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ADVICE TO COUNCIL NO: 02-13

Re: Continuing Innovations on Work in Financing for Sustainable Development

The Joint Public Advisory Committee (JPAC) of the Commission for Environmental Cooperation (CEC) of North America:

IN ACCORDANCE with Article 16(4) of the North American Agreement on Environmental Cooperation (NAAEC) which states that JPAC "may provide advice to Council on any matter within the scope of this agreement (…) and on the implementation and further elaboration of this agreement, and may perform such other functions as the Council may direct";

RESPONDING to Council's March 2002 request to provide further thoughts on financing for sustainable development;

HAVING PARTICIPATED IN and BUILDING ON the outcomes from the CEC Workshop on Financing and the Environment: Transparency, Disclosure and Environmental Reporting, held in New York City on 25 March 2002;

RECALLING Advice to Council 02-06 on Private Sector Cooperation and Financing, containing the following three recommendations:

1. That Council instruct the Secretariat to finalize its analytical work demonstrating how access to data and indicators can quantify environmental risk, making it relevant and accessible to financial institutions.

2. That Council further instruct the Secretariat to develop options for how best to attract the interest of leading financial institutions in introducing environmental priorities when making credit decisions.

3. That Council then consider initiating a meeting with some chief executive officers (CEOs) of financial institutions committed to and influential on environmental matters and with operations in North America, to identify new partnerships that are needed to meet the evolving environmental agenda.

MINDFUL of Council's decision, among others, in June 2002 to:

- Encourage efforts, in cooperation with the private sector and other institutions, to develop methodologies and information links to provide environmental information in a form more useful to financial institutions and to encourage the use of environmental information in credit, investment and asset risk management decisions;

- Consider how to advance work on existing requirements regarding disclosure of environmental information pertaining to financial reporting; and
- Look forward to the results of the JPAC workshop on finance and environment to be held in Monterrey, Nuevo León, Mexico in December 2002.

HAVING participated in a very informative public workshop organized in cooperation with the CEC's Environment, Economy and Trade Program on *Investing in North America's Future: Innovative Financing for Sustainable Development*, held on 9 December 2002, in Monterrey, where it was clear that many of JPAC's recommendations have been taken up as ongoing initiatives in the CEC Program Plan;

CONGRATULATING the CEC Secretariat for the high quality of the work being conducted and the plans for future initiatives;

JPAC recommends the following to complement the Secretariat's ongoing efforts:

1. Pursue the development of common and comparable measures with meaning for both the financial and environmental communities;

2. Take cognizance of the environmental externalities of in estimating the costs of goods and services;

3. Develop strategies for further evaluation on how common and comparable data from small and mid-sized enterprises (SMEs) can be collected and shared in order to assist in expanding their investment and credit opportunities;

4. Continue efforts to bring together interested parties in the financial and non-financial corporate sector and participate in events, such as the upcoming UNEP meeting in New York City with senior officials of the financial community; and

5. Encourage regulatory agencies and professional bodies to develop directives and guidelines to promote changed corporate behavior and lending practices, and encourage and promote new markets for investment.

Finally, a summary of the CEC's public workshop in Monterrey was kept and transmitted to the Parties and the Secretariat. JPAC encourages a careful review in order to canvass the many other important issues and points raised during the session.

APPROVED ON 10 JANUARY 2003

Public Workshop on Investing in North America's Future:
Innovative Financing for Sustainable Development

9 December 2002
Monterrey, Nuevo León, Mexico
Instituto Technológico y de Estudios Superiores de Monterrey (ITEM)

Co-chaired by Jon Plaut and Chantal Line Carpentier

Introduction

Jon Plaut, Chair of the Joint Public Advisory Committee (JPAC) of the Commission for Environmental Cooperation (CEC) of North America, opened the session. He welcomed everyone to Monterrey (ITEM), Nuevo León, Mexico and explained the day's events, including plans by JPAC to develop an Advice to Council on financing for sustainable development the following day during JPAC's Regular Session 02-04.

He then invited Mr. Alberto Bustani, the Dean of the *Instituto Tecnológico y de Estudios Superiores de Monterrey* to make opening remarks. Mr. Bustani explained the Institute's strong commitment to sustainable development and how the concept was being incorporated into all aspects of campus life, from curriculum to infrastructure and administration.

