



Overview of the climate impact of financial market players' action

■ EXECUTIVE SUMMARY

Commissioned by the Federal Office for the Environment (FOEN)



About the report

This report contributes to the analysis of the diverse impact channels and associated measures theoretically available to financial market players in order to bring about changes to protect the climate in companies in the real economy. To this end, the most recently published academic and non-academic literature has been surveyed and systematically evaluated, and a critical analysis of the impact channels regarding existing practical implementation has been carried out. The six impact channels analysed and discussed in this report are the secondary market, direct investments, real estate, banking, insurers and politics.

Commissioner

The Federal Office for the Environment (FOEN), Climate Division, 3003 Bern, Switzerland
The FOEN is an office of the Federal Department of the Environment, Transport, Energy and Communications (DETEC).

Supplier

CSSP – Center for Social and Sustainable Products AG (CSSP)

CSSP is an independent research and consulting house. Since 2009, CSSP has been helping its clients to understand, identify and change 'ESG & climate risk management'. yourSRI – a CSSP product – is a fintech platform that analyses the sustainability of assets under management amounting to around EUR 15 trillion on a daily basis. yourSRI combines conventional financial data with ESG and climate data in order to determine the ESG & climate KPIs of investment portfolios and collective investment schemes on this basis and facilitate appropriate reporting processes.

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By ratifying the Paris Agreement on climate change, Switzerland has committed itself to align finance flows with the climate goal (Art. 2 (1) c)). Climate change is growing in importance in the context of financial markets for private players and regulators. Financial players approach this topic in different ways. This leads to the question of which measures and strategies used by financial market players are able to make an effective contribution to achieving climate goals.

The study aims to discuss the impact channels and associated measures that are theoretically available to financial market players with respect to their impact on the climate. Impact should be understood here as a climate-relevant change in companies in the real economy. Overall, the climate impact of six impact channels is considered:

- Secondary market
- Direct investments
- Real estate
- Insurers
- Banking
- Politics

The potential of various climate-relevant actions is discussed based on the latest academic and non-academic publications released in the period from January 2018 to May 2020.

The results of the study are presented in this executive summary, a general report of roughly 120 pages (in German) and a publication database, in which the academic and non-academic publications are recorded with their bibliometric data and allocated to the impact channels.

Users are free to use the general report and the database with the appropriate source reference.¹

