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INCLUSIVE GREEN FINANCE

INCLUSIVE GREEN FINANCE (IGF) WORKING GROUP

PROMOTING INCLUSIVE GREEN FINANCE INITIATIVES AND POLICIES

PART OF THE AFI SERIES: DEFINING THE 4P FRAMEWORK

AFI SPECIAL REPORT

INTERNATIONAL CLIMATE INITIATIVE (IKI)

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The Inclusive Green Finance workstream is part of the International Climate Initiative (IKI), supported by the German Federal Ministry of the Environment, Nature Conservation and Nuclear Safety (BMU), based on a decision by the German Bundestag.

The Costa Rican forest seen from below. (Photo by Freddy Cascante/iStock)

EXECUTIVE SUMMARY

Around the world, Inclusive Green Finance (IGF) is gaining acceptance as an approach to addressing climate change, especially in developing countries. At AFI, the 4P Framework of Promotion, Provision, Protection and Prevention is being developed as a policy area by the IGF Working Group (WG) in consultation with financial regulators in the AFI network.

This first knowledge product seeks to deepen understanding of the first "P" — Promotion — by sharing the experiences of AFI members who have begun promoting IGF in their jurisdictions.

Promotion policies and initiatives prepare and encourage the private sector to offer financial services for green projects or climate-related activities to qualified beneficiaries, for example, through awareness raising, information sharing, capacity building and data collection. Promotion is the preparatory and framework development phase for action on inclusive green finance, and these policies and initiatives provide critical ongoing support to the other three pillars as they are implemented.

Based on internal research, AFI member surveys and stakeholder interviews, a framework has been developed to help AFI members begin their IGF promotion journey.

THE FRAMEWORK IS DIVIDED INTO FIVE SECTIONS

SECTION 1: INTERNAL PROMOTION

Internal promotion has been identified as a catalyst and starting point for policy action on IGF. Methods for kick-starting change and reorganizing to achieve new goals are explored through interdepartmental initiatives, internal capacity building and the development of centers of excellence on IGF-related topics.

SECTION 2: PROMOTING COORDINATION

Alignment with the national vision and promoting coordination among government actors is a key preparatory step for policy action on IGF. It requires interagency cooperation, and developing or revising financial sector strategies to support new goals related to financial inclusion and climate change.

SECTION 3: PUBLIC PROMOTION

Raising public awareness through public promotion is an ongoing effort. Moral suasion, publications, industry guidance and capacity building in the sector provide a foundation for stakeholders to pursue IGF policies.

SECTION 4: PROMOTING TRANSPARENCY

Promoting transparency in IGF policymaking should follow an evidence-based approach. Monitoring and reporting systems will need to be augmented to support new data, and integrating Environmental and Social Governance (ESG) criteria is becoming more common around the world. New risks will need to be identified and mitigated, and a national green classification system would be advantageous.

SECTION 5: PROMOTION THROUGH MONETARY POLICY

Once these four promotion policies are in place, promotion through monetary policy could help to achieve broader financing allocation objectives without direct capital injections or subsidies. Altering how central bank interest rates are determined, adjusting reserve and capital requirements and changing the collateral framework for open market operations to focus on IGF are all powerful indirect ways to promote IGF.

While promotion is a starting point for IGF initiatives and policies, it is also an ongoing set of activities that support the implementation of the other three P's through ongoing learning, sharing, organization, coordination, institutionalization and disclosure.

INTRODUCTION

It is widely accepted in the AFI network that climate change is a threat to development, and that it has already imposed a high cost on low-income and vulnerable populations in developing and emerging economies. However, research shows that financial inclusion is one way to build individual and collective resilience to the effects of climate change.[1]

In order to set financial sector goals that expand financial inclusion and help people to mitigate, adapt to and build resilience to climate change, it is critical that central banks and financial regulators understand and address the causes and effects of climate change and poverty in their economies. The traditional role of central banks and regulators — ensuring financial stability — can be aligned with promoting responsible financial inclusion for underserved segments of society. New roles can also be undertaken to respond to environmental crises.

Inclusive green finance (IGF) is a rapidly evolving policy area for AFI member institutions.

IGF policies and initiatives seek to include disadvantaged groups, such as women, youth, the elderly, forcibly displaced persons, persons with disabilities,[2] and MSMEs in climate mitigation and resilience-building efforts.

These policies have three things in common: they catalyze financial services from the private sector for climate action; they use financial infrastructure to deploy them; and they strengthen the resilience of financial institutions providing financial inclusion solutions to the effects of climate change.

Central banks have a unique perspective on climate change risks that private-sector players and policymakers cannot necessarily share given their differing interests and time horizons. This gives central banks an advantage in proposing policies that support climate action and debate, and enables them to engage in this debate themselves — not by stepping out of their role, but to preserve it. Even though some of the actions do not fall within the remit of central banks and supervisors, they are of direct interest because they can help them fulfill their mandates in an era of climate uncertainty.[3]

The adoption of IGF initiatives and policy development in AFI member jurisdictions has been mixed. There is ongoing debate whether a regulatory or voluntary approach should be taken, especially when reacting to climate risks in the financial sector. In some jurisdictions, awareness raising and industry adoption (e.g. by implementing environmental risk management and disclosure) is being done directly by the private sector via industry associations and progressive banks (typically foreign banks). However, in most cases, central banks or supervisory authorities are leading awareness-raising efforts and proposing policy reforms to promote industry adoption.

Regardless of the approach, financial institutions will ultimately be the ones providing financial services aligned with IGF policy objectives. Central banks and financial regulators will need to prepare for, coordinate and support this process. Financial regulators will need to develop an appropriate regulatory and supervisory framework while banks will need to integrate environmental and climate change risks in their strategies and risk management systems. Achieving these objectives will require a change in mindset for both regulators and bankers, and they would be well served by a carefully considered transition strategy.

1 (AFI, 2020)
2 In 2019, the AFI network approved the “Kigali Statement” which commit to harness the capacity of vulnerable groups to drive inclusive growth. For more information: https://www.afi-global.org/sites/default/files/publications/2020-10/Kigali_FS_20_AW2_digital.pdf
3 (Bolton, et al., 2020)
4 (AFI, 2020)

THE 4P FRAMEWORK

The national regulatory and financing structures of AFI member institutions vary considerably since each jurisdiction has unique mandates, political aspirations, capacity and resources. While there is no one-size-fits-all approach to promoting IGF policies, some common themes have emerged. In many cases, existing policy tools and techniques for promoting the financial inclusion of low-income populations and MSMEs can be refined and repurposed with a green focus. This allows policymakers to act swiftly while also taking the time to lay the groundwork for innovative policies that may require more preparation.

These policies are presented in a simple framework of the 4Ps of inclusive green finance: Promotion, Provision, Protection and Prevention.[4]

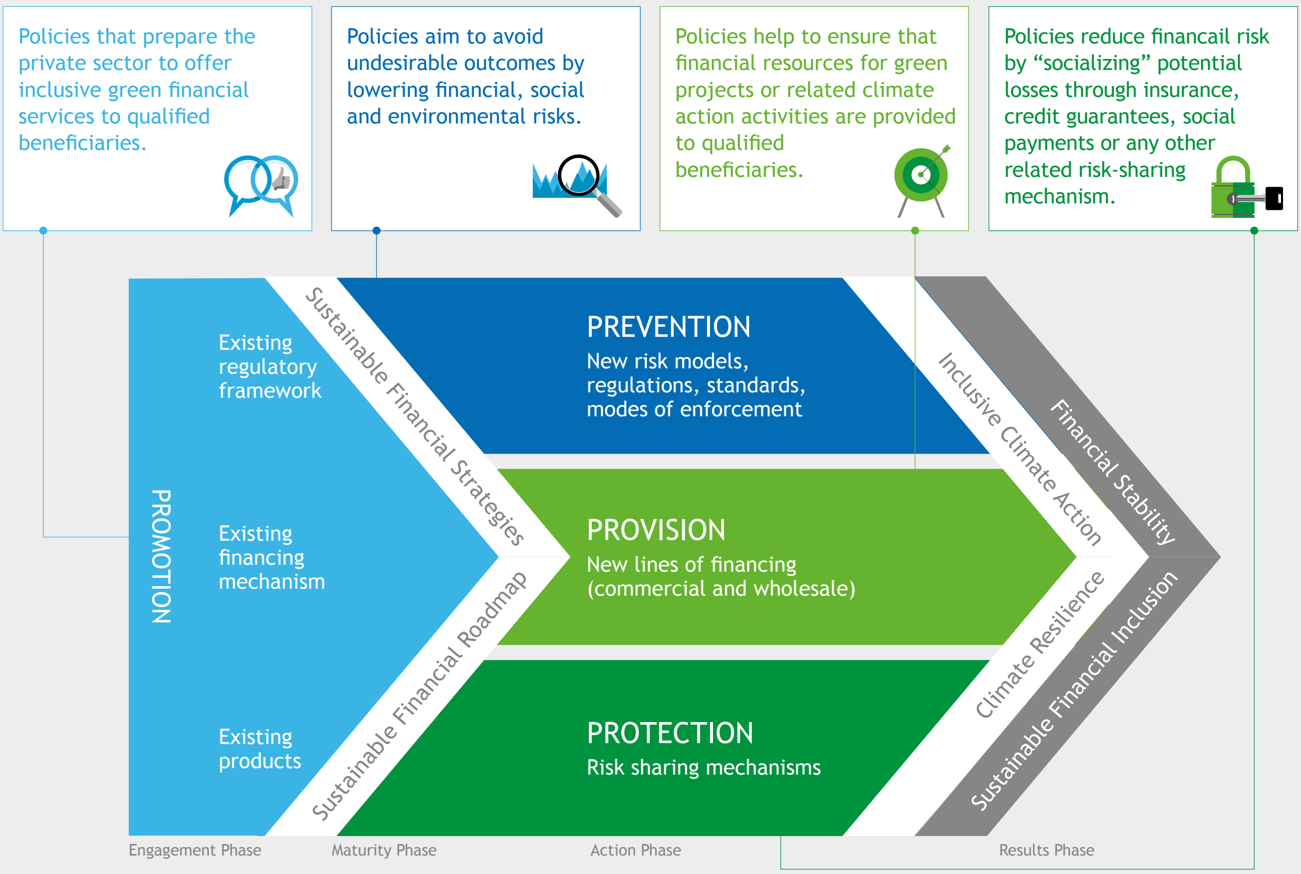
All policies under the 4Ps either catalyze financial services from the private sector or use financial infrastructure to deploy finance for climate action.

