CHAPTER 11

Sustainable Finance: Trends, Opportunities and Risks

Mario La Torre and Helen Chiappini

11.1 Introduction

Interest in sustainable finance—and any other investment supporting the creation of positive social and environmental effects—has grown over the last ten years. Following the global financial crisis, investors and policy makers reconsidered common financial schemes, business models and products through the lens of sustainability issues. Policy makers intercepted the growing trend and moved on with a set of new regulatory proposals. This was particularly true in the European Union where several regulations were proposed by the European Commission. Many of these issues are still open on both the theoretical and practical side.

This chapter aims to summarize some of the main trends, opportunities and risks linked with sustainability and, in turn, with sustainable finance.

M. La Torre
Sapienza University of Rome, Rome, Italy
e-mail: mario.latorre@uniroma1.it

H. Chiappini (✉)
G. d'Annunzio University of Chieti-Pescara, Pescara, Italy
e-mail: helen.chiappini@unich.it

© The Author(s) 2020

M. La Torre, H. Chiappini (eds.), *Contemporary Issues in Sustainable Finance*, Palgrave Studies in Impact Finance,
https://doi.org/10.1007/978-3-030-40248-8_11

The chapter is structured as follows. Section 11.2 outlines recent trends in sustainable finance. Section 11.3 discusses some of the main opportunities and risks linked with sustainable finance.

11.2 Recent Trends

Of the different trends characterizing sustainable finance, here, we consider the following three: a growing investors' preference toward sustainable finance, the spread of sustainable business models and, finally, the emerging policies and regulations targeting the industry.

11.2.1 Investors' Preferences Toward Sustainable Finance

Investors are orienting their preference toward sustainable investments (Credit Suisse 2019; Global Sustainable Investment Alliance—GSIA 2019). GSIA (2019) estimated that sustainable investments in Europe, the USA, Japan, Canada, Australia and New Zealand have grown by 34% since 2016, accounting for USD 30.7 trillion in 2018. The GSIA Report also estimated an investor's preference toward negative screening (USD 17.5 trillion), although different investment strategies spread across the geographical areas. In Europe, negative screening is the most common investment strategy, while in Japan corporate engagement and shareholders' action are the preferred strategies. In the other areas—the USA, Canada, Australia and New Zealand—the environmental, social and governance (ESG) integration strategy prevailed.

Several surveys highlighted that young generations pay great attention to how their savings are invested and, in general, appear sensible to the theme of sustainable investments (Credit Suisse 2019; Schoroders 2018). Specifically, Schroders (2018) pointed out that 52% of younger people invest in sustainability compared to 28% of oldest generations. Although this is encouraging data, such reports often omit to note that most of the wealth is currently in the hands of the oldest generations, so the amount of wealth that could be invested in sustainable finance is only a small proportion. The moral pressure that younger generations have on asset managers, however, appears relevant and able to generate a progressive shift in the asset managers' investment strategies.

11.2.2 Sustainable Business Models

Sustainability issues have positively contaminated traditional business models and a new concept of business models for sustainability has emerged over the last years (Stubbs and Cocklin 2008; Schaltegger et al. 2016). Traditional financial business models have been also (positively) influenced by sustainability challenges (La Torre et al. 2019) and innovative business models looking toward sustainability have been developed by the banking industry (Yip and Bocken 2018). The banking industry's commitment to sustainability was recently confirmed in the signing of the "Principles for Responsible Banking" (UNEP 2019a). In September 2019, 130 banks—managing one-third of the assets in the worldwide banking industry—signed an agreement toward climate change and inclusive growth. Such Principles include the sustainability alignment of banking activities "to be consistent with and contribute to individuals' needs and society's goals, as expressed in the Sustainable Development Goals, the Paris Climate Agreement and relevant national and regional frameworks" (principle 1, UNEP 2019a p. 3). To do so, banks should incorporate the impact and risk assessment of sustainability in their day-to-day activities, in addition to defining proper sustainability targets (principle 2, UNEP 2019a). Similarly, the insurance industry has launched public consultation on the first guide for the inclusion of environmental, social and governance factors in the business strategy of non-life insurance companies (UNEP 2019b).

