.
- The current legal architecture needs to be more effective in crystallising risks on the balance sheets of financial institutions. Financial supervisors need to lead by managing their own reserves and reconsidering collateral requirements by revisiting what it means to be market neutral when markets face critical failures and threats such as climate change.

How distributed ledger technology is making a difference in green finance?

- Distributed ledger technology (DLT) has a range of applications from tokenisation of infrastructure and decarbonisation of real estate to automated reporting by physical assets (e.g. solar panels) and digitalisation of green bonds.
- A prime advantage of DLT is 'digital uniqueness'. When applied to carbon savings, DLT can prevent the same carbon savings from being claimed twice. Similarly, DLT can increase transparency and monitoring in the energy sector by providing a verifiable record of each kilowatt (KW) generated. Another use case is commercial real estate.



- Regulation has a critical role to play in accelerating the uptake of DLT. A sand box approach is needed to propel innovation. Application areas include, in distributed solar, micropayments, green finance for small and medium enterprises, digital passports for physical assets, and digitally smart bundling of small-scale loans to recycle capital and foster markets.

Financing a sustainable oceans economy

- There cannot be a 'green' recovery without a 'blue' recovery. We now see broad consensus around the anthropogenic pressures on our oceans. Priorities for developing a sustainable ocean economy include offshore renewable energy, the greening of shipping, sustainable aquaculture, investment in sewage and wastewater infrastructure for coastal communities, coastal and marine habitat protection and comprehensive science-based marine spatial planning.
- While economic sectors are compartmentalised, the oceans are not. Developing a sustainable ocean economy requires a holistic approach to ocean management.
- We need to better articulate what sustainable business models for the ocean economy look like, and how such businesses can generate a return on investment. There is a clear case for metrics and indicators tailored to the ocean economy. Much can be borrowed and adapted from the green finance space.
- Scaling-up investment in the ocean economy requires ring-fenced funds and a robust pipeline of bankable projects. Different types of financing are already available for sustainable ocean projects, including blue credits, concessional financing, guarantees and grants.
- There is also broad agreement on the need to percolate the discussion to the local level and bring in the communities whose lives depend on the oceans. Municipalities and local authorities must play a leading role in shaping and implementing projects. Unfortunately, some of these municipalities and local authorities do not always have the capacity to borrow at the scale needed. We need solutions to overcome this barrier.

Measuring the climate alignment of investments and financing

- There is a difference between Paris alignment and climate finance. The latter is project-focused while the former is about systems. There is a need to integrate these two dimensions when measuring and tracking financial flows and concentrate efforts on assessing the impact of investments on the real economy.
- Environment ministries will need to collaborate with other ministries and agencies to get sufficient data to measure climate alignment. We therefore need a clear understanding of what the tangible benefits of measuring climate alignment are.
- Collaboration between the public and private sectors can encourage a race to the top. Such collective efforts could help governments identify regulatory bottlenecks, make climate related risks more apparent and equip the private sector to more efficiently assess and manage them.
- There are often inconsistencies in the quantification of emission levels. Investors need to therefore scrutinise the underlying assets and understand how the emission accounting has been conducted.



- We need clear and manageable KPIs, steering mechanisms (e.g. performance ratings for buildings), common definitions, standards and measurement criteria, and a convergence of methodologies.

Unlocking financing for biodiversity by private investors

- There is increasing empirical evidence that biodiversity loss poses significant financial risks to investors, in addition to risks to society and the planet. The ongoing pandemic has put biodiversity at the heart of financial discussions. Loss of natural capital could cause much greater economic disruption than climate change. It is therefore critical to acknowledge both the dependencies and impact on biodiversity of the business and financial sectors.
- Dependencies on biodiversity can lead to physical and other risks for corporates and investors, while negative impact of a corporate on biodiversity can lead to reputational risk. These risks, in turn, can translate to market and liquidity risks for financial institutions that finance these corporates.
- We need an effective measurement, valuation and accounting framework for biodiversity to demonstrate the risks and opportunities to businesses and governments. Various new initiatives, metrics and assessment tools are available, but there needs to be some standardisation. Further, challenges around data access (open source versus paid-for data) persist. It is noteworthy however, that while further standardisation and guidance is beneficial, no single measure will be sufficient to address complexities of biodiversity at project, corporate and portfolio levels.
- Investors need to start engaging with companies on issues like deforestation and their supply chain's exposure to biodiversity related risks. In parallel, governments have a huge opportunity to expedite biodiversity related investments through their recovery packages.
- It is essential to integrate biodiversity impact in a company's due diligence process. This is an important step in addition to CSR investments in biodiversity to ensure that companies can assess and address biodiversity risks to the business as well as biodiversity risks precipitated by their business.