The purpose of the framework is to provide an intuitive way for financial regulators to consider the full range of policy actions for IGF.

The first "P", Promotion, which is the focus of this report, includes policies and initiatives that prepare and stimulate the private sector to offer financial services to qualified beneficiaries for green projects or related climate action. For example, through awareness raising, information sharing, capacity building, data collection and certain monetary policy actions. Promotion is the preparatory and framework development phase for action on IGF, but also includes critical, ongoing efforts that support the implementation of the other three pillars.

When designing IGF initiatives, it is important to consider both the supply and the demand side. For example, promoting only the supply of green financial services might not be enough, and a range of promotion policies for green financial inclusion should be pursued that meet the needs of both sides.

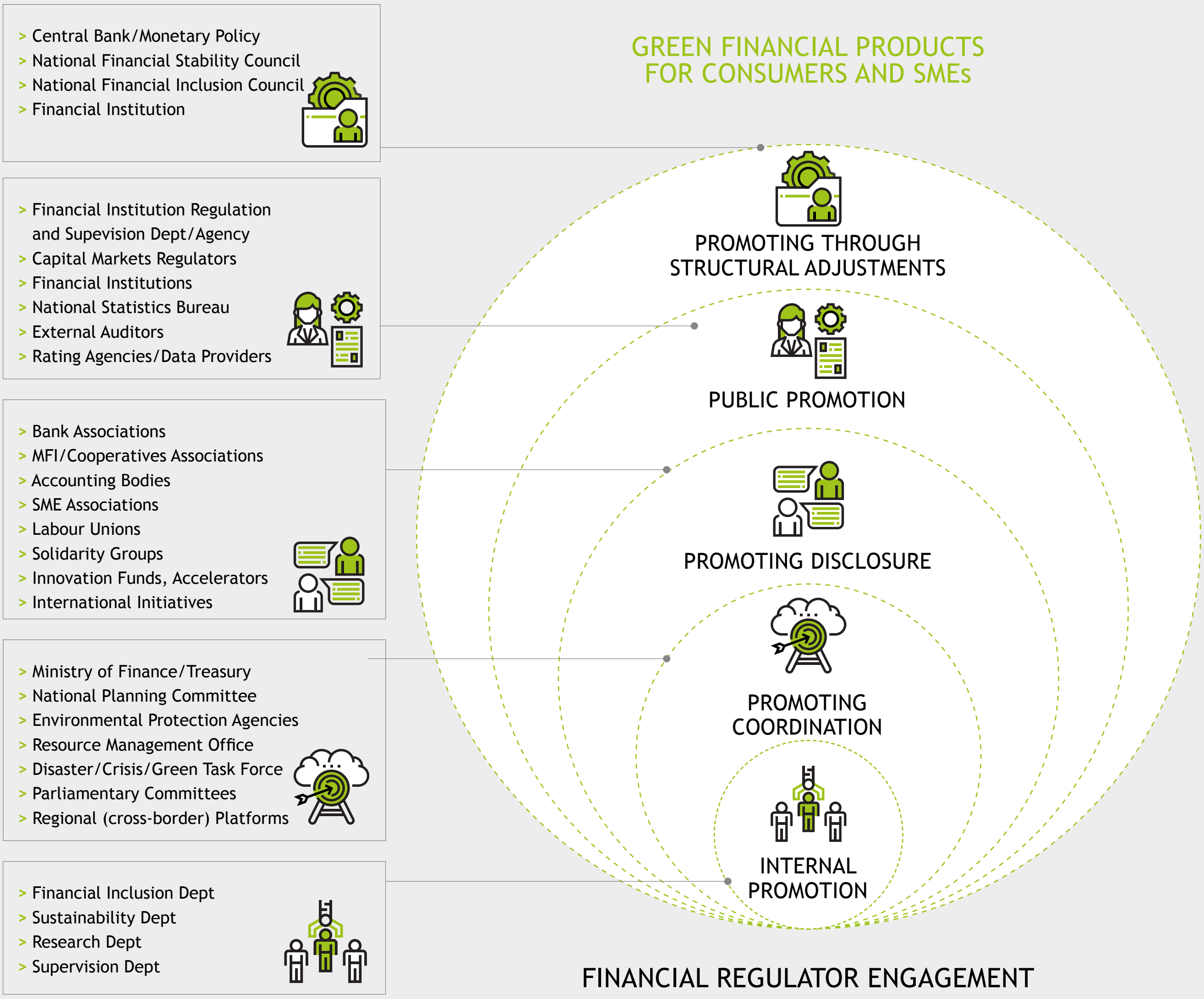
FIGURE 1. CONCEPTUAL FRAMEWORK: THE 4 PILLARS OF INCLUSIVE GREEN FINANCE



Source: Based on the AFI Conceptual Framework (4Ps)

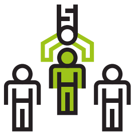
FIGURE 2. INCLUSIVE GREEN FINANCE COORDINATING MECHANISMS AND STAKEHOLDERS

Figure 2 is presented from the perspective of a financial regulator, and identifies potential stakeholders at different phases of the IGF promotion journey. IGF Working Group (IGFWG) members noted that this journey should be sequentially phased with enough time allowed for industry adoption and rounds of feedback and dialogue with different stakeholders, especially when policy is being formulated.



Source: AFI, based on interviews with IGFWG members on promotion policies

SECTION 1: INTERNAL PROMOTION



While national government bodies may not have defined a specific role for the financial sector in poverty alleviation or the response to climate change, financial sector regulators should be prepared for public pressure to introduce reforms.

The transition to integrating environmental and social factors in traditional risk governance frameworks is a significant challenge for regulatory design. The financial industry will be required to identify, assess and manage the financial risks of sustainability, particularly those related to the environment and climate change. Increasingly, macro risks from natural disasters and crises also need to be considered.

Rather than sitting back while legislatures debate, regulatory leaders should take a proactive, participatory role in urging decision-making and gaining clarity from policymakers to improve regulatory practice. To do this effectively, agencies should take an expert model approach to regulatory behavior rather than a purely legal one. The expert model will require stakeholders in both private and public spheres to strengthen their competencies in these new areas and work together to safeguard economic security with an inclusive green finance agenda.

THE CATALYST

Financial inclusion and climate change are intensely political. Increasingly, elected governments are having to respond to the environmental degradation, poor living conditions and inequality in wealth affecting the lives of their constituents. However, climate-related policies are also gaining acceptance in the financial sector and being adopted in greater numbers. This is due to the high costs imposed on countries most affected by climate change, and the financial instability it is causing due to the associated physical, transition and liability risks.

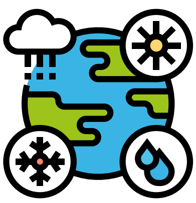
In many cases, IGF initiatives are led by central banks and financial regulators that have anticipated the risks of non-action. Since responsibility for financial and macroeconomic stability lies implicitly or explicitly with central banks, they are therefore compelled to address climate-related and other environmental risks at a systemic level.[6]

5 (World Bank, 2020)
6 (Dikau & Volz, 2018)

THREE COMMON DRIVERS ARE PROMPTING AFI MEMBERS TO PURSUE POLICY ACTION ON IGF:

1. NATURAL DISASTERS

Increasingly, severe weather linked to global warming and climate change is having an impact on national economies and imposing a high cost on vulnerable populations, particularly women, who are disproportionately affected. Devastating natural disasters linked to and exacerbated by climate change, such as cyclones, flooding, droughts, wildfires and famine, are moving the public to demand solutions from government.



2. BANKS

The global banking system is rapidly adopting sustainable banking practices in response to investor demand. International banks and investors that operate in AFI member jurisdictions are increasingly looking to adopt green standards to authorize access to international funding to deploy locally. Demand is rising for a level playing field that would obligate banks to implement comparable sustainable risk management practices.

3. INTERNATIONAL PRESSURE

Countries with the most globally important and at-risk environmental assets (e.g. the Amazon river basin, the Congo, the Nile) are facing international pressure from multilateral institutions like the UN to protect these assets. Financing of industries that degrade forests or water quality are being increasingly criticized, and international development loans and grants (e.g. IDA funding) are increasingly tied to environmental and social performance.[5]

THE CATALYST FOR IGF IN THE PHILIPPINES

For the Philippines, the catalyst for climate action and sustainable finance was Super Typhoon Yolanda in 2013, the most powerful tropical cyclone ever recorded, which caused catastrophic destruction across the country's major populated islands.

Bangko Sentral ng Pilipinas (BSP), along with local and national government agencies, were brought into the national spotlight to respond to over $12 billion in damages and the additional 2.3 million people suddenly living below the poverty line (World Bank, 2017).

The role of local financial institutions was critical, especially the smaller provincial banks that could support the disaster relief and recovery effort. The BSP began by formalizing business continuity plans internally and then formalized regulatory relief measures that could be offered to banks. After the crisis, climate change mitigation and resilience, alongside traditional poverty alleviation efforts, became priority areas for financial sector development.

While the National Economic Development Authority and the National Disaster Risk Reduction Management Council focused on the planning and monitoring of disaster rehabilitation and recovery, a Climate Change Commission coordinated, monitored and evaluated government programs and ensured climate change was mainstreamed in the national development plan. The BSP, Department of Finance (DOF) and Securities and Exchange Commission (SEC) pursued efforts to spearhead green and sustainable finance initiatives. Leadership came from a combination of the political executive branch and different agencies.

Some of these initiatives were formalized in the current administration's national development plan, and objectives were given primarily to reporting agencies. BSP, along with DOF and SEC, became part of the Green Force, a task force that is yet to be formalized, but that has already laid out an action plan for green and sustainable finance.