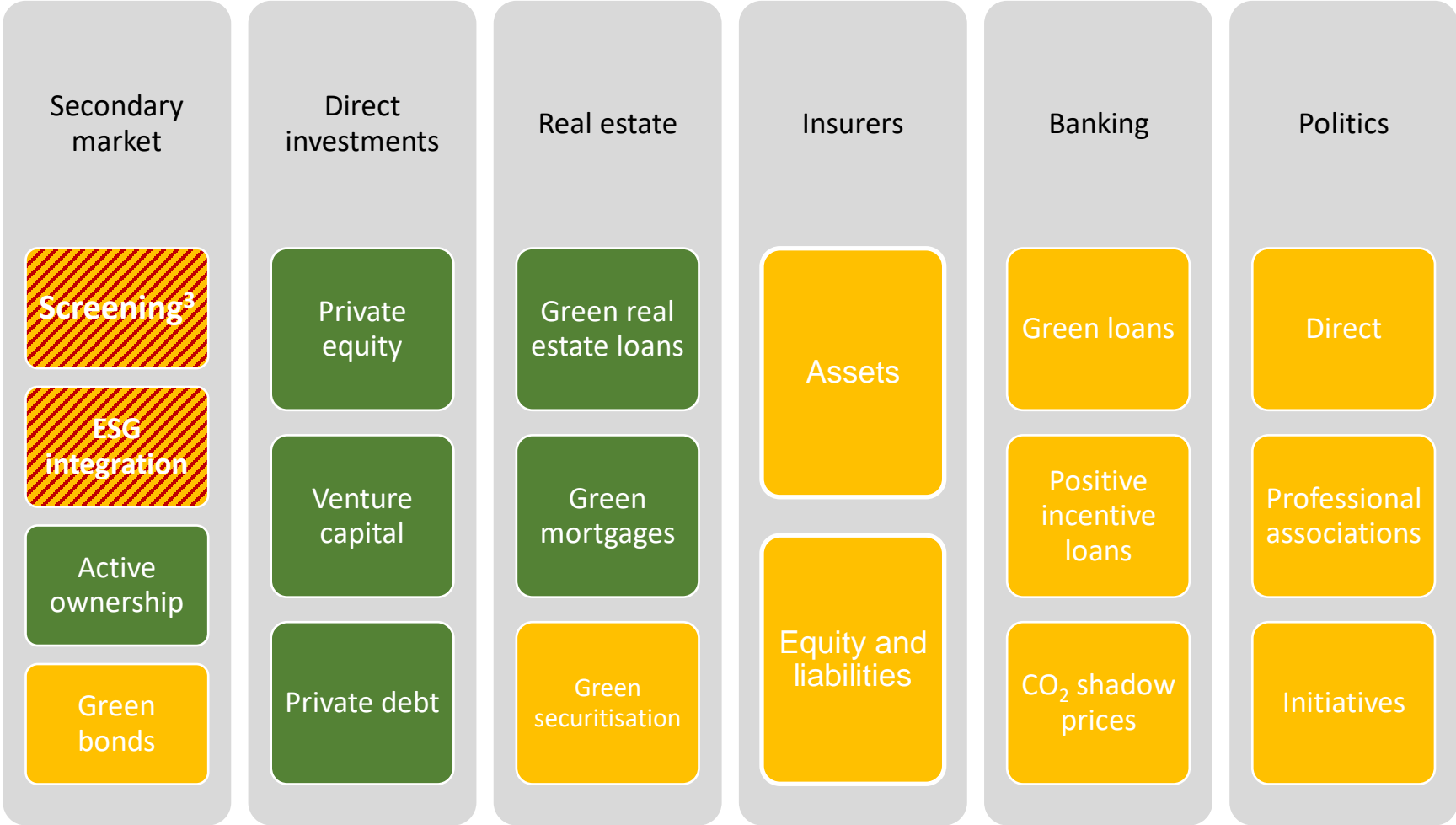
This executive summary summarises the key results below with three illustrations:

- Impact channels & measures at a glance
- Impact potential of impact channels & measures
- Conclusions and outlook

The executive summary is also available in French and German.

¹ The documents are available on <https://www.bafu.admin.ch/climate-and-financial-markets>

Overview of the current research regarding the climate impact of financial market actors' actions²



■ Potential for climate impact exists
 ■ Possible potential for climate impact
 ■ Potential for climate impact unlikely

² The six impact channels were specified by the client (FOEN). The colour scale should be seen as indicative and does not reflect the granularity of the individual measures with regard to the impact potential for the climate. The evaluation is based on the publications included in this study.

³ The term 'screening', in conformity with US SIF, combines the following approaches: positive/best-in-class and negative/exclusionary screening.

