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**2008 Financial Sector Development Symposium**

# *Greening the Financial Sector -*

# *How to Mainstream Environmental Finance in Developing Countries?*

4 and 5 December 2008

KfW, Berlin

**Concept Paper**

## 1. Background

The Financial Sector Development Symposia are an established annual tradition of KfW Entwicklungsbank in cooperation with the German Federal Ministry for Economic Cooperation and Development (BMZ). Each event features a new thematic focus for state-of-the-art contributions and discussions by a select group of leading professionals and aims to foster knowledge exchange and new initiatives. The scope of the symposia series has broadened over the years to encompass financial sector development and access to finance as a means of contributing to the Millennium Development Goals (MDGs).

In this context, the following topics were discussed at recent symposia:

- Microfinance Investment Funds: Leveraging Private Capital For Economic Growth And Poverty Alleviation (2004)
- UN Year of Microfinance 2005: New Partnerships For Innovation In Microfinance (2005);
- Financing Housing For The Poor – Connecting Low-Income Groups To Markets (2006);
- Mobilising Capital For The Poor – What Can Structured Finance Contribute? (2007).

## 2. The 2008 Symposium

*The 2008 Symposium will focus on environmental finance markets via the financial sector in developing and transition countries. (Direct international project financing of large investments will not be addressed). The financial sector has a huge potential to help achieve environmental goals, such as saving energy and reducing emissions, which needs to be tapped effectively and efficiently. The central question animating this symposium is how to mainstream existing and future environmental finance markets in ways that contribute to achieving the Millenium Development Goals. Under this "leitmotif", the symposium will discuss key challenges on the demand and supply side and also at the macro and sector levels. A wide range of approaches to promote environmental finance markets will be discussed, identifying opportunities, risks, bottlenecks and challenges. In the broadest possible sense we will examine the underlying framework conditions and incentives that are required in order for environmental financial markets to develop both with clear business and development perspectives.*

It is widely acknowledged that financial sector promotion is an instrument that is well-suited to help achieve the Millennium Development Goals, particularly by increasing poor people's income, by fostering the economic growth required to fight poverty and by contributing more directly to gender equality. However, the financial sector also has an enormous potential to help protect the environment (MDGs 7 and 8). The power of finance should not be underestimated in this context and should be more closely examined: Building inclusive financial systems clearly includes the role of the environment, not least because environmental problems hit poor people more severely than other sections of humanity.

Environmental finance is used here to cover a wide range of financial markets in developing and transition countries, excluding the direct financing of large investments. Such markets are devised to create new demand with corresponding business opportunities while they help protect the environment. This includes saving energy and reducing greenhouse gas emissions. Product examples include environmental credit lines to small and medium-sized industries, energy efficiency programmes (for micro, small and medium sized enterprises – MSMEs - as well as housing improvement). It also provides new approaches, especially to help rural people use appropriate financial services to cope with the effects of climate change via weather insurance schemes.

Financial institutions in developing and transition countries are increasingly called to help address a number of environmental problems facing the developing world, including

- continuously increasing energy demand due to high growth rates and high energy intensity in major middle-income countries;
- the fact that despite high world market energy prices, in many developing countries energy tariffs have been – and continue to be - highly subsidised. This policy thwarts efforts to promote financial products, e.g. to invest both in production technologies and housing improvements that have a higher degree of energy efficiency and fewer negative environmental consequences, such as $CO_2$ emissions;
- a heightened effort to help mitigate and adapt to the effects of climate change. Climate change as such cannot be reversed. However, there are ways to contribute to slowing down climate change processes and to develop, in a relatively short period of time, innovative financial products that reduce the vulnerability of shocks resulting from climate change, such as natural disasters of all kinds, and to adapt to the consequences of those shocks.

Doubtlessly, the public sector will not be able to bear the financial burden of addressing these challenges alone, so the financial sector can and should play a stronger role in providing a sufficient level of finance - both in scale and in depth of outreach. However, how can this be achieved? To answer this question, it’s crucial to understand the impediments to building sustainable environmental finance markets. Is it a problem of weak demand for environmental finance? If so, how can MSMEs and poor households benefit from energy efficient and/or “environmental” investments, and how can their financing be brought in line with the “logic” of sustainable financial institutions? Or is the reluctance of financial institutions to become engaged a major bottleneck? What prospects are there for turning environmental finance into “normal business”, i.e. standardised, profitable products responding to a sufficient demand? And finally, in what sense have framework conditions been an obstacle to the development of environmental finance markets? Based on these three dimensions, key questions to be addressed include the following:

- *“What makes clients want environmental finance?”* Is it just a question of incentives or is there (also) an “information gap”? How can demand best be stimulated, and how can existing demand be satisfied? What framework conditions in general (including energy prices) and what kind of incentives are required to create more demand? What experiences have been made with demand side targeting?

- *“What makes financial institutions want to engage in environmental finance?”* How can banks and other financial institutions be persuaded to become more engaged in small-scale environmental finance markets? How can the capacities of financial institutions be sufficiently strengthened to design and offer sustainable, standardised and profitable environmental finance products efficiently?