Accelerating greener investment - the role of taxonomies, institutional investors, regions and cities

- Mandatory disclosure, better data and models are essential to highlight and manage climate related risks. The urgency of climate action appears in climate value at risk (VAR) and temperature models. Currently, an aggregate world weighted equity index is estimated to have a 3.5 degrees impact. The universe of listed companies that is aligned with the Paris accord is very limited (~5%).
- Local authorities at the regional and city levels have to be first responders and play a leadership role. For instance, cities are playing a critical role in managing the pandemic through establishing hygiene protocols, sanitation and providing masks, food and public transport. However, cities face three significant challenges: (i) financial constraints due to expenditures exceeding revenues, (ii) labour crunch with officials dedicated to sustainability and managing climate change having to take up COVID related roles, and (iii) stagnant capital expenditure.
- Cities urgently need access to longer-term, affordable financing. Cities also need to diversify their sources of finance and crowd-in private investors at scale. There is however, a gap at city levels in terms of technical expertise, project planning and preparation.



- A bottom up response structure is essential to deal with systemic challenges like the ongoing pandemic and climate change, with cities at the forefront of decision-making. Multi-level governance structures need to be revised and smoothed. Furthermore, there is a need to enhance advisory services and technical assistance for cities. Cities are very diverse and they need support at all the levels of the financing cycle.

Channelling investment using sustainable finance taxonomies and definitions

- A major challenge to scaling up green finance is the absence of universal standards and definitions in the market. Given the global nature of capital markets, we need global action and cooperation to develop a commonly accepted taxonomy and maximise its impact in catalysing higher amounts of green investment.
- Taxonomies eliminate uncertainty, which is a primary concern for investors. Taxonomies reduce political risk and ensure that scientific findings – as vetting by government – are integrated in investment decision-making.
- Green finance taxonomies translate the Paris agreement into economic activities, providing a critical tool to calculate risks and opportunities. Taxonomies also help set the future direction of the economy by setting minimum standards that align with our climate and development objectives.

Financing water-related investment

- Upscaling investment in water-related infrastructure requires enhancing the attractiveness of the sector by providing systemic stability through regulation, transparency, good governance, and increasing the availability of data and information.
- Water investments must be approached in a more efficient way using digitalisation, cross-referencing with other relevant information, using private money wherever there is a business case, taking a holistic approach to project planning and design, capitalising on strong partnerships and establishing a conducive policy architecture.
- The sector's dependence on cheap concessional finance must be reduced to crowd-in the private sector and develop a private market. We must further consider not only the financial return of an investment, but the economic return as well, by integrating both monetary and social returns in the business case of water investments.
- There are promising opportunities for the insurance sector. Insurance companies can be co-investors in flood protection infrastructure and play a greater sector-wide role as they have a good understanding of the risk return profile of water-related investments.

ESG investing: financial and environmental materiality

- It is clear today that climate change presents material risks to our economies and must be priced by the market. More frequent extreme climate events, new regulations and behavioural changes will most likely accelerate the economic transition. This pace of change is currently the greatest risk not priced by the market.
- Currently ESG investing rating methodologies face market integrity or “greenwashing” issues associated with the climate and broader environmental “E” pillar scoring, requiring metrics for climate and other environmental criteria to measure impacts, not just processes.



- Standardisation and harmonisation of ESG data is critical to accelerate investment and drive market efficiency and integrity. Too much of the existing ESG data and scoring is backward-looking. We need to develop a forward-looking analytical framework that helps us evaluate which companies are best positioned to successfully transition to a low-carbon business model. The heterogeneity of ESG scores and methodology further complicates the question of how ESG relates to environmental materiality.
- There is a need for mandatory corporate reporting on ESG issues. Three different tiers of metrics could enable a deeper assessment of a corporate's sustainability performance: macro-level metrics (e.g. GHG emissions), industry specific metrics and company-specific metrics. Greater understanding of which elements of sustainability correlate with corporate performance is essential to developing investment-grade metrics.
- Central banks have an important role in encouraging ESG investment. Short of explicitly integrating sustainability in their mandates, central banks can take an implicit view of sustainability as key to ensuring long-term economic stabilisation. The asset purchase programmes of central banks is a powerful tool to encourage ESG investing though there are minor trade-offs involved. Purchasing green bonds, for instance, integrates sustainability in a central bank's reserve management but could lead to reduced portfolio liquidity, as green bonds are less liquid than traditional bonds.
- Unless we put in place a regulatory framework that actually ensures that companies that are sustainability leaders are also best positioned to out-perform markets, we will likely see limited examples of a successful relationship between sustainability leadership and financial results.