Detailed findings of the climate impact potential of actions

Impact channels	Measures	Core statements	Conditions for climate impact	Restrictions/risks
Secondary market	Screening & divestment i.e. essentially the exclusion of companies from the portfolio	<ul style="list-style-type: none"> > The impact relevance of exclusion procedures is not empirically proven. > Screening procedures are not impact-oriented measures. 	<ul style="list-style-type: none"> > Increase in the cost of capital exceeds the opportunity costs of adjusting the business model > Active communication of the exclusion > High investment volume 	<ul style="list-style-type: none"> > Softening as a result of limits introduced for exclusion (e.g. x% revenue exposure acceptable) > Transfer of ownership has no effect and results in business as usual (especially in the case of liquid securities/investments)
	ESG integration i.e. environment (E), social (S) and governance (G) criteria are taken into account	<ul style="list-style-type: none"> > ESG integration is mostly a measure for risk management. > The climate impact is not empirically proven and if, it is no more than a side effect. > Resulting tilting (over- and underweighting) does not create significant incentives for change in the real economy. 	<ul style="list-style-type: none"> > Good availability and quality of company data > Transparency on how ESG is integrated in the investment decision > Taking into account material ESG criteria > Sufficiently large deviation from customary benchmarks > High investment volume 	<ul style="list-style-type: none"> > Expensive data acquisition > Mixed data situation > Diversity of data and its use reduces the impact potential
	Active ownership i.e. dialogue with companies through exercising voting rights and active influencing	<ul style="list-style-type: none"> > Proxy voting: climate impact through group strength achievable. > Engagement: targeted climate impact is possible. 	<ul style="list-style-type: none"> > Significant exertion of influence exists (investment volume, reputation, etc.) > Measures required of companies must be material and protect the climate 	<ul style="list-style-type: none"> > Resource intensive for investors > Expertise in assessing environmental aspects necessary
	Green bonds i.e. fixed income securities for raising capital for 'green projects'	<ul style="list-style-type: none"> > For use of proceeds (UoP) bonds, there is little evidence of (additional) climate impact. > Ring-fenced capital for green project bonds can have an impact. 	<ul style="list-style-type: none"> > Ensure that existing 'green' projects are not only renamed, but an additional impact is achieved > Independent assessment needed (second-party opinion, third-party assurance, etc.) > Ensuring funds are used for the intended purpose 	<ul style="list-style-type: none"> > Relabelling > Risk of greenwashing > Refinancing existing projects
Direct investments	Private equity Venture capital Private debt i.e. provide risk capital	<ul style="list-style-type: none"> > Particularly suitable for financing young, growing and innovative companies that actively contribute to a net zero economy. > The entry of experienced investors causes a positive signalling effect. 	<ul style="list-style-type: none"> > Greater influence by investors when there are limited alternative financing opportunities > Climate-friendly business model > Climate-related expertise among investors 	<ul style="list-style-type: none"> > Greater financial risk > Investment restrictions for asset owners (e.g. pension funds) > Expertise in assessing environmental aspects necessary

Real estate	Green real estate loans Green mortgages Renovation loans i.e. financing 'green real estate projects'	<ul style="list-style-type: none"> > Great impact potential due to direct influence on real estate. > Important asset class for many investors. > Limited literature 	<ul style="list-style-type: none"> > Effective assessment and measurability of reduction of emissions and energy savings 	<ul style="list-style-type: none"> > Specific expertise necessary
	Green securitisation i.e. securitisations of 'green real estate projects'	<ul style="list-style-type: none"> > High leverage through securitisation. > Limited literature 	<ul style="list-style-type: none"> > Anchoring of the approach of using refinancing proceeds, i.e. new green projects are financed through the securitisation of freed-up capital 	<ul style="list-style-type: none"> > Risk of another bubble in the securitisation market
Banking	Green loans i.e. loans for 'green projects'	<ul style="list-style-type: none"> > Effectiveness possible as a result of use of funds for intended purpose. > Cooperation with NGOs for expertise. > Little evidence for additional climate impact. 	<ul style="list-style-type: none"> > Assessment of eligibility for assistance > Measurable key figures > Independent assessment 	<ul style="list-style-type: none"> > Lenders need to have climate-related expertise
	Incentive loans i.e. good environmental performance is linked to better borrowing conditions	<ul style="list-style-type: none"> > The basis for this is a company's overall sustainability performance. > Broad applicability, but unspecific capital use reduces its effectiveness. 	<ul style="list-style-type: none"> > Effectiveness of the incentive system > Measurable key figures > Periodic reporting > Independent assessment 	<ul style="list-style-type: none"> > Risk of dilution through misuse of the funds
	CO ₂ shadow prices i.e. lenders take account of climate risks	<ul style="list-style-type: none"> > Effective way to identify transition risks (regulatory risk, carbon tax, emission trading systems, etc.). > Two key approaches: social costs of carbon (SCC), social value of carbon (SVC). > Evidence of climate impact unclear. 	<ul style="list-style-type: none"> > A higher carbon price (US\$/ton of CO₂) > Broad application possible, beyond development banks 	<ul style="list-style-type: none"> > Major differences in carbon pricing > Around 80% of countries today do not have explicit carbon pricing > Average prices are too low, external carbon costs are not included
Insurers	Assets i.e. current and non-current assets	<ul style="list-style-type: none"> > On the asset side, insurers as asset owners operate in private and public capital markets; the statements in the other impact channels apply accordingly. 	—	—
	Equity and liabilities i.e. the equity and liabilities that arise from insurance services	<ul style="list-style-type: none"> > Insurers can create positive and negative incentives at product level in order to steer customer behaviour in a climate-friendly way. > Transition risk for insurers: greatest opportunities in automotive and greatest risks in agriculture, energy and the construction industry. > Insurers' experience and expertise regarding climate risk as a multiplier. 	<ul style="list-style-type: none"> > Significant climate impact potential > High proportion of revenue > Effective incentive systems are key > Providing climate-related expertise to other financial market players 	<ul style="list-style-type: none"> > Insurance products with high climate impact potential are a relatively low proportion of revenue > Conflicts of objectives possible, e.g. with social insurance > Little literature available