Super Typhoon Yolanda in the Philippines, was one of the strongest tropical cyclones ever recorded. (Photo by ymphotos/Shutterstock)

INTERDEPARTMENTAL INITIATIVES

In the context of climate change, central banks and regulatory agencies will need to reorganize to deliver important outcomes related to financial inclusion and financial stability. Identifying and assembling existing knowledge assets through cross-cutting or interdepartmental working groups or committees is a cost-effective way to promote institutional awareness of IGF topics and gain traction with new objectives.

GREENING FINANCIAL INCLUSION

Of the AFI IGFWG members surveyed,[7] most already had a dedicated Financial Inclusion Department tasked with supporting or supervising the implementation of a National Financial Inclusion Strategy (NFIS). Of those who had started to mainstream sustainable/green finance in their institutions, all indicated that this is being done within existing financial inclusion departments. Larger or more advanced institutions often have a separate, dedicated department for sustainable/green finance that works in parallel with financial inclusion.

INTERNAL CAPACITY BUILDING AND CENTERS OF EXCELLENCE

Regulators everywhere face the constant challenge of keeping up with innovation and best practices in the financial sector. Ensuring that staff have sufficient opportunities to learn about financial inclusion and sustainable finance has been recommended by AFI members as one of the most important activities when preparing for policy action.

Internal capacity building efforts can take many forms, from executive-level coaching to department training and peer learning activities. While these activities will likely be ad hoc at the beginning, as institutional knowledge builds up and IGF policy engagement becomes more intensive, a systematic learning system will likely be needed.

An efficient way to mainstream IGF internally is through a Center of Excellence (COE, also known as a “competency center” or “capability center”), which can bring people together from different disciplines and provide a formal and shared facility and resources.

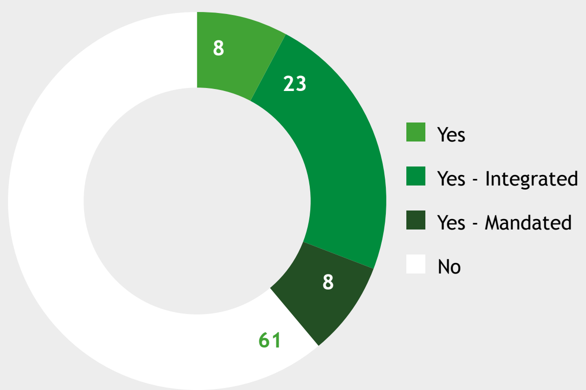
In more complex organizations, such as ones with multiple physical branches, teams often work in silos and do not have the opportunity to share their knowledge despite developing skills in parallel. A COE will identify these areas and coordinate internal resources to be shared among different groups.

Not only do COEs introduce more organizational efficiencies, but they also create more consistent experience for the private sector when they engage with different agencies on IGF-related topics.

It is also common for COEs to be independent entities shared with other government agencies or even with private-sector actors. For example, Papua New Guinea’s Centre for Excellence in Financial Inclusion is the apex organization for coordinating, advocating and monitoring all financial inclusion activities in the country. Members include the Central Bank of Papua New Guinea, the Department of National Planning and the Department of Treasury.

FIGURE 3: INTERNAL COORDINATION IN AFI MEMBER INSTITUTIONS, %

Does your institution have a Sustainable Finance or Green Finance Department / Unit?



Source: AFI, 2020 IGF Annual Survey. There are 27 institutions. Detailed information is in the Appendix.

7 See Appendix

AFI'S CAPACITY BUILDING INITIATIVES FOR INCLUSIVE GREEN FINANCE

AFI's mission statement asserts that capacity building empowers policymakers and helps drive initiatives and policies that accelerate financial inclusion for the underserved through knowledge sharing. Therefore, AFI provides ongoing, relevant support through member training, joint learning programs and in-country training.

The overall goal of member training is for participants to establish a common understanding of what IGF stands for and to gain a general understanding of a variety of IGF policies. The main topics include:

> Establish a common understanding of IGF, including the 4Ps framework developed by AFI;

> Learn from best practices in the AFI network in terms of how IGF components have been integrated in financial inclusion strategies and other national-level strategies;

> Identify key intersections between inclusive green finance and gender-inclusive finance or another vulnerable sectors.

Given that AFI is a knowledge-sharing and peer-learning platform, its member training and capacity building programs include the experiences of member institutions.

As part of their in-country implementation of national financial inclusion policy commitments, the AFI Management Unit's IGF Business Unit has been implementing capacity building on IGF for the staff of regulatory bodies. This program has been welcomed by members and additional institutions have expressed interest.

The in-country training program is fully endorsed by the co-host member. Country context is presented, as well as the existing green policies or climate change policies and processes in place. In addition to the general objectives of member training, this program includes:

> Identifying significant environmental and climate change challenges, as well as existing climate change policies and processes in place;

> Identifying key environmental and financial inclusion factors to be considered when designing IGF initiatives in the country; and

> Defining an action plan for advancing IGF policies.

A NOTE ABOUT INTERNAL RESOURCE ALLOCATION

Any new initiative undertaken by a regulator will face competition for attention and resources. Existing initiatives enjoy the security of fixed units, dedicated budgets and established operational processes. Some might be less important than they once were or even obsolete. If additional funding is not allocated for new IGF activities, an organization will likely have to consider reprioritizing existing work. Finding a balance between formal, established departments and unfixed, flexible methods is a necessary trade-off to ensure IGF activities have the commitment and focus they require.

GREENING INTERNAL OPERATIONS

Central banks and financial regulators can set an example in the industry by greening their own business practices. This involves encouraging employees and suppliers to adopt best practices for environmental protection that align with environmental NGOs and global environmental agencies. Some measures that could have significant influence include:[8]

> **Performing environmental risk assessments** of operations and launching programs to raise awareness and educate employees about environmentally friendly products and services.

> **Encouraging employees to green their daily operations**, such as using less paper and plastic, and encouraging the use of eco-friendly and recycled paper and materials.

> **Reducing reliance on traditional paper and energy-intensive publications** and stakeholder communication channels (e.g. using online and virtual solutions rather than leaflets, letters and paper reports).

> **Formulating environmentally friendly guidelines for employee training** to prevent environmental harm and adapt to greener practices. This enables employees to serve as ambassadors for environmental sustainability at both the individual and departmental level.

> **Constructing green buildings** with efficient water and waste treatment systems and solar powered equipment.

> **Using energy-efficient electricity,** including lights, tiles, refrigerators, air conditioning and heating systems.

> **Employing paperless internal communication,** training and approval processes that may currently depend heavily on paper-based methods.

> Utilizing efficient architecture in office buildings to save heat, light and power.

8 (Barua, 2020)

WALKING THE TALK: BANGKO SENTRAL NG PILIPINAS IMPLEMENTS SUSTAINABLE CENTRAL BANKING

The central bank of the Philippines, Bangko Sentral ng Pilipinas (BSP), has committed to pursue sustainable central banking as part of its strategic direction.

The BSP will endeavor to foster environmentally responsible and sustainable policies and work practices. Considering the multifaceted nature and considerable challenges of embedding sustainability principles within BSP, the following phased approach will be adopted:

a. **First,** the BSP will endeavor to raise awareness and increase understanding of sustainability concepts in relation to the BSP mandate beginning with top- and mid-level management.

b. **Second,** the BSP will conduct two layers of assessment of the impact of climate change on BSP offices and operations. The first is a vulnerability assessment of the potential impacts of climate change and other environmental risks in BSP branches and offices. This will be followed by a self-assessment exercise to determine the effect of climate change and other environment-related factors to BSP operations and vice versa. The exercise intends to identify areas in which climate change and other environment-related factors could create risks for BSP functions and/or operations. Likewise, the exercise will take stock of mitigating measures currently in place and propose additional or new measures in areas where the BSP needs to further strengthen resilience to climate- and other environment-related risks. It will also identify specific goals and priority plans for the transition of BSP units.

c. **Third,** building on the results of the above-mentioned activities and studies, the BSP will develop a Roadmap for Sustainable Central Banking. The Roadmap will provide the key steps or milestones, plans and strategies to adopt sustainability principles in the regulatory and supervisory framework, and integrate ESG criteria in the BSP's culture, core values and governance, enterprise-wide risk management system, consumer protection and financial education advocacies, investment management decisions and other operational activities and functions.

World heritage Ifugao rice terraces in Batad, Northern Luzon, Philippines. (Photo by R.M. Nunes/Shutterstock)

SECTION 2: PROMOTING COORDINATION

Once the catalyst for climate change action is triggered, the initial response from government is often ad hoc, politically motivated and/or disjointed. Financial sector regulators will also be bound by their mandates, which will be perceived as limited in scope. For example, measuring climate risk at the outset will be nearly impossible since those data points will not likely exist. However, waiting on the sidelines for other government agencies to act could expose financial regulators to the risk of not delivering their mandates.[9]

ALIGNMENT WITH THE NATIONAL VISION

Getting strategic alignment right at the national level was often quoted by AFI members as the first and most important step in the smooth implementation of IGF initiatives. For example, national development plans will often target agrarian reform, SME development, and technology innovation, all of which can be linked to financial inclusion and environmental sustainability. However, without the correct alignment of public sector actors and links to other national initiatives, the implementation of IGF initiatives may suffer from a lack of resources, competing agendas and public criticism.

For countries that have adopted the UN Sustainable Development Goals (SDGs), there is an opportunity to link IGF to poverty alleviation (SDG 1), gender equality (SDG 5), clean tech (SDG 7) and climate action (SDG 13).

Jurisdictions that have committed to nationally determined contributions (NDCs) to reduce carbon dioxide emissions under the Paris Agreement, and/or have national biodiversity strategies and action plans under the international Convention on Biological Diversity (CBD), should carefully consider how these declarations can be integrated or aligned with sustainable finance initiatives.

The difficulty of achieving alignment should not be underestimated. AFI members indicated that this phase requires intensive coordination and leadership by agencies to identify appropriate actions to respond to national objectives. Being proactive in this phase is critical as government will require financial regulators to lead in their area of expertise — financial services — but also to “think outside the box” in addressing untraditional risks and challenges posed by climate change.

