

Sustainable Finance - the right framework must be in place

A bylined article by KfW CEO Dr Günther Bräunig, published on 12 May 2018 exclusively in Börsen-Zeitung

The topic of sustainable finance has emerged from its niche and entered the mainstream in the past three years. I see two key drivers behind this trend. One of them was the adoption in September 2015 of the Sustainable Development Goals (SDGs) which aim to end global poverty by 2030 and protect the planet. The other was the legally binding agreement on climate action adopted by 195 countries at the COP21 summit in December 2015, which commits the signatories to limiting the increase in the global average temperature to well below 2°C above preindustrial levels.

A financial challenge

If this is to be more than a bold vision, broad structural change in the real economy and, accordingly, large amounts of capital are needed. The United Nations has calculated that realising the 2030 Agenda for Sustainable Development requires USD 3.3 to 4.5 trillion per year. Structural change is being hampered by what Mark Carney, the Governor of the Bank of England, has termed the 'tragedy of the horizon', the long time horizon mismatch between the cause and effect of climate change. Although the impacts will primarily hit future generations, it is the current generation that must urgently fight the causes.

The financial challenge cannot be met without a concerted effort by private and public providers of capital. Many stakeholders, especially from civil society, see the financial sector as a catalyst in the transition to a sustainable world. For one thing, it should not hamper the transformation process, for example by financing fossil fuel sectors. For another, it should make the appropriate products and financial resources available for the intended transition. In other words, the transition does not just affect the real economy but involves the entire financial system. All stakeholders must position themselves in an environmentally and climate-friendly manner and actively manage the risks associated with climate change.

International promotional banks have a lead role to play. By financing environmental and climate projects they can be pioneers and trendsetters. The goal is to generate impetus on the market and mobilise private capital.

KfW therefore deliberately applies 'smart' promotional approaches in its climate and environmental finance. These include, for example, ambitious energy efficiency standards in the area of 'construction and refurbishment', with reduced interest rates and repayment grants to reward compliance. In 2017 alone, we financed 400,000 housing units under this approach in Germany, leading to a sustained reduction in carbon emissions by 760,000 tonnes annually.

KfW is not just aligning its present set of instruments with sustainability. Sustainability is literally 'part of its DNA'. One look at the Law Concerning KfW and our functions and promotional history is enough to see this. KfW's financing of environmental protection dates back to the 1950s, when the concept was not very common. We have been active in the areas of education, healthcare and poverty alleviation for decades as well. Today, nearly all of KfW's financing operations can be attributed to one or more SDGs – whether it be social, economic, environmental or climate goals.

We voluntarily undertake to commit one third of our funds for environmental and climate projects. In the past years we have exceeded this target by far. The financing share of projects in the area of 'green finance' grew from 31% in the year 2010 to now 43%. In the last ten years, we allocated some EUR 280 billion to this focal area. That makes KfW a world leader in environmental and

climate finance.

KfW is giving more weight to sustainability in the capital market as well, for example by applying its sustainable investment approach more and more rigorously to its liquidity portfolio. As an investor and member of the Principles for Responsible Investment (PRI) initiative, we have been in dialogue with market participants on the theme of responsibility in the capital market since 2008.

Green Bonds – a milestone

In 2015, we were also mandated by the Federal Ministry for the Environment to launch a green bond portfolio, the volume of which we doubled to EUR 2 billion in 2017. In this way we are supporting the market segment on the demand side.

But KfW has intensively driven the development of the green bond market not just as an investor. We have been receiving excellent sustainability ratings for years. These ratings, combined with our many years of experience and expertise, encourage responsible investors to make their capital available for investment in climate action and environmental protection and to invest in 'Green Bonds – made by KfW'.

And every one million euros invested in a Green Bond from KfW reduces greenhouse gas emissions by more than 800 tonnes annually. We use the proceeds from Green Bonds exclusively to finance renewable energy projects. So far we have issued Green Bonds totalling around EUR 13.5 billion, which places us among the world's largest issuers.

Responsible Banking

As a bank committed to responsibility, we want to be sustainable in a holistic way: in our business, in our in-house operations and as an employer. After all, sustainability also means that we hold ourselves to the same standards that we apply to our financing operations. Operating a bank also provides a variety of pathways to sustainability. We buy 100% certified green electricity and set great store by the energy efficiency of our buildings. As a result, KfW's 'West Arcade' building is one of the world's most energy-efficient office buildings. KfW's business operations have been largely climate-neutral since 2006. For example, as an employer we promote work-life balance and work to continue increasing the proportion of women in management and expert positions through an equal opportunities plan.

KfW is a learning organisation. We grow with our tasks. We have enhanced our procedures and standards for environmental and social impact assessments of international financing operations and are in the process of significantly reinforcing our internal team of experts once again. I have added the topic of sustainability to my agenda as Chief Executive Officer of KfW. This reflects our aspiration to continue improving our own sustainability performance.

No promotional bank can meet the challenges on its own. Certain preconditions must be satisfied in order for more actors – particularly from the private sector – to become more involved in green finance. For example, there is still no agreement in the finance industry about what is meant by 'green' and 'sustainable'. A uniform understanding, defined in a taxonomy, is a basic prerequisite for developing standards for scalable financial market products.

One example: For energy-efficient houses in Germany, green financing has to comply with clear standards. Summed up in an easy to understand label, this simplifies matters for market participants and supports the desired upscaling of the market. At the same time, the corresponding label must achieve adequate market penetration but does not necessarily have to be imposed by the state.

In the past years, participants in the green bond market developed the green bond principles on a voluntary basis. These are already recognised globally, are increasingly being incorporated into the rules of green bond issuers and investors, and serve as a reference for regulators and stock exchanges. It obviously takes time for uniform standards to develop in new market segments. We want to help high quality standards such as the green bond principles to continue evolving and are happy to contribute our expertise to achieve this. Transparent standards are essential to enable solid, credible and sustainable growth of a market segment.

Accurate assessment of climate and other environmental risks is also a theme for activities in the field of green finance. Here, enterprises and banks should check whether their risk management sufficiently covers existing and future climate risks and the risks of deteriorating environmental, social and governance (ESG) aspects and whether their reporting is adequate. The EU is already working on these topics, but the question of how such standards can be implemented around the world is still unanswered.

Setting the course

Policymakers must lay the foundations on which the real economy can make the transition. Relevant guidelines and steering instruments are necessary for the transition to gain momentum. The topic of sustainable finance has arrived in the capital market. I am convinced that the finance industry will be able to cover the resulting financing requirements and position itself appropriately. If the right framework is in place, the necessary funds will flow as well.

Dr Günther Bräunig, Chief Executive Officer of KfW Group