Politics	Direct i.e. the financial institution is politically active	<ul style="list-style-type: none"> > Actively seek the political dialogue in order to ensure overall alignment of the real economy and the financial sector in line with the Paris Agreement. > Signalling effect through the company's political positioning (corporate political responsibility). > Positive correlation between exertion of influence and investor size (AuM, reputation, etc.). 	<ul style="list-style-type: none"> > Credibility of the financial institution's behaviour > Transparency regarding political engagement > Lobbying in the company's own name not via communication companies > Monitoring mechanisms 	<ul style="list-style-type: none"> > Greenwashing > Loss of credibility > Impact through political dialogue difficult to measure
	(Professional) associations i.e. the financial institutions support the political activities of their associations	<ul style="list-style-type: none"> > Investors/companies can indirectly achieve a political impact via association representatives. > Influence through large associations' opinions is crucial. 	<ul style="list-style-type: none"> > Playing an active part in political dialogue on real-economy, financial-sector and climate-related topics > Transparent communication > Review of whether the association's statements are aligned with member opinion. 	<ul style="list-style-type: none"> > Misalignment of statements in communication by associations and members
	Initiatives i.e. Financial institutions join together in initiatives	<ul style="list-style-type: none"> > Number of initiatives growing worldwide. > Such initiatives can have major signalling effects. > Guidelines for companies and investors help to proceed in the same direction and build up pressure. > Interfaces between various players can be overcome. 	<ul style="list-style-type: none"> > Initiatives with commitments to take concrete and measurable measures make an impact > Climate/environment and sustainability ambitions should be in line with the relevant international goals 	<ul style="list-style-type: none"> > Loss of direction and dilution of the measures as a result of a large number of initiatives > Low environmental ambition and misalignment of initiatives

Key conclusions from the study and outlook

1

Impact measurability: Although difficult, this is crucial for assessing the effectiveness of climate relevant actions to achieve the climate objectives defined in the Paris Agreement.

2

ACTUAL versus TARGET: The climate impact by financial market actors is defined as change in companies in the real economy. Thus, the decisive factor is not rewarding the ACTUAL situation but financing future change – the achievement of the TARGET situation.

3

Private versus public capital markets: Future change is frequently financed in private capital markets. A more direct climate impact can be achieved in private equity, venture capital and private debt than secondary markets.