- *What framework conditions are conducive at the macro and sector levels*? How can the right incentives be put in place so that sustainable environmental finance markets can be developed to which relevant target groups have adequate access? Incentives are discussed here in a rather broad sense, going far beyond the old question of how to deal with subsidies. It is the overall set of framework and market conditions that influence financial institutions’ decisions to offer more environmental finance to their clients. More generally, what is the role of the public sector in setting suitable framework conditions, and what, ultimately, makes environmental finance a “triple-win-business”, benefiting the environment, financial institutions and their clients?

- *“How do we know that a “triple-win-situation” is actually happening?”* How can stakeholders measure the impact of environmental finance?

The 2008 Symposium will be a forum for the exploration of approaches to environmental finance on a broad scale. It will position the financial sector as a tool for responsible development finance guided by environmental objectives in developing and transition economies. The two-day exchange aims to identify current frontiers and the prospects environmental finance offers.

Expert presentations in each session will introduce core issues as a basis for panel discussions. Leading professionals in financial sector development and environmental finance, donors, development finance institutions, bankers, financial managers, networks, energy agencies, lobby groups and researchers will review experiences, share approaches and explore new initiatives. As in the past, the expert papers presented at the Symposium will be published.

## 3. Symposium Topics

### 3.1. Mainstreaming Environmental Finance into Financial Markets – Relevance, Potential and Obstacles

Goal: To provide an introduction and initial overview of environmental finance via the financial sector, laying out the key issues necessary to understand the relevance of environmental finance for the financial sector, identifying the potential and the key challenges on both the demand and the supply side.

Issues for discussion: How relevant/important is environmental finance in achieving the MDGs and other central frameworks of reference? What is unique to environmental finance relative to other financial markets generally? What are key challenges on the demand and supply sides of environmental finance markets, and what bottlenecks are likely to be encountered at the sector level? What roles can or should donors and International Finance Institutions play?

### 3.2. Mainstreaming Framework Conditions for Environmental Finance Markets – The Role of the Public Sector

Goal: To discuss the role of public sector structures and institutions (including but not limited to the Government). In what ways and contexts do public sector entities encourage or discourage in providing environmental finance in developing / transition countries? The Symposium will explore legal/regulatory framework conditions that are conducive to environmental finance development, focusing on the supply and the demand side (incl. energy prices).

Issues for discussion: What are the underlying assumptions for "conducive" framework conditions? What impact do low/high energy prices have on environmental finance? What legal and regulatory framework conditions are required to build environmental finance markets? What has been learned from recent experiences with subsidies that create both positive environmental impact and additionality on the one hand while avoiding moral hazard on the other? What are the implications of green finance for MSMEs and households to produce positive environmental impacts? What role can/should donors/International financial institutions/investors play to promote environmental finance?

### 3.3. Mainstreaming Environmental Finance Markets (I) – Small-Scale Energy Efficiency and Renewable Energy Finance

Goal: To highlight the opportunities, challenges and limitations of existing environmental finance markets that focus on the demand for and the supply of energy efficiency and small-scale renewable energy finance ("EERE"), particularly for micro, small and medium-sized enterprises (MSMEs) and households.

Issues for discussion: Presenting best practices: what are the challenges and bottlenecks in promoting energy efficiency and small-scale renewable energy programmes, including both SME and housing finance. Analysis of recent experience: where enterprise (and regulation) lead, finance follows – or the other way about? How does demand for energy-efficiency translate into finance products? How to raise awareness? Green strategies for financial institutions: what is the right product mix for i) energy efficiency and ii) renewable energy programmes, and what role is the role for microfinance institutions? What kind of subsidies are most appropriate for EERE programmes?

### 3.4. Mainstreaming Environmental Finance Markets (II) – The Role of Weather Insurance and the Carbon Market

Goal: To discuss the role of weather insurance and carbon markets as strategies to mitigate and adapt to the effects of climate change.

Issues for discussion: What role do financial markets play in the climate change debate, in both mitigation and adaptation strategies? What are the key challenges from a financial sector perspective? How can rural clients become familiar with insurance products and small-scale energy efficiency related investments? Which types of weather insurance schemes already exist? How can financial institutions address the potentials and the bottlenecks in linking their instruments with the carbon market, the emissions trade etc.? What is the role of development finance institutions and the opportunities for the private sector? How can microfinance institutions become involved?

### 3.5. Mainstreaming Impact Over Time – Who Measures What for Whom?

Goal: To assess the current state of knowledge with regard to both the environmental and financial sector impacts of environmental finance in developing and transition countries, documenting experiences so far and exploring possible standards for measuring such impact.

Issues for discussion: What impact can environmental finance have in dealing with greenhouse gas emissions, the energy costs of SMEs and households, resource use generally, and the overall strengthening of the financial sector? How can the financial frontier embrace environmental protection and related product diversification? What are "appropriate" standards for measuring impact? What are the roles and responsibilities of financial institutions in measuring impact?

### 3.6. Mainstreaming Environmental Finance – What Potential for Going Further?

Goal: To take stock and construct a vision of the development of environmental finance through 2015.

Issues for discussion: What progress can be expected in the medium term: Will environmental finance markets become part of the mainstream in the financial sectors in developing/transition countries or continue to face a niche existence?