

FINANCING THE FUTURE

Report of the Italian National Dialogue on Sustainable Finance

EXECUTIVE SUMMARY



UN Environment Inquiry

The Inquiry into the Design of a Sustainable Financial System has been initiated by the United Nations Environment Programme to advance policy options to improve the financial system's effectiveness in mobilizing capital for sustainable development. In October 2016, the Inquiry published the second edition of its landmark report, *The Financial System We Need*, entitled *From Momentum to Transformation*.

More information on the Inquiry can be found at: www.unepinquiry.org or from: Ms. Mahenau Agha, Director of Outreach mahenau.gha@unep.org.

MATTM

The Italian Ministry of Environment, Land and Sea promotes, within the framework of the Italian government, ambitious environmental (including climate) and sustainable development policies, aiming at maximizing resource efficiency and decoupling economic growth from environmental impact. Following the 2015 Paris Agreement on Climate Change and the UN Agenda 2030 approved in 2015 with its Sustainable Development Goals (SDGs), the Ministry facilitates the preparation of the new National Strategy on Sustainable Development based on SDGs, international cooperation activities for achieving the 2°C (and possibly 1,5°C) target, the decarbonization of the Italian economy. It is in charge of the G7 Environment Presidency for 2017. <http://www.minambiente.it>

This report has been edited by MATTM and UN Environment based on the inputs from National Dialogue on Sustainable Finance members and reflects a consensus view. The proposals do not necessarily imply agreement by all members or institutional endorsement by any participating company, institution or organization involved in the analysis or proposals.

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REPORT OF THE ITALIAN NATIONAL DIALOGUE ON SUSTAINABLE FINANCE

EXECUTIVE SUMMARY

- Italy faces a strategic opportunity to harness its financial system to support the transition to a low-carbon, inclusive and sustainable model of development.
- The National Dialogue on Sustainable Finance was established to identify options that would improve the integration of sustainability factors across Italy's financial sector.
- The dialogue identified a growing awareness and increased actions by financial institutions across the banking, capital markets, institutional investment and insurance sectors.
- The dialogue also recognized the barriers that prevent the scaling up of this good practice, including mispricing, short-termism, and low levels of awareness and capability.
- The dialogue identified 18 specific options, grouped in four areas: policy frameworks; financial innovation; market infrastructure; and knowledge building.

A SHIFT TOWARDS SUSTAINABLE FINANCE IS UNDER WAY

The 2015 Sustainable Development Goals and the Paris Agreement on climate change require a new generation of innovations from the financial system. In response, Italy's National Dialogue for Sustainable Finance was launched in February 2016 to take stock of existing practice, identify key challenges and suggest policy options to take promising developments to scale. It was initiated by the Ministry of Environment together with other Ministries and Public Authorities, and included a series of working groups comprised of leaders in the financial sector and the research community. The dialogue was convened in partnership with the United Nations Environment Programme, who brought international experience to bear.

Harnessing the financial system will be essential for achieving a successful transition to a low-carbon, inclusive and sustainable model of development. Sustainable finance involves the integration of environmental, social and governance (ESG) factors across the financial system with the goal of strengthening resilience, targeting capital allocation and improving accountability. The dialogue focused mainly on the environmental dimension of financing sustainable development, often called 'green

finance'. Green finance aims not only to guarantee finance for needed environmental projects but also to make more sustainable all finance ("greener finance").

The dialogue clearly demonstrated that a shift is already under way both domestically and globally. There is growing recognition that ESG factors are now material for value creation. Environmental threats such as climate change and water scarcity are creating risks to financial assets – and new challenges particularly for the insurance sector. Banks, capital markets and institutional investors are starting to incorporate environmental and social factors in capital allocation decisions. Public finance will be key to enabling this shift, but the bulk of the capital required will need to come from the private sector.

Internationally, policy cooperation is deepening. Italy is an active participant in the G20's Green Finance Study Group and is taking part in the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). Within the EU, sustainability is also a core investment goal of the Juncker Plan and the Commission has announced its intention to develop a comprehensive European strategy on sustainable finance. Increasingly, finance ministries, central banks and regulators are identifying how sustainability factors impact upon financial stability and long-term investment.