When traditional business models for sustainability are not able to meet the growing sustainability issues, collaboration between public-private actors may help in the achievement of social and/or environmental goal. This is, for instance, the case with collaborative business models (Austin and Seitanidi 2012). Significant support in contrasting emerging social and environmental needs may come from social impact bonds (La Torre et al. 2019) and other financial architectures, based on the pay-by-result scheme.

11.2.3 New Policies and Regulations

Sustainable finance currently works outside a specific regulatory framework. However, several actions have recently emerged aimed at regulating some specific aspects of sustainability and financial products labeled as "sustainable." The European Commission represents one of the most

dynamic actors within the sustainable finance panorama (Birindelli et al. 2020; Quirici 2020). However, other countries have also set some policies and regulations on sustainable finance. For instance, Russia is attempting to legally define what green banking is (UN 2019), while Italy has already included a formal definition of ethical and sustainable banking in its Banking Law (Bittucci 2020).

Other policies on green bonds spread around the world. For instance, green bond guidelines were released by the Santiago Stock Exchange and by the China Securities Regulatory Commission and People's Bank of China (UN 2019).

All regulations and policies related to sustainable finance bring the great advantage of shedding light on when a sustainable finance institution (i.e., green bank) or product (i.e., green bond) may be properly considered sustainable. By contrast, such policies and regulations often do not appear harmonized and coordinated in different markets. The Global Financial Markets Association (2019 p. 13) properly noted that *A better-aligned set of regulatory requirements would help institutions to focus their business models to support the scale and pace of change required to meet sustainability goals. While each jurisdiction has its own policy issues and priorities, individual jurisdictional policies could impact how firms operate globally, so flexibility should be ensured. Dialogue between authorities across borders is critically important to avoid market fragmentation.*

11.3 Opportunities and Risks of Sustainable Finance

The rise of sustainable finance, and more in general, the worldwide spread of awareness for sustainability issues, drives several considerations.

The reorientation of investment strategies is part of a more global sustainability movement aimed at fostering sustainable consumer attitudes and, through this, aimed at reorienting firm production. This worldwide movement is obtaining good results: a recent study from New York University (2019) highlighted that products labeled as "sustainable products" are bought 5.6 times more than "not sustainable" products. Similarly, Accenture (2015) estimated that the transition toward a sustainable economy may generate profit opportunities for around USD 4500 billion per year. At least two main issues seem to emerge from such data:

first, the so-called risk of greenwashing and, second, the risk connected to the transition toward a low-carbon economy. Consumers (and investors) are exposed to the risk that both consumer products and financial products labeled as "sustainable" are not materially sustainable. The awareness of this potential issue seems higher than in the recent past, when little research (e.g., La Torre and Chiappini 2016; Chiappini 2017) considered this aspect. Several policy makers are currently working on how to protect consumers against the risk of greenwashing. An example can be found in the Technical Expert Group's (2019) taxonomy on green activities. The taxonomy, however, poses new and relevant issues in term of transitional risk. The GSIA (2019), for instance, observed that *Overly-restrictive taxonomies that are too limiting in what is considered "green" or too aggressive in labeling assets or activities as "brown" may exclude scalable dimensions of sustainable finance that could aid companies' transition efforts.* Thus, policy makers working on the prevention of greenwashing must pay attention to balancing market protection and market incentives with the purpose of not compromising the investors' green push.

On the other hand, a fast transition toward a green economy may negatively impact the financial industry. Several Central Banks and policy makers are currently working on stress tests and guidelines (Bank of England 2018; European Banking Authority 2019; UNEP 2019a, b).

Finally, the Paris Agreement and the urgent need of a "green new deal" seem to have tarnished the other side of the coin: the social issues and the sustainability of public expenditure.

This pathway is defined by the need to seek private capital and reconvert production process, on the one hand, and, on the other, by the risks of greenwashing, so that a 4.0 sustainable finance must be found.