4

Company versus project performance: The overall environmental performance of companies in transformation may be low, but individual projects may have a high level of environmental relevance. They can nevertheless, be eligible for support because of future changes.

5

Leverage for asset owners and asset managers: If asset owners demand climate-related transparency and impact measurement in reporting, this will inevitably lead to the use of climate-relevant information in asset managers' decisions to invest. Conversely, asset managers can create incentives with offerings and information.

Independent validation and additional effect instead of relabelling: In order to avoid the risk of greenwashing, an independent, periodic audit is crucial for any financial products labelled 'green'. Transparency is also needed regarding the achievement of additional climate impact. Uniform criteria increase transparency and impact potential.

6

Loss of trust as a result of greenwashing: Losing investors' trust in green financial products would have serious consequences and could set back the work of sustainable green initiatives.

7

Use of refinancing proceeds: In order to ensure a green cycle of capital, the proceeds from the green securitisation market should also be used to (re)finance green projects.

8

Initiatives with measurable commitments: Initiatives where members commit to concrete, measurable and quantifiable measures particularly impact the climate.

9

Impact through lobbying for green policy: Transparent political activity and public commitment can contribute to the acceleration of the transformation towards a low-carbon economy.

10

Annex 1: Allocation of selected literature to impact channels (2018–2020)[§]