9 (Bolton, et al., 2020)

Fisherman life and activities on boat in the morning at Bangpra reservoir, Chonburi, Thailand. (Photo by Jamikorn Sooktaramorn/Shutterstock)

INTERAGENCY COOPERATION

National strategies for poverty alleviation and environmental sustainability are typically formulated by executive planning commissions that assign implementation tasks to relevant government agencies. For financial regulators, this might require cooperating for the first time with other government agencies, such as environmental protection, agriculture and energy ministries/agencies. Seeking formal cooperation through Memoranda of Understanding (MoU) can be helpful if national tasks need joint efforts, and public signing ceremonies will send a signal to industry that intragovernmental alliances are being formed. More formally, interagency working groups or task forces may be set up to drive cooperation initiatives forward.

COORDINATING MECHANISMS: EXAMPLES FROM THAILAND AND PARAGUAY

One example of a government coordinating mechanism from AFI's network comes from **Thailand.** The Thai financial sector's Working Group on Sustainable Finance includes the Ministry of Finance, the central bank, the insurance regulator, the stock exchange and the Securities and Exchange Commission. This working group sets the highest priorities for the financial sector and is currently developing a sustainable finance roadmap for the country. Through constant exchange, working group members are collaborating on the design of green incentive schemes for the financial sector, green labeling/definitions, the development of disclosure standards and harmonizing policy. At the national level, the Bank of Thailand is a member of the Committee for Sustainable Development, which reports to the deputy prime minister on progress achieving the SDGs.

Paraguay has a multi-institutional coordination mechanism for advancing national financial initiatives. It works through seven specialized working groups: Credit, Savings, Insurance, Payments, Financial Education, Consumer Protection and Vulnerable People. The groups are currently working to incorporate green elements in the National Financial Inclusion Strategy, an initiative led by the Ministry of Finance.

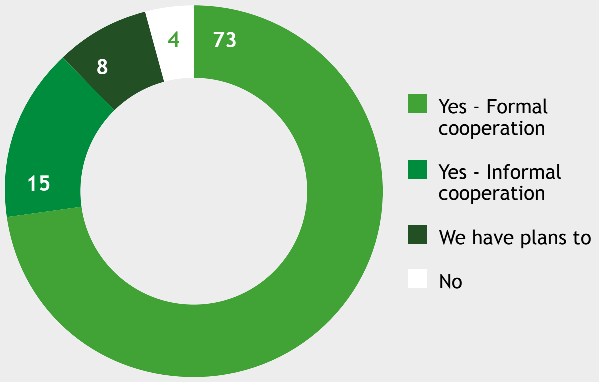
FINANCIAL SECTOR STRATEGIES

"Financial sector strategies enable financial policymakers and stakeholders to take a holistic view of the financial development needs in their country and formulate balanced financial policies. They help policymakers consider the systemic risk involved with different development policies and make informed choices about the way forward." There is an emerging trend in the AFI network to link financial inclusion and climate change on the national strategic level, either in National Financial Inclusion Strategies (NFIS) or other financial sector strategies.[10]

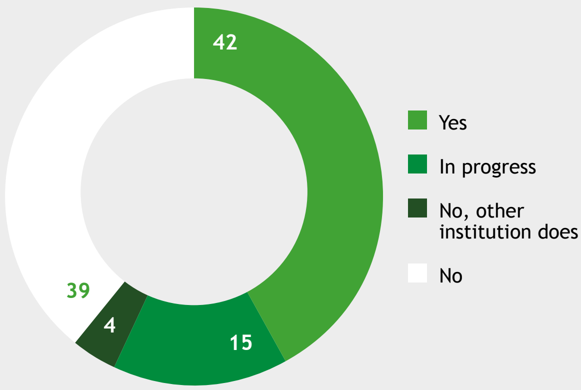
10 (AFI, 2020)

FIGURE 4: COORDINATION MECHANISMS ACROSS AFI MEMBERS, %

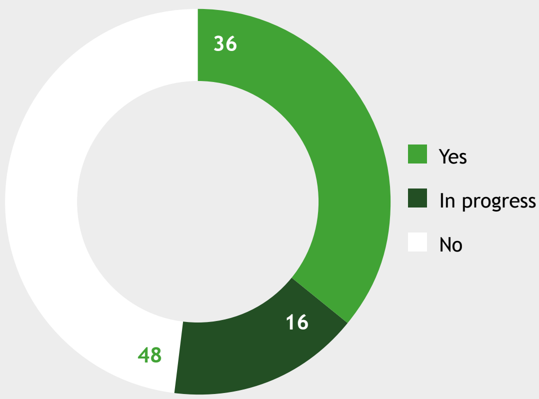
Does your institution cooperate with other ministries or agencies on issues relating to Financial Inclusion, Climate Change and/or Sustainable Finance?



Does your institution lead in any inter-agency cooperation on the issue of financial inclusion and climate change mitigation and adaptation?



Is there a working group or task force that is mandated to address climate change and financial inclusion issues in your country?



Source: AFI, 2020 IGF Annual Survey

To advance green finance objectives and include more stakeholders, some AFI members are explicitly including green initiatives in their NFIS.[11] Some notable examples:

> **Sri Lanka's NFIS** mentions green finance under SMEs. The strategy was developed by the Sri Lankan Ministry of Finance with the support of the World Bank, and will be launched in 2020.

> **In July 2020, the Executive Committee Meeting of Bhutan** approved the first Green Finance Roadmap in Bhutan, led by the Royal Monetary Authority. Green finance has also been identified as one of the thrust areas for the 21st Century Financial Sector Roadmap for inclusion in the Government of Bhutan's 21st Century Economic Road Map. The development of the Green Finance Roadmap will provide an opportunity to develop a long-term strategy for the promotion of green finance, to mobilize finance to achieve Bhutan's sustainable development goals, and to align policies among the public and private sectors, international organizations and other multilateral agencies.

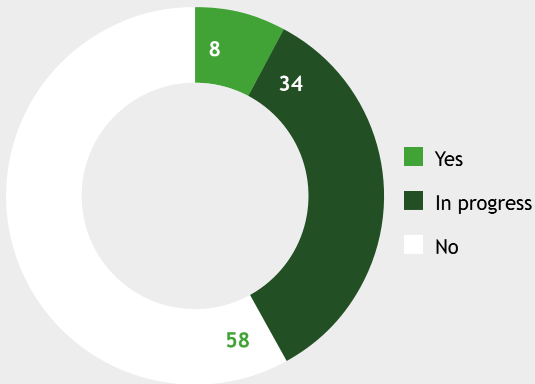
> **Bangladesh Bank's NFIS** will be released soon, which has green finance as one of its key pillars. It includes specific targets for the inclusion of women and populations affected by climate change.

> **The Central Bank of Egypt** is preparing an NFIS and is considering making sustainability, which includes climate change, a pillar of the strategy's framework. It also includes targets for financial inclusion for women.

> **Fiji's National Financial Inclusion Strategic Plan**, 2016–2020 highlights the importance of financial inclusion policies in mitigating and building resilience to climate change. The Plan calls for the Reserve Bank of Fiji to "provide support for the development of green financial services and products for individuals, households and MSMEs that reduce negative environmental impacts or provide environmental benefits."

FIGURE 5: NFIS THAT INCLUDE IGF ISSUES, %

Does your country National Financial Inclusion Strategy address issues relating to climate change and/or green finance?



Source: AFI, 2020 IGF Annual Survey

11 The Financial Inclusion Peer Learning Group, in coordination to IGFWG is developing a Guideline Note on "Integrating IGF policies into NFIS".

Mandarin oranges, Bhutan's biggest food export, are being threatened by climate change. Bhutan. (Photo by D. Talukdar/iStock)

SECTION 3: PUBLIC PROMOTION

It will likely be necessary to help both the public and financial service providers (FSPs) make the connection between financial inclusion and mitigating and building resilience to climate change.[12] IGF policies suffer from “long-termism”, which means that the financial industry, which is mainly concerned with financial risks and returns, must accept potentially lower financial returns in the short term to realize greater social and environmental outcomes in the longer term.[13] It will therefore likely fall to government actors, especially central banks, to publicly address this market failure while also assuming the difficult task of designing gender-sensitive policy solutions that balance economic stability with environmental and social concerns.

Financial regulators have a choice: take the lead on IGF issues or leave it to financial institutions to upgrade banking practices on their own.

If financial regulators decide to take the lead, two approaches are possible: regulatory or voluntary.[14] In either case, they will need to deliberately engage with other stakeholders. They should present draft analyses and proposals outside the institution, educate stakeholders on the pros and cons of adopting new policies and identify potential allies and contributors. However, care should be taken that engagement does not compromise the regulator’s ability to take adverse action against financial institutions in the future, for example, by granting stakeholders veto power or creating a stalemate by allowing anti-regulatory sentiment.[15]

Taking a proactive public stance, especially giving voice to disadvantaged groups or interests that might otherwise be excluded, will build the institutional credibility needed to undertake IGF reforms.

AFI members already implementing IGF reforms noted that identifying and taking advantage of opportunities for partnerships is almost always a preferable and more fruitful approach to building industry consensus. However, more advanced jurisdictions have noted that a paradigm shift requires a more regulatory-led approach.

MORAL SUASION

Central banks routinely use moral suasion, such as public statements, interviews or meeting minutes, to shape public expectations. Although typically used to manage expectations on inflation, moral suasion can also be a way for central banks to promote gender-sensitive IGF policies in the best interests of the country. It employs the strategic use of advocacy (rather than legal intervention) to encourage financial institutions to act. For example, to promote the financial inclusion of disadvantaged populations (e.g. people in remote areas, women or forcibly displaced persons) or to signal the importance of environmental sustainability of business activities they finance (e.g. water conservation for agriculture in dry climates).

In the IGF survey, some AFI members indicated that many international banks in their jurisdiction already advocate for IGF topics, such as sustainable finance, and although this is a rapidly growing trend internationally, local financial institutions tend to lack the mindset for change. Use of moral suasion can help prepare the leadership of local financial institutions before policy is formalized and regulatory changes take effect.

PUBLICATIONS AND INDUSTRY GUIDANCE

Gender-sensitive IGF policy reforms should be formulated through transparent decision-making processes and supported with publicly available documentation. In addition to participation in industry working groups or platforms, financial regulators should commit to publishing their findings or research on IGF.

When regulations and financial supervisory techniques are updated to include IGF, prior industry consultation and published industry guidance are vital for smooth implementation. A request for information or industry consultation is an excellent way to gather industry views on IGF policy challenges.

