1.2.2 Financing in Support of Environmental Protection and Conservation

Project Summary

This project continues previous work exploring the interrelation between finance and environment, focusing on two areas emphasized by the CEC Council at its ninth regular session. These are (1) How environmental information affects financial markets, and (2) What are the investment opportunities in the environmental "sector."

The role of the private financial services sector in supporting environmental goals is critical. The Johannesburg declaration on sustainable development emphasizes the need for private sector corporations to enforce corporate accountability in a transparent and stable regulatory environment. Implementation language includes: increased investment in cleaner production and eco-efficiency in all countries through incentives and support schemes and policies directed at establishing appropriate regulatory, financial, and legal frameworks. In partnership with the finance sector, UNEP, and others, this project will continue its work in identifying needs for information and financial analysis in supporting investments in green markets, in particular, those related to debt, equity, and venture capital finance. Second, the project will focus on ways environmental information—and, in particular, information related to environmental risk—is relevant to improving transparency and stability in financial markets. The project will examine how to advance work on existing requirements regarding disclosure of environmental information pertaining to financial reporting. The sectoral analysis will concentrate on the energy sector—including "upstream" activities of relevance to that sector.

The environment represents an important, dynamic, and growing business area for two reasons: (1) Environmental management is closely linked to business and financial risk management, and (2) The environmental goods and services sector represents an important investment opportunity. To address the latter, the project will identify and broker partnerships in support of environment-related financing, such as the North American Sustainable Agriculture Fund.

Goals and Objectives

Building on a decade of work on finance and the environment by UNEP and OECD, among others, and the CEC's previous work, the goal of this project is to secure private financing for environmental protection and biodiversity conservation in North America. This will be accomplished by harnessing the power of the financial service sector to support economic and trade activities that provide enhanced environmental protection and consideration. Experience shows that efforts to support green markets in "win-win" trade-environment links require not only the appropriate public policies, but also innovative partnerships with the private sector. The same is likely to be true for "win-win" investment-environment links.

The project will work in cooperation with the private sector and other institutions to encourage efforts to develop methodologies and information links. These are required to provide environmental information in a form more useful to financial institutions; to encourage the use of environmental information in credit, investment, and asset risk management decisions; and to consider how to advance work on existing requirements regarding disclosure of environmental information pertaining to financial reporting. The project will also encourage small and medium-size sustainable enterprises through the sustainable agriculture fund and other or similar instruments in other sectors. The goal is to expand access to financing and credit in these markets, including (where appropriate) access to micro-credit—both directly through project financing and indirectly through supporting market measures. The project will work with the financial services sector, UNEP, specific industry stakeholders, the Parties, and the NGO community to identify ways in which private-public partnerships can be deepened and strengthened.

The project will focus on the following objectives:

- Continue to examine what kind of information is needed to ensure the financial viability of investments related to green goods and services. In particular, examine the type of indicators and other information investors require to meet returns on investment and financial risk-related objectives.
- Extend lessons learned from the Sustainable Agriculture Fund to renewable energy and other sectors as appropriate.

- Facilitate partnerships between different actors within the financial services sector so as to provide targeted information on environmental opportunities in green markets.
- Develop methodologies to provide easier access to relevant and comparable environmental information in a format appropriate for financial analysis.
- Document the case for corporate social responsibility 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.

Expected Results

- In the long run, increase private financing in support of environmental protection and biodiversity conservation—directly, through increased financing in the environmental sector, and indirectly through improved market signals that incorporate companies' environmental risks.
- In the short run, this is achieved by improving the provision of information about the financing characteristics of green markets, documenting the business case for these investment opportunities, and clarifying the role of the public, NGOs, consumers, and market mechanisms in supporting investments in green markets.

Rationale

Increased private sector funding of environmentally preferred investments is critical to advancing conservation and human and ecosystem health. The link between environmental protection and the financial services sector has been recognized for some time and covers two broad issues: the extent to which financial markets can internalize environmental costs and benefits in pricing signals in general; and the availability and conditions of private financing to support environmental goods, including the investment in green goods and services. In a perfect world, all the information provided to the Securities Exchange Commission in the US, the National Banking and Securities Commission in Mexico, and the provincial equivalents in Canada, would be sufficient to assess the potential environmental risks of a company, and the market would price financial resources accordingly. Given that available information fails to assess and report these risks, companies spend significant sums in due diligence and other fees to assess the environmental risk they may be exposed to in merging with, or acquiring, a company in addition to the cost of conducting environmental impact assessment required by the law. Moreover, the financial market does not adequately reward companies that invest in the mitigation of potential environmental risk through lower interest rates, lower collateral, or better access.

Progress to Date

In 2001, the project undertook several initiatives in the field of financing and the environment. Examples include the release of the report on "Investment Opportunities for Small and Medium-size Enterprises in Mexico in the Climate Agenda." In 2002, the work continued. It was found that given current economic conditions, the private financial sector alone can not profitably support a North American Sustainable Agriculture Fund prototype with shade coffee (CEC 2002). A preliminary analysis that compared security exchange rules in Canada, Mexico, and the United States regarding the disclosure of environmental information was presented at a New York meeting in March 2002 on financing and the environment. Highlights of the meeting were that: (1) experience suggests that while obligations regarding the disclosure provisions covering environment-related risks are on the books, evidence of enforcement is uneven; (2) green and social investments remain niche segments of the market; there does not seem to be a bridge between mainstream banking and investment decisions, and environmental issues; (3) SEC filings are not considered a useful source of information about environment-related issues; and (4) the problem is not lack of environmental information—a large amount is transmitted through a multitude of reporting initiatives—rather, the problem is that information is not measured in a unit of analysis that is useful to the financial community, nor is it comparable among industries or even companies within the same industry. Sector level work (pulp and paper, oil and gas, electric utilities, and mining sectors) will be presented at a follow-up meeting in February 2003. The working level meeting with accounting firms, rating agencies, financial auditors, fund management companies, investment firms, securities exchanges and regulators, will distill where and how environmental risks are financially important, based on sectoral level work. Best-practices in reporting will also be developed.