Italy faces a strategic opportunity to align its financial system with sustainable development. Reforms to green the finance sector can help to identify new growth areas, new ways of ensuring the soundness of financial institutions and new ways to serve clients at home and abroad. This can contribute to wider financial stability and long-term economic recovery. For Italy, the prominent place of small and medium-sized enterprises (SMEs) in the economy creates a particular imperative for greening the financial system.

THE MOMENTUM IS POSITIVE, BUT HAS NOT YET ACHIEVED A SYSTEMATIC IMPACT

The dialogue identified a number of signs of momentum across Italy's banking, capital markets, insurance, investment and public finance sectors, including:

- **Banking:** According to the *Banks and Green Economy* report and the Banks Observatory lead by ABI, Italy's banks have lent €27 billion between 2007 and 2014 for renewable energy, including €18 billion for solar. Investment in energy efficiency, notably in the building sector, has high potential, but faces a number of barriers.
- **Capital Markets:** In the 2016 ranking of sustainability disclosure on 45 stock exchanges, Borsa Italiana climbed 11 places to 19th position. In terms of revenues from listed companies involved in the green economy, the Borsa ranks 10th among global stock exchanges. In addition, a number of innovative instruments have been launched to encourage SMEs to access capital markets. Currently, Italy has €738 billion in bonds that are aligned with action on climate change.
- **Institutional Investment:** In 2015, about €616 billion in assets under management were managed according to a range of Sustainable and Responsible Investment (SRI) strategies, about 6% of the European total.
- **Private Equity:** The integration of ESG concerns in the selection criteria and in the management practices of PE fund managers is more and more widespread. Sustainability is perceived as one of the keys to unlock value from SMEs.
- **Insurance:** Over 22% of Italy's insurance market is covered by companies that have signed the UN Principles for Sustainable Insurance.
- **Public Finance:** Cassa Depositi e Prestiti (CDP), Italy's national promotional bank, has placed sustainable development at the heart of its new business plan.
- **Metrics:** from 2016, the Indice di Benessere Economico e Sociale (BES), a complex system of social and environmental indicators that serve as a precursor to the SDGs, will be used together with GNP in the budget and stability law as a barometer to measure sustainable growth of the country.

These promising developments, however, have not yet achieved a systematic impact across the financial mainstream as a result of a number of challenges:

- Unpriced environmental externalities can still tilt the risk/return profile away from sustainable finance.
- Limited access to finance for enterprises, especially for small and medium enterprises, is constraining their participation in the growing green economy.
- Financial decision-making does not yet adequately take account of long-term challenges such as climate change.
- Italian public opinion is not yet sufficiently informed about the relevance of environmental threats for the health of the economy and of the financial system.
- The country's financial culture does not place sufficient emphasis on the skills and capabilities required to respond to the sustainable development imperative.

Together these factors have led to insufficient flows of capital to the green economy, unrecognized risks and the prospect of leaving the country's sustainable development and climate goals unrealized. Since savers' and consumers' demand for green products and services is expected to grow faster in Italy than elsewhere, the country may miss the opportunity to improve its economic performance by pursuing new green business options and adopting new financial approaches. These challenges are, however, by no means unique to Italy – and there is increasing activity at the international level to overcome these hurdles.

OPTIONS FOR ENHANCING SUSTAINABLE FINANCE

Looking across Italy's financial system, the dialogue has identified 18 separate options that fall into four broad action areas.

Putting in place supportive policy frameworks

- 1 Strategy:** The government could embrace the agenda set at the recent G20 summit and set a comprehensive national agenda that will enhance the role of finance as a driver for sustainable development. One of the three pillars of the Green Act (currently under discussion) focuses on this exact point, which presents a unique opportunity for structuring a national sustainable finance strategy, within the framework of the national sustainable development strategy, that would be capable of mobilizing the capital needed to deliver the SDGs and the Paris Agreement's objectives.
- 2 Public Finance:** The CDP could systematize its sustainable development mandate into consistent policies and processes, and strengthen its accountability towards all stakeholders. Specific attention could be devoted to the financing of energy efficiency and sustainable infrastructure. Local Authorities – the Regions in particular – should strengthen the importance of sustainability in their plans and policies and orientate their investments accordingly.
- 3 Fiscal Policy:** Tax expenditures could be reviewed to remove progressively – but with speed and certainty – environmentally harmful subsidies in the energy sector. Italy could also promote a debate in Europe on how best to give the right price signals to consumers, producers and the financial system, building on experience with economic instruments (e.g. carbon markets).
- 4 Systemic Review:** Banca d'Italia and other market regulators could use their databases and their knowledge to evaluate the implications of climate change for Italy's economy and financial system and suggest measures to encourage good practice by financial institutions.