12 (AFI, 2020)
13 (Bolton, et al., 2020)
14 Rather than intervening directly, the state lays out market rules and incentive structures that guide business operations in a desirable direction.
15 (Sparrow, 2000)

A formal public comment process can also capture industry concerns on proposed regulations. When new regulations or rules are developed, accompanying guidelines should always be published as they enable regulator expectations to be better understood and provide financial institutions with a clear path to follow.

The specifics of IGF-related provision policies (policies that ensure financial resources for green projects or related climate action are provided for qualified beneficiaries) and IGF prevention policies (policies that aim to avoid undesirable outcomes by lowering financial, social and environmental risks) will be elaborated in future publications in the AFI 4P policy series.

AWARENESS RAISING AND CAPACITY BUILDING

Regular communication with regulated institutions and the public should be conducted through carefully planned awareness-raising campaigns. These campaigns will likely involve more than one government actor, and must be gender sensitive and fully inclusive.

On the supply side, awareness raising and capacity building initiatives for financial institutions can take many forms and target different levels of the organization (i.e. executive outreach, branch training, investor triple bottom line returns).

YOUTH: KEY TO DRIVING THE INCLUSIVE GREEN GROWTH AGENDA

In a special report[1] promoting inclusive green investments in Kenya, the International Finance Corporation (IFC) and UNEP Inquiry highlighted the potential of youth to drive the inclusive green growth agenda. In a country where 75 percent of the population (44 million) are under 30, poverty and unemployment have become a huge challenge, especially for youth.

The sectors likely to be most affected by climate change (water and forestry, agriculture, livestock and fisheries, trade, extractive industries, energy, physical infrastructure, tourism and health) also offer opportunities for investment that could play a significant role in innovative adaptation and mitigation initiatives that boost employment, crucially among youth.

1 Aligning Kenya's Financial System with Inclusive Green Investment

> View here

Somali refugee working as a herdsman. Kenya. (Photo by Djohan Shahrin/Shutterstock)

Public awareness raising and capacity building can happen at the micro level (e.g. community outreach, small business associations and cooperatives), the meso level (e.g. training academies and universities) or the macro level (e.g. parliamentary or ministerial). It will be important to inform and educate consumers about the societal need for green finance as this will stimulate the demand side, particularly women who are disproportionately excluded from the financial system.

In some cases, AFI members report that although green financial products have been developed, there has been little public uptake. To avoid this, the public must be aware of climate change issues and understand climate change resilience building or mitigation features of green finance. Working with women and women's groups can not only enable greater financial inclusion overall, but also help to spread knowledge and awareness of IGF at the community level.

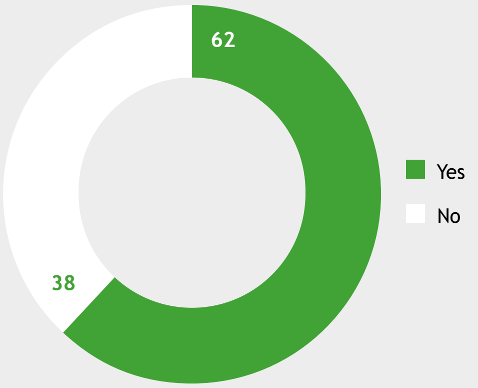
Although IGF is aimed primarily at retail and MSME customers, climate change risk is a universal issue in the financial sector. Capacity building for the financial services industry may cover overlapping topics, from investment and insurance to banking and non-bank financial services. Understanding the problems of climate change in a jurisdiction (especially for the most disadvantaged groups, including women) is the first step. Then, informed IGF solutions can begin to be designed locally for respective stakeholders.

Many AFI members noted that the industry associations and think tanks in their jurisdictions have already started to discuss financial inclusion and green finance topics with their members (often prompted by a natural disaster or poverty crisis in the economy). However, women's voices were often absent from these discussions. Supporting meso-level institutions to be fully gender sensitive, via sponsorship or participation, is a relatively easy but important way to engage in public promotion and signal the importance of IGF policy reform.

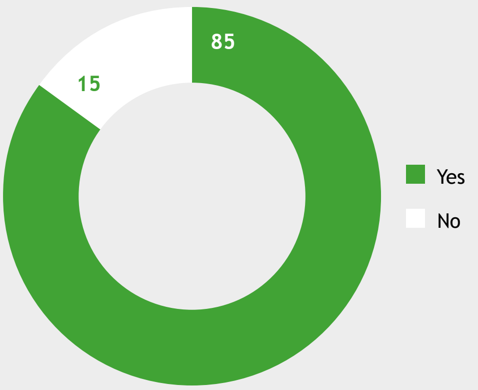
Peer learning activities are also a way for institutions to learn from other countries' experiences with financial inclusion and climate change policies, particularly where IGF intersects with other policy areas, such as gender-inclusive finance. Regional conferences, international working groups and multilateral initiatives are increasingly supporting the public and private sectors in developing countries on IGF-related policies.

FIGURE 6: PUBLIC PROMOTION ACROSS AFI MEMBERS, %

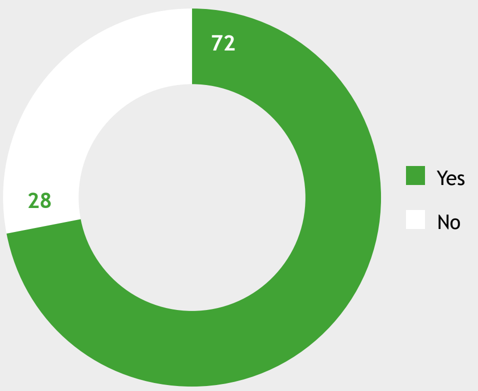
Does your institution have any joint activities with the Bankers' Associations or other entities that included the topics of financial inclusion or climate change?



Does your institution host or participate in any banking sector conferences that include the topics of financial inclusion or climate change?



Does your institution sponsor any capacity building initiatives (workshops or training programs) that include the topics of financial inclusion or climate change?



Source: AFI, 2020 IGF Annual Survey

COSTA RICA'S PROMOTION JOURNEY

Costa Rica embarked on the promotion of IGF in 2017 following two pivotal events that year: the publication of the "Recommendations of the Task Force on Climate-related Financial Disclosures" in June, and a financial inclusion and deepening report as part of a Financial Sector Stability Review (FSSR) by the IMF in November. From this moment on, climate-related risks became of growing interest to the General Superintendence of Financial Institutions (SUGEF). It joined the United Nations Environment Programme Finance Initiative (UNEP-FI) as a supporting institution and started drafting a "Regulation for the management of environmental and social risks, and climate-related risks in the loan portfolio".

At that time, different actors and interest groups in the financial system were endorsing elements of financial inclusion and green finance. As a result, IGF initiatives were isolated and there was a lack of coordination. Costa Rica has attracted green investment internationally due to its commitment to environmental protection (through its Nationally Determined Contributions, National Decarbonization Plan 2018-2050 and National Adaptation Policy). Banks facilitating these investments have been held to higher standards, but their activities were perceived as promoting an uneven playing field compared with banks that did not apply these higher standards.

While the National Stock Exchange promoted the "Declaration on green economy principles" and was interested in promoting green bonds, Costa Rica´s Central Bank was conducting climate research and began analyzing climate risks from a macro perspective. The Ministry of Environment and Energy (MINAE) was working hard to fulfill the country's commitments to the Paris Agreement, the General Superintendence of Insurance (SUGESE) was working on the implementation of parametric insurance and SUGEF was interested in the effects of credit risk. All these issues had to be analyzed together and coordinated.

In response, with assistance from the German Agency for International Cooperation (GIZ), MINAE, SUGEF and SUGESE hosted a series of eight roundtable workshops with financial institutions on climate change and green finance with the participation of many other government agencies.

The workshops were well received by participants who engaged with and learned from one other for the first time. For example, it emerged that several agencies were producing and sharing data that could help inform climate risk, in addition to enabling the identification of potential services and products focused on IGF.

At the end of this process, the Chamber of Banks and Financial Institutions issued a protocol on green finance principles and committed to promoting green products in the country.

The roundtable meetings raised awareness, not just about business investment (i.e. the concern of bankers), but also the management of climate and environmental risks (i.e. the concern of supervisors). Afterwards, the Chamber of Banks and Financial Institutions launched green banking education initiatives on their own, while some banks lobbied for SUGEF to start applying green banking standards. The National Counsel for Supervision of the Financial System took up these issues. The Central Bank became a member of the Network for Greening the Financial System and SUGEF joined the Sustainable Banking Network (SBN).

SUGEF ENVISIONS THAT THE FOLLOWING SEQUENTIAL REFORMS WILL SUPPORT THE IMPLEMENTATION OF GREEN BANKING

1	**INDUSTRY DIALOGUE**	Regulatory and Ondustry Roundtables				
2	**ISSUANCE OR REGULATION** To integrate climate risks into formal risk management framework, strategic planning and governance of financial institutions.	Draft Proposal	Consultation and Feedback from the Financial Sector	Issuance of Final Regulation	Transition Period For full adoption of regulation.	
3	**COLLECTION OF DATA** On flows from the financial system to green activities.	Formualtion of Data Definitionas	Internal System Adjustments	Issurance of Guidelines for data Classification	Transition period For financial institutions adjustment of system.	Mandated Reporting and Enforcement
4	**STRESS TESTING** Taking into account climate variables.	Internal Capacity Building and External Data Source Identification				

Coffee production played a key role in Costa Rica's history and continues to be important to the country's economy. (Photo by Edwin Remsberg/Getty Images)

SECTION 4: PROMOTING TRANSPARENCY

Implementing IGF policies will require financial regulators and financial institutions to expand their views and look beyond their current work areas to identify important issues. This will require investing in mechanisms that help them search for and share new information. Regulators may need to adapt existing systems and techniques for intelligence gathering and surveillance. Financial institutions may have to augment lending procedures to manage newly defined risks for borrower default (i.e. climate-related risks such as flooding, fire and drought) and provide additional transparency.

EVIDENCE-BASED POLICYMAKING

To develop a broader view and adhere to gender-sensitive, evidence-based policymaking, financial regulators will need to establish information networks with related agencies and conduct both quantitative (internal and external data sources) and qualitative (focus groups, surveys, questionnaires and canvassing external stakeholders) analysis. This analysis should provide a baseline for measuring policy action supported by subsequent data collection. It is also important to consider random audits or inspection components to uncover the true nature of information issues.