The JPAC chair then continued by explaining the role of the CEC and JPAC in the issue of financing for sustainable development and how this topic has emerged as an important strategic direction. He reviewed JPAC's past Advice to Council and how JPAC was asked by the Alternate Representatives to further consider the matter. The Final Communiqué from the June 2002 Council Session provided further instructions and the issue has made its way into the CEC's 2003–2005 program plan.

He then introduced his co-chair, Chantal Line Carpentier, Acting Head of the CEC Environment, Economy and Trade program area. Ms. Carpentier concluded her welcoming statement by saying that at the end of the day, the meeting would be a success if participants understand the importance of the link between the environment and the financial sector.

Session I

Ms. Carpentier provided background information on the program, noting that there is increasing recognition of the role that financial markets can play in supporting environmental actions. The CEC is committed to contributing ideas and directions to this discussion, notably in the area of risk assessment by financial institutions and in seeking how and what environmental information should be harmonized.

She explained that one of the program's objectives is to stimulate an increase in private funding to the environmental sector, given that public financing will be insufficient to meet growing needs. An important element is to standardize disclosure rules within the three countries. Without complete and comparable information, the market cannot be efficient.

More stringent application of existing laws is a first important step, along with harmonization and increased enforcement.

The two main issues are:
1. Disclosure and
2. Investment in Environmentally Preferable Goods and Services.

She explained the three key elements of the program:

- How to improve the base of information—what is available, what is being reported, and how it could be used by financial institutions with a focus on the pulp and paper, oil and gas, utilities and mining sectors.
- A better understanding of how environmental auditing, accounting practices and data sources can assist.
- Improve and standardize mandatory and voluntary disclosure.

Comments from the public included:

- There seems to be a focus on large-scale financing. We also need to explore financing for smaller companies and projects that don't have market access. Banks will not finance small businesses, community development, community based projects.
- The experience with NADBank should be explored to see if it could be replicated in other areas.

She then introduced Mr. David Velasco from *Café de la Selva*, recipient of a special award at the World Summit on Sustainable Development and finalist in the 2002 Ecuador Initiative. He provided an overview of their fair trade coffee project, developed by indigenous communities in Chiapas, Mexico. The project began as a response to the crisis in coffee prices and the serious negative effects on producers that have led to increased poverty. Collateral consequences were also significant, such as drug trafficking, production and consumption and the increased presence of guerrillas.

The project aims to add value by expanding and controlling all levels of production and distribution, from growing, processing and marketing, to direct sales through their own coffee shops. This approach has decreased economic vulnerability—by strengthening the link between producer and consumer—and yielded environmental and financial benefits, by involving indigenous women and using profits to improve community infrastructure.

Some of the challenges are balancing attention to all stages of the project, strategic planning, and financing, and increased competition from companies such as Starbucks.

The co-chair thanked Mr. Velasco for a very stimulating presentation.

Comments from the public and JPAC included:

- The importance of environmental education and the positive effects on indigenous communities cannot be overstated. This very successful model should be expanded to other indigenous cooperatives offering different products, such as bakeries and confectionaries.
- There is a potential for collaborating with universities such as this one through the green campus program by establishing coffee shops and creating a market.
- It is the responsibility of civil society in Mexico to assist and support these projects. They are of excellent quality and have shown to relieve poverty. Small and medium-size businesses in Mexico can help.
- What are the opportunities for women to obtain financing within the CEC and how are women actually involved in this project?

Mr. Velasco replied:

- It is important to understand that the starting point of this project was social need. It was not done for the communities but by the communities themselves to reduce their dependency on global coffee markets.
- The objective is to sell coffee in the cup through our own shops. We are working with small investors so as not to lose control. We are also involved in diversifying with complementary project and marketing these in our shops such as ceramics, candy, and pastries. In fact we just received a national award for the best dessert. That is the ultimate objective. Our biggest limitation is capital.
- One of our biggest challenges is to solve the education gap. We are operating in a very marginal area where illiteracy rates are around 36 percent. We are starting our own education program. The existing education system does not work for us—where we are essentially 'majoring in peasantry.'
- We need to cooperate and form alliances with financial, business, academic and research institutions to overcome financial and technical deficiencies. We have technical deficiencies. Forums such as this assist us greatly in networking and forming alliances.
- We lack the tools to strengthen our competitiveness. We also need to lessen migration from Chiapas to the border region.
- Finally, women have a very important role in this project and I would be happy to share the details of this with you.