The 2002 Summit on Sustainable Development, with its emphasis on Phase Two partnerships, creates the best opportunity in a decade to engage the financing and investment community in environment-related investment. In collaboration with UNEP and the Carnegie Endowment, the CEC generated a background paper that provides a factual update of recent trends in the current status and immediate prospects for environment-related investment, including Foreign Direct Investment (FDI), as well as debt, equity and venture capital investments, to environment-related investments in developing countries with the goal of stimulating discussions among the private sector and public agencies on the need for innovative partnerships for sustainable development.

Some of these results have been presented at a joint JPAC-Environment, Economy, and Trade program meeting on Investing in North America's Future: Innovative Financing for Sustainable Development, 9–10 December 2002, in Monterrey, Nuevo León, Mexico.

Based on the past three years' of experience with the coffee project, it is clear that a lack of micro credit is one of the major reasons for its small market share of shade-grown coffee. To attract private funds, the profitability and limited risk of shade coffee systems must be demonstrated. The project surveyed industry, farmers, and financiers to gather information, commitments, and partnerships required by lenders before they agree to participate in a sustainable agriculture fund, and prepared a prospectus containing estimates of the economic and financial returns from shade and organic coffee production systems. In the process, it became clear that other products grown with coffee represent a large share of total revenues, and thus the Fund was reoriented toward shade or sustainable agriculture (agroforest systems) more generally. Because the literature and experience thus far do not present clear-cut models easily applicable to cost-effective micro credit delivery, work continues to design such a model that meets most of the credit demand and has a low default rate. Thus, the project observed and studied the entire production/consumption chain from the financier, through the producers, its preparation, commercialization and export to consuming countries, to its final sale. This enabled the project to:

- Determine where resource allocation, management, infrastructure, information flow etc. could be improved;
- Identify which actors are best suited to undertake each improvement: governments, NGOs, the coffee industry, financiers;
- Recommend policies, economic instruments, institutions, and infrastructure development for each actor along the coffee production/consumption chain; and
- Demonstrate that given current circumstances, it is not profitable for the private sector to invest in a coffee agroforest fund, that the fund would need to be supported by the non-private financial sectors, and that the Parties would need to show some commitment.

Actions 2003

Overview

This project will focus on two areas: lessons learned from other sectors in establishing the North American Sustainable Agricultural Fund and analysis at the sector-specific level on how environmental information disclosure is used and can affect capital markets.

2003	**Estimated Resources Required (C$)**
Action 1: Continue to document how environmental information could better inform financial markets	**120,000**
• Activity 1: Expand information disclosure provisions among the three countries, at a sector level (pulp and paper, oil and gas, electric utilities, and mining sectors)	50,000
• Activity 2: Convene a meeting of financial regulators, finance departments, industry representatives, and other institutions to explore how to provide environmental information in a form more useful to financial institutions	40,000

• Activity 3: Develop methodologies and information links to encourage the use of environmental information in credit, investment, and asset risk management decisions. In particular, document environmental risks in ways that make business sense to CFOs and CEOs	30,000
Action 2: Continue to explore ways to increase the financing of environmentally-preferable goods and services	**75,000**
• Activity 1: Leverage the expertise accumulated so far to develop partnerships with the coffee industry, the Parties, ENGOs, and development banks to facilitate the creation of a pilot fund	45,000
• Activity 2: Continue documenting private-public partnerships to increase financing of Environmentally-preferable Goods and Services in general. To the extent possible, extend lessons learned to the renewable energy or other sectors	30,000
Total Resources Required	**195,000**

2004–2005
Action: This project is anticipated to continue to study and work on financial mechanisms, increasing its collaboration with the private sector, UNEP, and other groups, and focusing on issues central to other project areas in addition to environment, economics and trade.

Public Participation

This project is designed to support increased partnerships with the private sector and to clarify links between financing and various market measures, including labeling, voluntary initiatives by industry, and other measures. An important emphasis of the project will be to encourage an ongoing exchange of information between environmental, producer, and consumer groups involved in green markets and the financial services sector.

Capacity Building

An important objective in encouraging mutually beneficial relationships between the financial services sector and community, environmental, and other groups that support an environmental agenda, is providing relevant information and support to these and other groups in the field on how to encourage partnerships that are truly "win-win." Among the goals of the project will be a needs assessment to help community, environmental, and other groups build beneficial relationships. Lessons learned will be updated and distributed broadly.

Expected Partners and/or Participants

Along with the specific industry stakeholders, the CEC will continue to involve selected representatives of the private financial services sector, including commercial and investment banks, insurance, and re-insurance sectors, pensions and other funds, and representatives of relevant international and other organizations, including the World Bank, UNEP, the World Business Council for Sustainable Development (WBCSD), the OECD and various environmental and other groups. JPAC will continue to actively participate in these activities as well.

Linkages to other CEC Projects

This project will be closely linked to the Conservation of Biodiversity program area and will explore potential collaboration in the work on Children's Environmental Health. This project builds on the green goods and services project, which identified the need to work in the credit aspect of green market development.