PRIVATE SECTOR DISCLOSURE

Supply-side data from FSPs, such as commercial banks, microfinance institutions (MFIs), credit unions and other financial institutions will need to be expanded to accommodate sex disaggregation and new IGF-related policy goals. Eventually, new reporting requirements will need to be codified via regulatory rules.

Gender-sensitive financial inclusion indicators can be collected through data from administrative records that regulated financial institutions report on a regular basis. However, climate risk and environmental data will require FSPs to acquire new knowledge about climate change and environmental impacts on the real sector.

The effectiveness of a company's governance framework and the financial institutions that lend to them is vital to ensuring high-quality data is reported.

When institutional governance is weak, data quality will be poor, not disaggregated, unverifiable and unreliable. For example, ESG standards (which consider the impact of a company on the environment and society) are in their infancy and many jurisdictions do not have agreement on what they should be or how to report and enforce them.

The financial industry would be well served by a multi-stakeholder platform (either public or private sector-led) that helps stakeholders reach a common understanding of green definitions. This could eventually lead to the development of a national green taxonomy and prompt financial institutions to self-report data on environment-related risks. Due to the nature of company-level environmental impact data, cooperation with non-financial regulators (e.g. environmental agencies) will likely be necessary to design a gender-sensitive national standard and reporting frameworks for green finance initiatives.

MONITORING STANDARDS AND METHODS

For financial regulators in the AFI network, there are two main perspectives on IGF reporting. One is the monitoring of credit risks in the context of environmental and social risk, and the other is monitoring the provision and uptake of inclusive and green financial services in the economy.

The institutionalization of Environmental and Social Risk Management (ESRM) practices by lenders falls under the Prevention "P" of the IGF 4P Framework. However, it should be noted that the reporting of ESRM by lenders will need to be promoted via guidelines and updated reporting standards.

For financial institutions to effectively evaluate the environmental and social risks of their clients, and accurately report lending portfolio allocation by green or socially responsible categories, business and economic activity in the real sector will need to be assessed accordingly. Integration of ESG criteria is the main globally recognized approach.

IGF DATA

The AFI Core Set of Financial Inclusion Indicators (the "AFI Core Set") was developed to provide regulators and policymakers from across the AFI network with a shared starting point from which to collect data and reveal the state of financial inclusion in a country.

These quantitative indicators are being used to measure and monitor financial inclusion in support of respective national policies. The original Core Set measured two key aspects of financial inclusion — access and usage of financial services — and has since expanded to include the quality dimension of financial inclusion in response to AFI member institution needs.

Several AFI members have already undertaken efforts to collect and publish green financial metrics, and their experiences are being shared with the working group. While the collection and sharing of green finance activities is still largely undeveloped, two member examples stand out:

> **Bangladesh Bank** has made a steady effort to collect and share data on green finance, culminating in the publication of the Sustainable Finance Department's quarterly report, "Green Banking Activities of Banks & Financial Institutions and Green Refinance Activities". The Bank also includes a chapter on sustainable banking in its annual report that highlights the progress of green banking activities, which has been emulated by the rest of the country's banks and financial institutions. At the beginning of 2018, Bangladesh Bank significantly revised its reporting format, which now includes reporting of sex-disaggregated data on green finance.

> **Bangko Sentral ng Philipinas (BSP)** is gathering data and conducting research on the impact of extreme natural disasters on banking operations at municipal and branch levels. The BSP has been collecting branch-level information on types of deposits, loans, loan loss provisions and net income since 2008. This data will be matched (or cross-referenced) with data from weather stations across provinces. Provided by the Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA), this data will determine the quantitative impact of extreme natural disasters on banking performance. The BSP also intends to improve reporting requirements to facilitate more specific data collection for monitoring and assessing climate and environment-related risks.

Only a few financial regulators are collecting and sharing information on inclusive green finance for specific purposes. Data collection on green finance activities is, in general, still lacking. Therefore, the Inclusive Green Finance Working Group (IGFWG) and Financial Inclusion Data Working Group (FIDWG) are developing a guideline note on collecting inclusive green finance data from the demand side as a first step. The second phase of the project is to develop guidance on collecting data from the supply side to augment the Core Set with "greening" measures.

A boat carrying Bengalese women moving on black Buriganga River, Dhaka, Bangladesh. (Photo by Tarzan9280/iStock)

Numerous institutions, such as the Sustainable Accounting Standards Board (SASB), the Global Reporting Initiative (GRI), the Task Force on Climate-related Financial Disclosures (TCFD) and the Carbon Disclosure Project (CDP), are working to develop business disclosure standards and define materiality to support aspects of an ESG-integrated valuation and investment approach.

To measure the impacts of climate change, broad international consensus is needed to first identify the physical, liability and transition risks associated with climate change, and then develop climate-related financial disclosures that are consistent, comparable, reliable, clear, efficient and provide useful information for lenders, insurers and investors to make decisions.

Although ESG disclosures are primarily used for corporate financing activities at the MSME level (i.e. equity and bond valuations or project finance), a simplified version can be used for traditional bank lending. For example, the GRI Sustainability Reporting Standards[16] are principle-based, which allows businesses to apply them in a manner commensurate with local business accounting and reporting practices. ESG disclosure guidelines for public companies are typically issued by the respective securities and exchange commission, but there should be ESG disclosure alignment for private companies, too. For instance, some countries in the ASEAN region, such as Malaysia and the Philippines, have sustainability reporting guidelines issued by their SECs which also usually cover Private Limited Companies.

Governments can support ESG integration by developing a nationally agreed-upon sustainable classification system (or taxonomy) for economic activity in their jurisdiction. In the absence of formally agreed-upon classification standards, market actors tend to introduce their own definitions, which makes it more difficult to compare reported data. “The comparability and reliability of ESG data will only improve if clear and sufficiently granular taxonomies for ‘green’, ‘brown’ and ‘social’ activities are developed and consistently implemented by the financial sector”.[17]

GREEN TAXONOMIES

A green taxonomy is a classification system for identifying activities or investments that meet key climate or green objectives for identified thresholds and/or national targets.[18] Developing a green taxonomy addresses the need for clarity and transparency, both in what is meant by “green” and what qualifies as green in a jurisdiction. Expanded “sustainable taxonomies” can also include social equity and gender implications of economic activity.

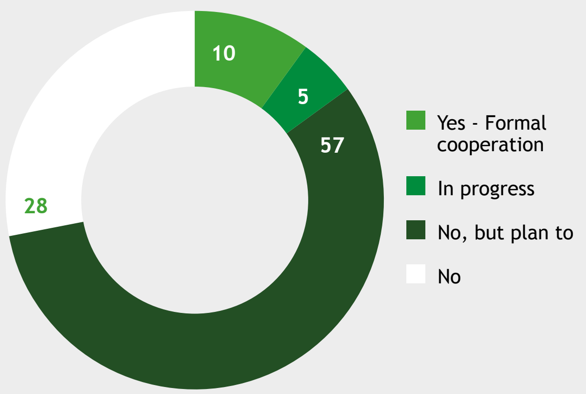
Because a green taxonomy can be instrumental in redirecting investment capital to achieve national economic sustainability goals, efforts to understand and standardize green finance are converging on financing activities that can address climate change and other environmental challenges, such as natural resource conservation, biodiversity conservation, and pollution prevention and control.[19]

The users and uses of a green taxonomy will vary. For example, financial institutions can use a taxonomy to originate green credit products more easily and consistently, and to disclose exposure to green investments as required by regulators. Bond issuers can identify eligible activities or projects more easily and use thematic labeling for bonds. Investors can identify opportunities that comply with sustainability criteria for impact investments, while financial regulators can base regulatory interventions and disclosure guidelines on the taxonomy.

A green taxonomy also enables policymakers to measure financial flows toward national sustainable development priorities.

FIGURE 7: GREEN TAXONOMIES OF AFI MEMBERS, %

Does your country have a green taxonomy?



Source: AFI, 2020 IGF Annual Survey

16 (Global Reporting Initiative, 2020)
17 (World Bank, 2020)
18 (ICMA, 2020)
19 (World Bank, 2020)
20 (World Bank, 2020)

MONGOLIA'S GREEN TAXONOMY

The Green Taxonomy of Mongolia[1] is an example of a national taxonomy that addresses a wide range of green activities, either financed through capital markets or commercial banks.

The taxonomy was approved in 2019 by the Financial Stability Council, established in 2007 by the Bank of Mongolia, the Ministry of Finance and the Financial Regulatory Commission as part of the National Program for the Development of the Financial Market of Mongolia for the 2017–2025 period. The Green Taxonomy includes eight categories of eligible projects:

1) renewable energy;
2) energy efficiency;
3) pollution prevention and control;
4) sustainable agriculture (land use, forestry, biodiversity conservation and ecotourism);
5) low-pollution energy;
6) green buildings;
7) sustainable water and waste use; and 8) clean transport.

It addresses almost all potential green activities with 28 sub-categories of specific projects and technologies.

Source: https://www.ifc.org/wps/wcm/connect/fa534a1e-34a5-49ed-ac09-8fa8e143535f/EN+Framework.+Green+Taxonomy+Mongolia.pdf?MOD=AJPERES&CVID=m.UgfA4

IMPROVING DATA COLLECTION AND DATA SHARING IN COSTA RICA

One of the main outcomes of Costa Rica's climate dialogue roundtables with the financial system was a pledge by several government agencies to share climate information with financial institutions. There was a mutually agreed recommendation to set up a repository for the use and analysis of climate-related data.

Collecting traditional banking data is one of SUGEF's central roles. As the supervisor of all financial intermediaries in the country, SUGEF is responsible for collecting a myriad of credit portfolio data from every financial institution on a daily, weekly, monthly and annual basis. SUGEF receives millions of data points from its supervised institutions every month, and verifying the accuracy of the data is challenging. It employs a risk-based approach that includes random sampling and profiling of higher risk or systemically important institutions. The data is made available to all other market participants on SUGEF´s website.

To address the information gap in green banking, SUGEF began to institute changes in how it collected data from financial institutions.