The co-chair then introduced Mr. Miguel González, Corporate Director, Environmental/Security and Health, and Technology Vice President from Cemex. He shared experiences of the Eco-efficiency Program that his company has run very successfully and which can contribute to analyzing links between financing and the environment. He explained that environmental investing has to be part of long-term growth—otherwise there will be a loss of investors and customers, along with increased costs of remediation. Combining the concepts of sustainable development and environmental responsibility is the most efficient and profitable way of doing business today. Environment, social considerations and economy are all interconnected.

The challenge is to ease the tension between the objectives conservation and productivity by the efficient use of natural resources and communicating the results. Cemex responded to this challenge with the Eco-efficiency Program, launched in 1994 with investment in improved and new infrastructure, recycling, natural materials, reducing emissions, use of waste materials, and active promotion of a culture of eco-efficiency through communication and outreach.

He went on to demonstrate some very significant economic results, using an example of a decision to use wastepaper to fuel a kiln, resulting in reduced energy consumption and emissions and saving the company US$2.3 million per year.

His final message was a call to invest in innovation and changing the corporate culture by involving the entire staff in these decisions.

Comments from the public and JPAC included:

- Cemex is to be congratulated for demonstrating that when a company takes on environmental concerns as part of its corporate strategy, strong income can be produced.
- Cemex uses natural resources and these are finite. Is that taken into consideration in your analysis of long-term results?
- Combustion of wastepaper can increase emissions of dioxins and furans as a byproduct of chlorine. Do you have data on this?
- Have details on your program been published?

Mr. González replied:

- Community awareness is an important part of our strategic thinking. Eco-efficiency can be introduced in any sector.
- It is our corporate policy to encourage our suppliers to adopt these eco-efficiency measures.
- Regarding the value of extracted resources, we are transforming these materials. The extracted resource becomes a school highway, etc., and we can remediate the area at the end of its lifecycle.
- We will apply eco-efficiency to new facilities that are acquired. Governments are now facilitating our involvement.
- Regarding alternative fuels, this is a very interesting question. We do not want chlorine in our process and are very careful about this.
- We have joined a global action plan so all our information (and that of other cement companies) is available.

The co-chair then introduced Mr. John Ganzi, Executive Director, Finance Institute for Global Sustainability.

He began by explaining that it was important to start this workshop from the industry perspective. The world of finance does not "do produce." The "fuel" that supports those activities is capital and that is the focus of his presentation.

He explained that there are essentially three categories of capital: government, developmental institutions (export/import banks that are often government-driven), foreign-direct investments (such as Starbucks in Mexico), and private financial institutions (commercial banks, pension funds, etc.).

He went on to explain that, within private financial institutions, there are three types of services provided: securities trading, credit with interest (most common) and insurance (the biggest risk taker in the financial service market place). Each are driven by risk—how much money will I make versus how much risk will that take? Private financial institutions have a significant impact on development and human sustainability because they can move money freely and quickly.

He gave examples of where the financial sector and environment are already intertwined:

- Securities markets—eco-funds, sustainably responsible investments and shareholder engagement; here, he suggested that the last has great potential.
- Credit—real estate, environmental technology, infrastructure projects.
- Insurance underwriting for such environmental and climate-change risks as asbestos, pollution, rising sea levels, windstorms draught, and floods (where environment and finance first interface).

He suggested that the greatest common challenge is to find financing for aging infrastructure, especially that involving water. The private sector will have to cooperate with governments.

Another area of financing potential is pension funds. This is an area where more regulation is being introduced and some countries are now screening for environmental considerations (Switzerland, for example). He concluded with several suggestions for consideration by the participants:

Where do we go from here?

- There is a need for transparency and access to information. The Enron and WorldCom financial scandals have demonstrated this.
- We need models, tools and case studies. A case study on small and medium-size enterprises to document the process and lessons learned would be very useful.
- Standardizing the regulatory reporting framework. For example, the current environmental reports of Dow and Dupont cannot be used by financiers—the data are not comparable.

What is needed?

- Environment-oriented firms and technologies are not great investments. We need to integrate sustainability into business.
- Financiers follow; they do not lead. The viability of small and medium-size businesses needs to be proved to assist them in getting funding. This can only be accomplished with information being made available in a way that is useful to financiers.

Governments can:

- Facilitate corporate transparency
- Improve standards for reporting and indicators
- Promote new models
- Facilitate dialogue
- Adopt free market pricing to assist the financing of potable and wastewater infrastructure
- Devise protocols for the involvement of pension funds
- Handle credit extensions at market rates (he noted here that restrictions on the NADBank resulted in 90 percent of the fund not being invested)
- Harness the power of government purchasing to favor green goods and services

Possible roles for the CEC:

- Training entrepreneurs
- Function as broker of capital flows
- Work with all national governmental agencies on establishing comparable reporting requirements across all NAFTA countries—across all sectors that touch the environment.