Impact channels	Literature
Secondary market	<p>2° Investing Initiative. (2019). Impact Washing Gets A Free Ride: An Analysis of the Draft EU Ecolabel Criteria for Financial Products. [LINK]</p> <p>Berg, F., Kölbel, J. & Rigobon, R. (2019). Aggregate Confusion: The Divergence of ESG Ratings. SSRN Electronic Journal. [LINK]</p> <p>Blitz, D. & Swinkels, L. (2020). Is Exclusion Effective? The Journal of Portfolio Management, 46(3), 42–48. [LINK]</p> <p>Chowdhry, B., Davies, S. W. & Waters, B. (2019). Investing for Impact. The Review of Financial Studies, 32(3), 864–904. [LINK]</p> <p>Flammer, C. (2019). Green Bonds: Effectiveness and Implications for Public Policy. Cambridge, MA. [LINK]</p> <p>Giese, G., Lee, L.-E., Melas, D., Nagy, Z. & Nishikawa, L. (2019a). Consistent ESG through ESG Benchmarks. The Journal of Index Investing, 10(2), 24–42. [LINK]</p> <p>ICF, (2020). Industrial Innovation: Pathways to deep decarbonisation of Industry. Part 2: Scenario analysis and pathways to deep decarbonisation. [LINK]</p> <p>Kapraun, J. & Scheins, C. (2019). (In)-Credibly Green: Which Bonds Trade at a Green Bond Premium? SSRN Electronic Journal. [LINK]</p> <p>Kölbel, J., Heeb, F., Paetzold, F. & Busch, T. (2020). Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact. Organization & Environment, 33(4), 554–574. [LINK]</p> <p>Larcker, D. F. & Watts, E. M. (2020). Where's the greenium? Journal of Accounting and Economics, 69(2-3), 101312. [LINK]</p> <p>Morgan, J. & Tumlinson, J. (2019). Corporate Provision of Public Goods. Management Science, 65(10), 4489–4504. [LINK]</p> <p>Oehmke, M. & Opp, M. M. (2019). A Theory of Socially Responsible Investment. SSRN Electronic Journal. [LINK]</p> <p>Pastor, L., Stambaugh, R. F. & Taylor, L. A. (2019). Sustainable Investing in Equilibrium. SSRN Electronic Journal. [LINK]</p> <p>Rohleder, M., Wilkens, M. & Zink, J. (2020). The Effects of Decarbonizing Institutional Portfolios on Stock Prices and Carbon Emissions. SSRN Electronic Journal. [LINK]</p>
Direct investments	<p>Jung, J., Herbohn, K. & Clarkson, P. (2018). Carbon Risk, Carbon Risk Awareness and the Cost of Debt Financing. Journal of Business Ethics, 150(4), 1151–1171. [LINK]</p> <p>Ragosa, G. & Warren, P. (2019). Unpacking the determinants of cross-border private investment in renewable energy in developing countries. Journal of Cleaner Production, 235, 854–865. [LINK]</p> <p>PRI. (2019). Spotlight on Responsible Investment in Private Debt. [LINK]</p>
Real estate	<p>2° Investing Initiative (Hg.). (2018). The Elephant in the Room: Aligning Global Bond Markets with Climate Goals. [LINK]</p> <p>IFC. (2019). Green Buildings: A Finance and Policy Blueprint for Emerging Markets. [LINK]</p> <p>PWC & WWF. (2019). Paradigm shift in financial markets: The economic and legal impacts of the EU Action Plan Sustainable Finance on the Swiss financial sector. [LINK]</p>
Banking	<p>Byrd, J. W., Cooperman, E. S. & Hickman, K. (2020). Capital Budgeting and Climate Change: Does Corporate Internal Carbon Pricing Reduce CO2 Emissions. SSRN Electronic Journal. [LINK]</p> <p>Carattini, S. & Sen, S. (2019). Carbon Taxes and Stranded Assets: Evidence from Washington State. CESifo Working Paper, No. 7785, 1–57. [LINK]</p> <p>CISL. (2020). Bank 2030: Accelerating the transition to a low carbon economy. [LINK]</p> <p>European Investment Bank (Hg.). (2020a). Carbon Footprint Report 2019: Greenhouse gas emissions resulting from EIB Group internal operations. [LINK]</p> <p>European Investment Bank (Hg.). (2020b). EIB Project Carbon Footprint Methodologies: Methodologies for the Assessment of Project GHG Emissions and Emission Variations. [LINK]</p> <p>Loan Market Association (Hg.). (2020). Sustainability Linked Loan Principles: Supporting environmentally and socially sustainable economic activity. [LINK]</p> <p>Ralite, S. (2019). There are more effective alternatives to the Green Supporting Factor: Responsible Investor's latest instalment of The EU Action Plan. Response Global Media Limited. [LINK]</p>
Insurers	<p>IFC. (2019). Green Buildings: A Finance and Policy Blueprint for Emerging Markets. [LINK]</p> <p>Kruttili, M. S., Roth Tran, B. & Watugala, S. W. (2019). Pricing Poseidon: Extreme Weather Uncertainty and Firm Return Dynamics. SSRN Electronic Journal. [LINK]</p> <p>Kölbel, J., Leippold, M., Rillaerts, J. & Wang, Q. (2020). Does the CDS Market Reflect Regulatory Climate Risk Disclosures? SSRN Electronic Journal. Advance online publication. [LINK]</p> <p>UNEP. (2020). Using hindsight and foresight - Enhancing the insurance industry's assessment of climate change futures. [LINK]</p>
Politics	<p>Chronos Sustainability (Hg.). (2020). Investors Take Next Step to Promote Responsible Climate Change Lobbying. [LINK]</p> <p>Fast Company (Hg.). (2018). Corporations' green promises are often undermined by their lobbying. [LINK]</p> <p>InfluenceMap (Hg.). (2019). The EU's Sustainable Finance Taxonomy: An analysis of how business has sought to influence this key EU policy. [LINK]</p> <p>Lyon, T. P., et al. (2018). CSR Needs CPR: Corporate Sustainability and Politics. <i>California Management Review</i>, 60(4), 5-24. [LINK]</p> <p>PRI. (2018a). Converging on Climate Lobbying: Aligning Corporate Practice with Investor Expectations. [LINK]</p>

[§] This is a selection of academic and non-academic publications with relevance for the corresponding impact channels, although relevance for further impact channels is not excluded. This is not a full bibliography that was compiled in the course of the project. Nor is the number of publications per impact channel representative of the universe.