The goal of its new reporting system is to specify whether credits are aimed at green activities.

Credit portfolio data is complex, and to determine whether green credits were being granted, a classification system or "green taxonomy" had to be developed. With the assistance of the Group of Climate Financing of Latin America and the Caribbean (GFLAC), an international consulting firm, SUGEF created this taxonomy and integrated the reporting requirements in its existing XML reporting templates. The new requirements were disseminated to financial institutions through a series of training workshops and accompanied by formal guidelines.

Once SUGEF´s internal systems are adjusted, financial institutions will be given a six-month grace period to update their own internal systems to generate the requested data and trial the new reporting. Once SUGEF begins receiving the new data, it will publish a set of reports that will provide the basis for inter-agency information sharing. An appropriate time series will be developed over time.

Yurt with solar panel surrounded by farm animals in a landscape of Western Mongolia. (Photo by Katiekk2/iStock)

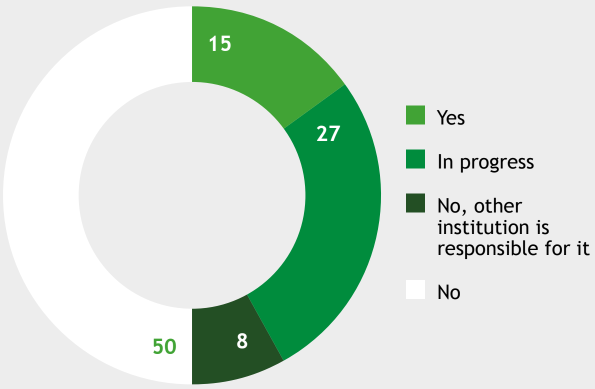
The process of formulating a green taxonomy should be undertaken jointly by financial sector regulatory authorities in close coordination with the national authorities responsible for defining the country's sustainable development agenda and priorities, as well as with the national authorities responsible for supporting and promoting environmental protection and climate action. Setting up a multi-stakeholder steering committee is also helpful in designing and developing the taxonomy.

> Climate, environmental and energy scientists, as well as technical experts in the sector, need to be involved from an early stage.

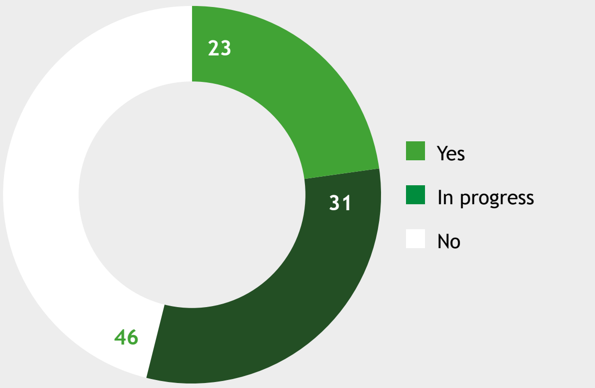
Consultation with stakeholders in all sectors, including industrial corporations, cooperatives, small and medium enterprises (SMEs), FSPs and others, is highly recommended. Direct stakeholder input and participation is critical to the creation of a robust green taxonomy.[20] IGF benefits from a comprehensive national green taxonomy that takes into account contributions from MSMEs or micro-level activities related to climate and environmental change adaptation and mitigation efforts.

FIGURE 8: GREEN DISCLOSURE AMONG AFI MEMBERS, %

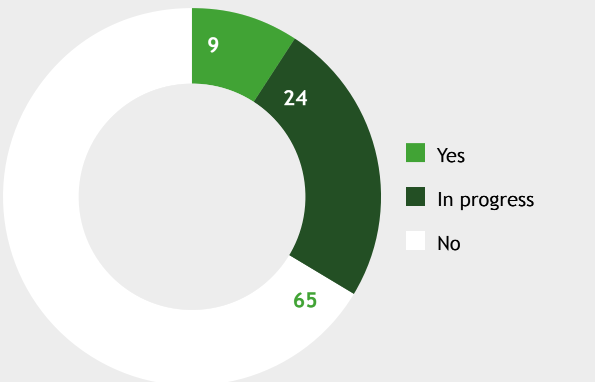
Does your institution collect and/or disseminate data/statistics relating to climate change or green finance?



Does the financial sector follow any Environmental Social Governance (ESG) Standards?



Does your institution identify Climate Risks in its Supervision process?



Source: AFI, 2020 IGF Annual Survey

20 (World Bank, 2020)

SECTION 5: PROMOTION THROUGH MONETARY POLICY

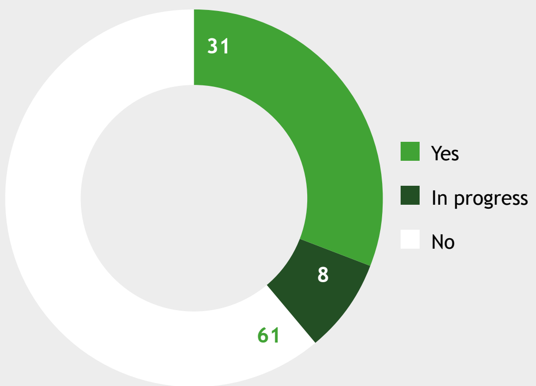
LINKING MONETARY POLICY TO THE 4P FRAMEWORK

Central banks can augment traditional monetary policy instruments to promote access to finance for disadvantaged groups, including women, youth and forcibly displaced persons, and to promote the financing of environmental and climate disaster response initiatives. The use of monetary policy instruments to support IGF objectives overlaps with Promotion and Provision policies.

Monetary policy promotion aims to change financing behavior by altering the money supply without using direct capital injection or mandating quotas. Examples of promotion include changing the criteria for setting central bank interest rates, adjusting reserve and capital requirements and changing the collateral framework for open market operations. The capacity of central banks to learn about the impacts of monetary policy change through better data collection on IGF and coordinated peer sharing is also included under Promotion. Gender-sensitive IGF provision policies of a central bank, such as the use of refinancing facilities, lending quotas and quantitative easing, will be covered in a separate report.

FIGURE 9: MONETARY POLICY UNITS ADDRESSING CLIMATE CHANGE IN THE AFI NETWORK, %

Does the Monetary Policy or Research Unit in your institution address climate change and/or Financial Inclusion issues?



Source: AFI, 2020 IGF Annual Survey

Monetary policy action to promote IGF is an extremely complex and challenging proposition due to the short-term price instability that might occur while trying to achieve long-term price stability. There is a lack of peer experience in implementing green monetary policy, and a potential downside of these adjustments is creating undesirable market distortions through improper actions. Identifying market (or regulatory) failure and setting intervention boundaries is absolutely necessary.

In all cases, government intervention should be carefully researched and designed to avoid disincentivizing private sector investment altogether. Interventions need to be monitored and evaluated carefully to measure impact and ensure the desired effects of correcting market failure is being achieved.

BASE INTEREST RATES

Central banks use a variety of methods to set base interest rates, depending on their jurisdiction. However, the main outcome of interest rate adjustments is raising or lowering the cost of borrowing from a central bank by commercial banks. These interest rates can be differentiated to favor banks that adhere to green principles for lending. For example, fully fledged green banks could take advantage of lower funding costs than banks that do not undertake greening efforts, therefore incentivizing non-green banks to adopt green principles to gain access to cheaper sources of funds.

RESERVE REQUIREMENTS

Reserve requirements require banks to hold a portion of deposits in reserve with central banks to safeguard financial stability (e.g. to prevent bank runs or influence interbank operations). A higher reserve requirement effectively reduces the available money supply. For example, differentiated reserve requirements (with IGF-related stipulations for how funds can be used) could allow banks that acquired funds raised through green savings and deposit accounts to hold lower reserves, thus making more funds available for banks to lend to consumers affected by climate change or to green businesses.

21 Forthcoming IGFWG Special Report: "Greening the Financial Sector through Provision Policies", 2020.

CAPITAL REQUIREMENTS

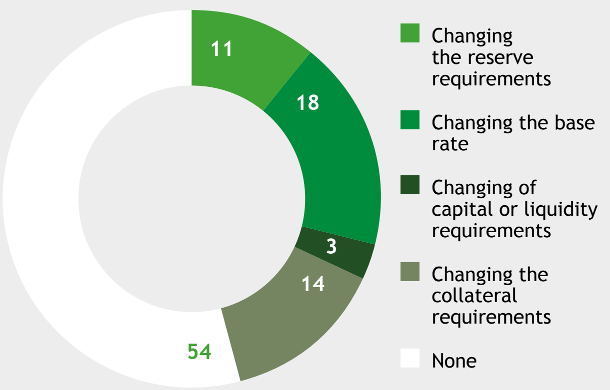
The setting of capital requirements has a direct impact on the ability of banks to lend, as it requires them to hold a certain amount of liquid capital against a certain level of assets. Maintaining higher capital requirements can help ensure financial stability in a financial crisis by helping banks stay solvent in the face of loan defaults. However, higher capital requirements can translate into higher borrowing costs for consumers, especially for women and SMEs, and reduce the availability of credit in the system.

By adjusting the calculation of regulatory capital for banks, policy objectives and market failures can theoretically be addressed in the medium to long term.

For example, a mechanically simple negative incentive approach is to increase risk weights for so-called "brown" segments, which would factor environmental risk into the price and eventually divert investment from carbon-intensive or environmentally costly assets. Or, a promotional approach would reduce the risk weighting for SME segments (to account for the market's inherent inability to assess risk for SME business models) and, in turn, reduce the regulatory costs of those investments and channelmore lending to SMEs.

FIGURE 10: CLIMATE-RELATED MONETARY POLICY MECHANISMS OF AFI MEMBERS, %

Which of the following monetary policy measures has your institution taken to improve access to finance for MSMEs in response to climate change disasters or effects?



Source: AFI, 2020 IGF Annual Survey

However, if the risk weightings are not commensurate with the actual level of risk in a market, market distortions and unintended consequences can arise. Careful definition of market segments and asset classification will be required at the outset, and close monitoring of market reactions are necessary after reforms are implemented.