Comments from the public and JPAC included:

- Have you looked at the energy services companies and what they do in providing energy performance contracts?
- The link between private finance and infrastructure is problematic. What do we really mean by sustainability—sustaining financial capital or the environment?
- Have we witnessed changed behavior as a result of things being done differently in countries where pension fund regulation has been introduced?
- Is there any concrete evidence that foreign direct investments have a positive effect on environmental sustainability? Are there any case studies?

Mr. Ganzi replied:

- Infrastructure projects are inherently private/public initiatives.
- From a financier's perspective, sustainability means getting your money back with a dividend. The challenge for us is to break down the wall between environmental considerations and financing. We are now tackling that question in relation to infrastructure projects.
- There are strict domestic controls but essentially no international rules.
- Regarding the regulating of pension funds, it is essentially too early to tell. We need three years of data before we can predict anything.
- Regarding foreign direct investments, he suggested consulting work done at Yale University. This is not his personal area of expertise.

The co-chair then introduced Kaj Jensen, Assistant Vice President, Corporate Environmental Risk Management from FleetBoston Financial (a large financial holding company), who began by observing that sustainable investments are occurring, but not yet as a mainstream effort. What does occur is a secondary benefit as a result of careful risk review. He went on to explain the two sides of risk. The first is risk capitalization—understand the environmental risk and work with it.

The second is risk aversion—in a down-economy, investors are more likely to invest in companies taking less risk. The latter means they are less likely to look at innovative ideas and ways of managing risk.

He continued by describing some of the current realities in lending at his institution. The first was "brownfields," which are abandoned, contaminated or under-utilized industrial properties. With a good risk review team, such sites can be profitably redeveloped. Now Fleet attracts these developers because of its internal expertise.
The second is the area of "green buildings" that are eco-efficient and eco-designed, or existing buildings that are ecologically renovated. The problem with green building investment again comes back to risk. It is a relatively new area so there is no proven track record.

He went on to discuss some financing initiatives developed by the United Nations Environment Programme (UNEP) to assist stimulating private and public partnerships. FleetBoston is participating in a North American task force.

He concluded by saying that, along with oversight on the long-term sustainability of investments, regulators need to consider other risks like climate change, develop triple bottom-line reporting, and provide clear guidance regarding risk reporting for environmental liabilities. He encouraged NGOs to continue pressure for change and to help 'tip the scale' to make innovative products or investments more attractive.

Comments from the public and JPAC included:

- Concerning green buildings, there is a rating system in the United States. Are financial institutions using this rating system? He noted that Pennsylvania in fact has a record of accomplishment, that green buildings are not always more expensive, and cited several examples.
- It is important to define what we mean by sustainable development and sustainable investment. Financiers are oriented towards profit. It is very important to decide if we are saying that profit is not the main consideration, or is making the environment a consideration more profitable?
- Is the consensus that was reached at the Global Forum: Financing the Right to Sustainable and Equitable Development, in Monterrey in March 2002, linked to this session?
- What would be the basic requirement for companies to implement policies that benefit sustainable investment?
- Having agencies create directives for environmental auditing and providing evidence of due diligence can go a long way to promoting change in corporate behavior, and thus furthering sustainable development.

Mr. Jensen replied:

- Regarding green buildings, FleetBoston is involved in lending but there is a higher risk. We need good solid data over an acceptable amount of time. We are working to get case studies out into the community to promote investment in this area.

- Yes, sustainable development means profitability for the company—in our case. This allows FleetBoston to provide financing for programs such as brown buildings. We see this as investing in the community and being social responsible—the triple bottom line.
- No, there is no direct relationship with the March meeting in Monterrey; however, the Declaration and related materials were made available to JPAC and the presenters prior to the meeting.
- Developing guidelines and educating investors on the risks of not incorporating environmental considerations can be a very effective technique.