References

Accenture. (2015). *Circular Advantages.* https://www.accenture.com/t20150523t053139__w__/us-en/_acnmedia/accenture/conversion-assets/dotcom/documents/global/pdf/strategy_6/accenture-circular-advantage-innovative-business-models-technologies-value-growth.pdf

Austin, J. E., & Seitanidi, M. M. (2012). Collaborative Value Creation: A Review of Partnering Between Nonprofits and Businesses: Part I. Value Creation Spectrum and Collaboration Stages. *Nonprofit and Voluntary Sector Quarterly, 41*(5), 726–758.

Bank of England. (2018). *Transition in Thinking: The Impact of Climate Change on the UK Banking Sector*. https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/report/transition-in-thinking-the-impact-of-climate-change-on-the-uk-banking-sector.pdf?la=en&hash=A0C99529978C94AC8E1C6B4CE1EECD8C05CBF40D

Birindelli, G., Trotta, A., Chiappini, H., & Rizzello, A. (2020). Environmental Impact Investments in Europe: Where Are We Headed? In M. La Torre & H. Chiappini (Eds.), *Contemporary Issues in Sustainable Finance. Creating an Efficient Market Through Innovative Policies and Instruments.* Palgrave Macmillan. Cham, Switzerland

Bittucci L. (2020). *Sustainable Banking*: un'Analisi delle *Significant Bank* Italiane. Working paper.

Chiappini, H. (2017). *Social Impact Funds: Definition, Assessment and Performance*. London: Palgrave Macmillan.

Credit Suisse. (2019). *Creating a World with Next Generations and Their Families.* https://www.credit-suisse.com/microsites/next-generation-and-families/en/next-gen.html

European Banking Authority. (2019). *EBA Action Plan on Sustainable Finance*. https://eba.europa.eu/eba-pushes-early-action-sustainable-finance

GSIA. (2019). *2018 Global Sustainable Investment Review*. http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf

La Torre, M., & Chiappini, H. (2016). Microfinance Impact Vehicles: How Far Are They from OECD Social Impact Investment Definition? In V. S. Carbò, P. J. Cuadros Solas, & F. Rodriguez Fernande (Eds.), *Bank Funding, Financial Instruments and Decision Making in the Banking Industry*. London: Palgrave Macmillan.

La Torre, M., Trotta, A., Chiappini, H., & Rizzello, A. (2019). Business Models for Sustainable Finance: The Case Study of Social Impact Bonds. *Sustainability, 11*(7), 1887.

New York University. (2019). *Sustainable Share Index: Research on IRI Purchase Data 2013–2018*. Stern Center for Sustainable Business.

Quirici, A. M. (2020). The Increasing Importance of Green Bonds as Instruments of Impact Investing: Towards a New European Standardization. In M. La Torre & H. Chiappini (Eds.), *Contemporary Issues in Sustainable Finance. Creating an efficient market through Innovative policies and instruments.* Palgrave Macmillan. Cham, Switzerland

Schaltegger, S., Hansen, E. G., & Lüdeke-Freund, F. (2016). Business Models for Sustainability: Origins, Present Research, and Future Avenues. *Organization & Environment, 29*(1), 3–10.

Schroders. (2018). Global Investors Study 2018. http://www.schroders.com/en/insights/global-investor-study/2018-findings/sustainability/

Stubbs, W., & Cocklin, C. (2008). Conceptualizing a "Sustainability Business Model". *Organization & Environment, 21*(2), 103–127.

The Global Financial Markets Association. (2019). *GFMA Sustainable Finance Survey Report*. https://www.gfma.org/wp-content/uploads/2019/06/gfma-june-2019-sustainable-finance-survey-report.pdf

UN. (2019). *Sustainable Finance*. Progress Report. https://unepinquiry.org/publication/sustainable-finance-progress-report/

UNEP. (2019a). *The Principles for Responsible Banking*. https://www.unepfi.org/wordpress/wp-content/uploads/2019/09/PRB-Guidance-Document-Final-19092019.pdf

UNEP. (2019b). *Underwriting Environmental, Social and Governance Risks in Non-life Insurance Business*. https://www.unepfi.org/psi/underwriting-esg-risks/

Yip, A. W., & Bocken, N. M. (2018). Sustainable Business Model Archetypes for the Banking Industry. *Journal of Cleaner Production, 174*, 150–169.