THE EU SUPPORTING FACTOR

In the EU, where Basel III reforms called for increased capital adequacy, a capital reduction factor for loans to SMEs was introduced that allowed banks to counterbalance a rise in overall capital requirements and theoretically maintain access to credit for SMEs. A similar approach to capital reserve requirements is being considered by the European Commission, which is proposing a green supporting factor or brown penalty to spur green investment.

Source: (European Banking Federation, 2017)

COLLATERAL FRAMEWORK

A more controversial approach to regulating money supply is adjusting the collateral framework that central banks use for open market operations. For example, if preference is given to government-issued green bonds when engaging in market buy-sell operations, the bonds would have more guaranteed liquidity and, therefore, promote more investment in them.

A weighting of eligible collateral towards low-carbon assets is likely to reduce the credit spread of newly eligible companies[22] and provide a powerful signal to other financial market participants.[23]

However, the use of this policy tool will depend on sophisticated credit assessment expertise or well-developed credit rating agencies. It will also require the central bank to have a sufficiently large supply of actively traded securities.

22 (Mésonnier, 2017)
23 (Braun, 2018)

CONCLUSION

There is no one-size-fits-all approach to linking financial inclusion and climate change at the national level. Nevertheless, AFI member institutions are increasingly accepting IGF as an important and shared policy area to address financial inclusion and climate change. AFI's 4P Policy Framework (Promotion, Provision, Protection and Prevention), which has been developed in close consultation with AFI members, is continually being informed by their experiences.

The ideas shared in this report are intended to help financial regulators think about actions they can take to start the IGF journey in their own jurisdictions using promotion initiatives and policies.

While the 4P Framework defines Promotion policies independently from Provision, Protection and Prevention, in reality, these policies usually work in tandem. Promotion policies have been suggested as a starting point for implementing IGF. Designing appropriate coordination mechanisms at the outset and starting with voluntary approaches before imposing legal mandates has been largely identified as a preferred approach by AFI members.

Integrating climate-related risks in prudential regulation, and identifying and measuring these risks while also promoting financial inclusion, is not an easy task. While the promotion of IGF initiatives and policies is important at the start, it is also necessary to continue promoting the ongoing activities that will support implementation of the other P's. Learning, sharing, coordination and institutionalization are the hallmarks of financial sector transitions and, the promotion of policies and initiatives never really stops.

RECOMMENDATIONS FOR VULNERABLE SECTORS

It is also essential to consider policy approaches that are tailored to the needs of vulnerable groups. Women and young people are a critical segment of the population with the potential to drive economic growth, but their livelihoods,[24] economic opportunities and other aspects of their development are affected disproportionately by climate change.

Policymakers should therefore consider specific policies when designing and implementing interventions for vulnerable groups, including:

Internal promotion: Implement capacity building programs to better understand how the vulnerabilities of women and youth are exacerbated by climate change, how IGF initiatives could help to mitigate and adapt to negative impacts (especially how to cope with financial shocks)[25] and the potential of IGF policies to support employment and entrepreneurial opportunities for women and youth.

Promoting coordination: Include women's associations and youth groups and networks in the dialogue to participate in the policy development process and the development and implementation of green finance interventions.[26]

Public promotion: Engage with and promote green education for women and youth to support entrepreneurship and employment.[27]

Promoting transparency: Sex- and age-disaggregated data can enhance understanding of the financial and non-financial needs (e.g. financial literacy) of vulnerable populations, and support decisions about the types of IGF initiatives to be delivered based on their life stages and the challenges they encounter during the transition period. Collecting sex- and age-disaggregated data also improves transparency in the financial sector. At the country level, this data is critical for understanding the depth and breadth of financial access and usage by young people, as well as the types of barriers they face.

24 As of 2019, there were 1.2 billion young adults between the ages of 15 and 24, with a greater proportion of youth in less developed regions (UNDESA, 2019b). In many developing countries, the youth segment comprises the largest and fastest growing proportion of the total population.

25 COVID-19 has had a critical impact on youth: disruption to education and training, employment and income losses, which could lead to the emergence of a "lockdown generation". They are over-represented in informal economic sectors ravaged by COVID-19, and, as such, are largely excluded from the formal financial sector and social security schemes. More than one in six young people are out of work as a result of the pandemic, with young women particularly affected (ILO, 2020).

26 In Sierra Leone, for example, youth are represented by key stakeholders in each of the central bank's financial inclusion working groups: Financial Literacy, Financial Products and Services, Financing for Micro, Small and Medium-sized Enterprises and Digital Financial Services.

27 One initiative in this field is Jeunes Volontaires pour L'Environnement in Togo. The program provides young people with environmental education and trains them as environmental protection champions in their schools, homes and communities. After completing the training, the young people graduate with knowledge of key environmental issues, project design and group management, as well as the ability to create solutions that address key environmental problems in their communities.

RECOMMENDATIONS

THE FOLLOWING RECOMMENDATIONS WERE RECORDED FROM WORKING SESSIONS OF THE AFI IGF PROMOTION SUBGROUP FOR THIS REPORT

INTERNAL PROMOTION

Catalysts, interdepartmental initiatives, internal capacity building and Centers of Excellence

> **Don't wait; time is of the essence.** Consider your mandate, engage in dialogue and guide the narrative of green finance and financial inclusion topics in your jurisdiction.

> **Manage a lack of resources and balance roles.** Failure or delay in action may have greater cost implications in the long run than investing in new initiatives now.

> **Promotion is the first step.** Raise awareness first, draft regulations later.

> **Develop an internal approach** to IGF, understand the market failures and societal benefits of IGF and why action is needed from the regulator (start building internal capacities).

PROMOTING COORDINATION

Alignment with the national vision, interagency cooperation, financial sector strategies

> **Don't underestimate the benefits of getting stakeholders in the same room.** There is much to learn and agreements can be reached.

> **Build consensus** with other financial sector regulatory agencies and establish effective coordinating mechanisms.

> **Ensure alignment with national goals** while developing an action plan or strategy.

> **Contribute to the global effort** to implement the Paris Agreement and achieve climate-related Sustainable Development Goals (SDGs)

PROMOTING TRANSPARENCY

Evidence-based policymaking, standards and methods for monitoring

> **Policymaking should be publicly transparent.**

> **Do not confuse disclosure with action** (disclosure can demonstrate action). Simply passing disclosure requirements does not necessarily move the needle.

> **Consider global best practices.** Much work has already been done and can be leveraged.

> **Adapt existing rules** rather than making a parallel set of rules.

> **Benchmarks and a taxonomy are useful, but a scorecard can be even better.**

Sustainable energy, wind turbine, China. (Photo by silkwayrain/iStock)

PUBLIC PROMOTION

Moral suasion, publications and industry guidance, awareness raising and sector capacity building

> **IGF topics should be addressed in cooperation** with the private sector and not "demanded". Create spaces where the industry can express its concerns.

> **Do not overwhelm stakeholder cooperation.** Identify your most powerful allies (sometimes "less is more") rather than overburdening the process by involving too many stakeholders.

> **Identify champions** in the private sector (who do not need convincing) and become allies, not adversaries.

> **Ensure a phased approach while allowing time for learning.** Sequential reforms that build on each other are more likely to culminate in regulatory actions.

> **Consider supporting or participating in capacity building initiatives for the sector.**

PROMOTION THROUGH MONETARY POLICY

Monetary and macro-financial policy

> **Powerful traditional tools can be used in untraditional ways.**

> **Beware of conflicting mandates.**

> **Short-term effects may be different than long-term effects.**

> **A properly defined regulatory perimeter and monitoring program are critical.**

ACRONYMS

4P	Four Policy: Promotion, Provision, Prevention and Protection
AFI	Alliance for Financial Inclusion
ASEAN	Association of Southeast Asian Nations
BIS	Bank of International Settlements
BSP	Bangko Sentral ng Pilipinas
CB	Capacity Building
COE	Center of Excellence
DOF	Department of Finance
ESG	Environmental, Social and Governance
ESRM	Environmental and Social Risk Management
EU	European Union
FSP	Financial Service Provider
GRI	Global Reporting Initiative
IGF	Inclusive Green Finance
MoU	Memorandum of Understanding
MSME	Micro Small and Medium Enterprises
NFIS	National Financial Inclusion Strategy
SBN	Sustainable Banking Network
SDG	Sustainable Development Goals
SEC	Securities and Exchange Commission
SME	Small and Medium Enterprises
SUGEF	General Superintendence of Financial Institutions (Costa Rica)
UN	United Nations
WG	Working Group

APPENDIX

INCLUSIVE GREEN FINANCE 2020 IGF ANNUAL SURVEY

The IGF Survey was launched in June 2020. The objective of the survey was two-fold:

1. To collect updated IGF policies, follow up on ongoing policy implementation and look at how the AFI Management Unit could support such initiatives; and
2. To gather information to develop future Knowledge Products (reports from the Promotion and Provision Subgroups).

This exercise targeted all IGFWG institution members. The following 27 member institutions responded to the survey:

1. Da Afghanistan Bank (DAB)
2. Banco Nacional de Angola (BNA)
3. Bangladesh Bank (BB)
4. Royal Monetary Authority of Bhutan (RMA)
5. Banque de la République du Burundi (BRB)
6. National Bank of Cambodia (NBC)
7. Superintendencia de Economía Popular y Solidaria (SEPS)
8. Central Bank of Egypt (CBE)
9. Banco Central de Reserva de El Salvador (BCRES)
10. Reserve Bank of Fiji (RBF)
11. Bank of Ghana (BoG)
12. Banque Centrale de la République de Guinée (BCRG)
13. Central Bank of Jordan (CBJ)
14. SACCO Societies Regulatory Authority (SASRA) Kenya
15. Maldives Monetary Authority (MMA)
16. Comisión Nacional Bancaria y de Valores (CNBV)
17. Financial Regulatory Commission of Mongolia (FRCM)
18. Bank Al-Maghrib (BAM)
19. Banco de Moçambique (BdM)
20. Bangko Sentral ng Pilipinas (BSP)
21. Central Bank of Samoa (CBS)
22. Banco Central de São Tomé e Príncipe (BCSTP)
23. Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO)
24. Central Bank of Sri Lanka
25. Bank of Tanzania (BoT)
26. Central Bank of The Gambia (CBG)
27. Banco Central de Timor-Leste (BCTL)

The survey results have not been published as they are for internal use only.

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