Green infrastructure in the decade for delivery: assessing institutional investment

- Return on infrastructure assets is attractive especially with current low interest rates. The regulatory environment is the challenge. Solutions to upscale private investment in infrastructure are already well known; it is important that we move at scale and focus on implementation.
- There is rising interest in infrastructure debt. Private infrastructure debt provides greater flexibility than bank finance, aligns well with the capital structure of projects and offers investors some illiquidity premium over bonds.
- Going forward, value creation in the infrastructure sector will occur increasingly through asset development instead of refinancing project debt. This trend is the beginning of a new style of asset management, with longer-term investment horizons. The industry is moving towards a longer-term view, which will pressure infrastructure funds to deliver value through the management of assets.
- Modalities to monetise infrastructure assets to provide market liquidity is essential to upscaling infrastructure investment. Securitisation, structured products and blended finance are important tools to make this happen.
- There is often a gap between the actual and perceived risk of emerging market assets. Structuring can help make risk profiles of emerging market projects more palatable to private investors. Development finance institutions have an important role to play and must become investment catalysts by focusing on capital mobilisation instead of lending.



Green recovery and meeting environmental objectives in developing countries

- It is clear that there is no trade-off between the recovery and transitioning to a green and sustainable economy. Investment and job creation is a critical pillar of the recovery and must include an environmental agenda. This will require strengthening policies on environmental investments.
- If the financial sector can ensure that more resources are channelled to green projects, the overall recovery would be much greener. To catalyse private investment, four elements are needed: (i) taxonomies, (ii) disclosure, (iii) incentives for green investments, and (iv) green financial products.
- Central banks can support the transition to a sustainable economy by (i) instituting a collateral framework that supports green assets, (ii) prioritising climate friendly assets in their asset purchase programmes, (iii) mandating corporate disclosure of climate-related risks, and (iv) greening their own portfolios.
- We need to create more fiscal space by using international and central bank financing programs. The recovery from the ongoing pandemic needs to focus on society and environment.
- Public financial institutions (PFI) need to readjust their business model to accelerate the transition. PFIs need to evolve from subsidising investments to becoming providers of long-term, patient capital with a focus on project origination. They can become platforms to expedite critical projects and provide proof of concept to foster new markets.

Finance to Accelerate the Sustainable Transition-Infrastructure (FAST-Infra)

- We need to create investment vehicles for a variety of uses. These include platforms for securitisation, for better structuring guarantees, and for delivering finance to national development banks (NDBs) that are often at the forefront of sustainable infrastructure construction and pre-financing.
- NDBs are at the frontlines of renewable auctions, shouldering construction risk and carrying the costs on their balance sheets. NDBs would like to diversify their portfolios and offload some renewables to the capital markets.
- A clear global label for sustainable infrastructure could stir investor demand just as in the case of green and sustainable bonds. Such a label would enable efficient risk assessment and increase transparency, especially in emerging economies.
- Furthermore, there is a need to enhance the capacity of local institutions to provide guarantees. International institutions cannot shoulder the entire burden. Local institutions must develop the technical expertise and capacity needed to support local projects and crowd-in private capital. Additionally there must be a global facility to backstop the guarantees issued by local institutions.

Clean energy investments to support a sustainable COVID recovery

- To reach a net-zero world by 2050 we need to reduce emissions significantly. Half of the much needed emissions reduction will be achieved using technologies that are either currently in their infancy or do not exist. Innovation is key; solar and wind alone will not cut it. There is a large role for the public sector. Long-term guarantees, subsidies, loan interest loans and tax breaks can play a critical role, as can standards such as for efficiency as well as building and transport codes.



- In Europe, stranded assets are already a phenomenon, and provide clear testimony of how fossil fuel assets lose market share to renewables and suffer losses in value. The most underappreciated aspect of renewables, from a financial perspective, is that they are inherently deflationary. There is no upstream in renewables with high risks and price fluctuations.
- Government finances are extremely stretched. Tools and vehicles to crowd in private capital are very needed. Strong climate action has a multiplier effect.

