How the world is warming to sustainable investing

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The European Union (EU) is considered by many to be the leader in sustainability regulation. This is true in the sense that it was the first to set the foundations for a sustainable finance framework and has a head start in developing the corresponding regulation. Other markets, particularly Asia, are close at its heels, and some are using the EU's framework as inspiration.

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“In a recent study, we travelled around the world - alas only digitally and in fewer than 80 days - to highlight key developments in sustainability policy and regulation. We compare the evolution in regulation to that of the sustainable investment funds market and to what clients have been saying about their attitudes,” says Anastasia Petraki, head of policy research, Schroders.

Sustainable finance in a nutshell

Different regions take different approaches, with some emphasising regulation and some leaving it to the market to grow more organically.

For example, Petraki says that sustainability policy may start with a government setting a goal for reducing carbon emissions. “An action plan soon follows, outlining what needs to change in the real economy to achieve this goal, such as developing new technologies, or greener transport and infrastructure. This is then followed by another plan detailing how the financial sector can help fund the transition,” she says.

This brings us to what policymakers call “sustainable finance”. In a nutshell, this is a framework for the financial services sector where climate change and environmental risks are considered in everyday business, operations, products and services.

“The ultimate intention is for this to become business-as-usual, so that private funding flows consistently towards projects and activities that support the transition to a greener economy.

“This definition is narrower than the way we, at Schroders, think of sustainability. For us, sustainability is the outcome that is achieved by tying environmental, social and governance risks to investment and capital allocation decisions. By doing so, the investment industry’s fiduciary goals can become aligned to the wider policy agenda," she says.

How is South Africa doing?

The study doesn’t look specifically at South Africa, but Petraki comments that South Africa too is taking its first steps towards a sustainable finance framework.

“A working group led by the South African National Treasury has been working on this since 2017 and last May (2020) published a technical paper outlining what is already happening domestically and internationally, identifying market barriers and recommending further action for sustainable finance,” says Petraki. She says that different workstreams have ensued from this looking at:

- building sustainability capacity and competency in financial services, the public sector and regulators
- creating a green finance taxonomy and governance framework with a focus not only on green but also transition activities
- the financial instruments landscape to understand what this already looks like and what investor appetite there may be
- developing TCFD (Taskforce for Climate-related Financial Disclosures) reporting requirements
- developing a benchmark climate risk scenario for risk management and stress testing in financial services

“This work goes hand-in-hand with other policies such as the introduction of a carbon tax (currently at R127 per tonne), tax incentives for R&D in green technologies, and increasing investment in renewables for electricity generation (Independent Power Producers initiative),” says Petraki.

She believes that it is clear that South Africa is working towards decarbonising its economy and sustainable finance will play a role. “The frequent references to “guidance” and “guidelines” would indicate that South Africa is more likely to take a principles-based approach focusing on best practice,” says Petraki.

She adds that, interestingly, this would help the sustainable investment market grow more organically than if government intervenes with strict rules as the EU has.

More than a fad: the proliferation of sustainability policies beyond the EU

Policymakers have been very prolific in recent years. More than 120 new or revised policy instruments with a sustainability focus were established in 2020 – the highest number ever recorded and over 30% more than in 2019, according to the Principles for Responsible Investment. Petraki says that the sharpest increase has been seen in Europe but there has also been significant activity in Asia.