The co-chair then opened the floor to general questions and comments:

- The place to begin changing the culture and rules is with the professions that have the largest influence. Guidelines or directives for the accounting profession would thus also be very helpful.
- Economic decision-making for environmental protection is offered as a working definition of sustainability.
- We have to 'think out of the box' and push the definition of sustainability. Are we incorporating profit into sustainability or sustainability into profit? There are examples in other parts of the world—Australia, for example—of providing capital flow to communities.
- Public institutions can do two things to promote financing and risk management for green buildings: adopt energy performance contracts or buy insurance.
- JPAC was invited to consider the risks to Mexico of opening the border to agricultural products.
- Do not neglect small and medium-size enterprises in these discussions. In Mexico, there is little opportunity for these businesses. Is there more opportunity in the US and Canada?
- JPAC should also begin to look at acknowledging and valuing other ecological services—such as regulation of the hydrological cycle, biological disease and pest control, protection from disturbances, nutrient cycles, waste treatment, pollution control and detoxification, pollenisation, soil formation, erosion control, genetic information banks, regulation of atmospheric gases, etc.—then establish mechaninsms to assign payment requirements for people who benefit from these services.
- A lot has been said about financial profitability but not much has been said about social benefits as part of profitability.
- An important result of this meeting is highlighting the need for business and the CEC (or other environmental organizations) to work together if progress is to be achieved.
- Creating directives for the accounting profession is a very good idea. We rely heavily on this profession. When working as auditors, accountants never talk about sustainability issues. Create a "Chinese wall," because the same accounting firm consults on the issue of sustainability. NGOs could help lobby for the development of rules. Governing guidelines would go a very long way to regulate the profession.
- Bankers will never care about social issues. We need to make it part of their business. We have to talk their language and accounting is a very good entry point.
- There is very little documentation available on SMEs and it is hard to get funding to do the necessary research.

- Until we figure out how to value ecosystems, we will continue to destroy them and then build environmental theme parks, because the latter creates jobs. Capitalism is the overriding system. We have to "price it" if we want to change it.
- We need to focus on the needs of SMEs, not change the rules or excuse them. Perhaps someone could take up the challenge of formalizing the *Café de la Selva* project into an SME case study.

Session II

Chantal Line Carpentier explained that this morning's session had focused on increasing awareness of environmental considerations in the practices of financial institutions. This afternoon the discussion would be on how to increase the flow of capital to environmentally preferable goods and services. She then provided a review of the attached CEC draft discussion paper on private sector financing and the environment that had been distributed to participants prior to the meeting to stimulate discussion.

Comments from the public and JPAC included:

- This is a very difficult topic and the discussion has been enlightening. The discussion paper mentions some risk management actions, for example, the recent sinking of an oil tanker off the coast of Spain. Would the use of environmental due diligence during risk assessment reduce availability of credit if environmental standards are not met?
- Reply: A very interesting question. Normally an institution would investigate before providing credit if the fleet were used as collateral, along with the ability to service the debt or repay the loan. The transportation sector is very complex. Tankers are usually leased—in fact, sometimes they are owned by financial institutions themselves with the shipping and maintenance responsibility shifted back to the transporter. It becomes very difficult to perform due diligence and ascertain who ran the ship at any point in time.
- The EU just established standards for double-hulled tankers. But these are much more expensive. Retiring the single-hulled tankers has a negative effect on the smaller operator. It might be the 'right thing to do' environmentally, but it will have implications for SMEs.
- How are green goods and services defined? Also, labeling and certification are voluntary. A better route may be to require companies to disclose fully what is in a product.
- With current interest rates, Mexico cannot complete, therefore, its firms are forming joint ventures with foreign companies.
- Conservation of species and areas (such as forests) should be included in these assessments. Groups and individuals operating these programs should be able to access credits.
- Reply: Kyoto is not in operation, nor is the carbon credit system. The only available source at this time is a World Bank pilot fund.
- Foreign direct investments, with their ability to take money in and out quickly, are the antithesis to environmental sustainability.
- Some of us think that carbon sequestration is not the solution and will never absorb annual emissions. It merely distracts from the true solution, which is to reduce emissions. We need more work on valuing the benefits of ecological systems—payment for this service by a watershed, for example. There are methodologies available.

Next steps and closing remarks

The co-chair explained that JPAC would be developing an Advice to Council. He noted that this is a very important project for the CEC Secretariat. UNEP is organizing a meeting in New York City with the financial community on 28 February 2002. The CEC and a JPAC representative will attend.

He concluded with a thought from the great social philosopher, John Stuart Mill, on the dichotomy of the way we look at nature: on the one hand it is something we are part of; on the other something we seek to control. There is a long history and both ideas are very much alive. "We have had a very rich day discussing both of those paths."

Chantal Line Carpentier warmly thanked all the participants for their thoughtful and thought-providing comments.