- 5 **International Cooperation:** Italy could include green finance as part of its cooperation activities with developing countries (as has been done through the microfinance green schemes) and ensure that the funding profile of the export credit agencies is consistent with goals for decarbonization and resilience.

Stimulating financial innovation in priority areas

- 6 **SMEs:** A new effort is needed to identify mechanisms for complementing traditional sources of bank credit for SMEs operating in the green economy with other, more sophisticated, financial instruments that allow a longer-term view.
- 7 **Real Estate:** The government could take the opportunity of the Piano Casa to encourage significant investment on the quality of buildings and increase their resilience to natural catastrophes. Besides, an innovation lab could work with banks to design new financial instruments to support investment needed to improve the energy efficiency of residential, commercial and public buildings.
- 8 **Green Bonds:** A green bond development committee including public and private entities could be formed to identify and deliver the critical steps needed to develop the market, particularly the provision of access for small issuers and savings opportunities for retail investors.
- 9 **Insurance:** The government and insurance companies could explore a national scheme to cover risks from climate-related natural catastrophes, in particular for residential properties, that adopts both traditional and non-traditional reinsurance structures (CAT bonds, ILS, collateralized, etc.).
- 10 **Clean Tech:** The government, along with financial institutions, could leverage the role of Italy in the Mission Innovation initiative to scale up private capital for breakthrough sustainable technologies.

Improving market infrastructure in terms of disclosure and governance

- 11 **Stock Market Disclosure:** Borsa Italiana – in addition to its new reporting guidelines to raise the level of disclosure on its markets, including flows of green revenues – could take further actions to increase the level of transparency and facilitate the engagement of responsible investors. The introduction of a voluntary certification scheme on the sustainability of funds (e.g. the LuxFlag model) could also help transparency and accountability on the issuers' side.
- 12 **Corporate Reporting:** The EU's non-financial reporting directive could provide a first step toward improving transparency, and prepare the way for responding to the recommendations of the FSB Task Force. A higher number of companies could be encouraged to disclose their ESG data by investors and others, with different expectations for SMEs, in line with traditional comparable transparent economic, capital and financial data.
- 13 **Investor Disclosure:** All institutional investors could publicly report on how ESG factors impact their portfolios and how they are supporting the climate transition. They could also disclose the extent to which their investment and voting policies cover ESG issues and identify the results that arise from their implementation.
- 14 **Corporate Governance:** The Italian Corporate Governance Committee could further strengthen the focus on the importance of sustainability issues – such as environmental and social issues – for long-term value creation, calling on boards to take on the responsibility of developing

consistent strategies, establishing culture and values of the company setting the correct “tone from the top”, and encouraging specific measures on linking, for instance, executive pay to sustainability performance.

Building capacity, awareness and knowledge

- 15 Risk:** A collaborative consortium of financial institutions, academics and public authorities could be established to pilot ‘environmental stress testing’ models and to make recommendations for improved analysis and data availability. Supervisors and surveillance authorities could push their European peers to evaluate the relevance of ESG factors at both the micro and macro level and consider the extent to which they are implemented in risk control models.
- 16 Public awareness:** An information campaign could be launched in partnership with key financial institutions, civil society organizations, religious bodies, trade unions and banking foundations to highlight the importance of environmental threats and the role that consumers and investors can play in influencing the supply side in the market.
- 17 Capacity building:** Financial institutions could identify the skills needed to make their professionals green finance literate, and incorporate these into training programs. In parallel, universities and academic bodies could enrich their educational offer on green finance sector reform and integrate these skills into professional curricula for continuing development.
- 18 Measuring progress:** The government could – leveraging the competence and the data sets of the National Institute for Statistics (Istat) – encourage the development of a model for measuring the progress of the financial system towards sustainable development, drawing on national and international expertise. The output of this monitoring activity should become a compass for orientating public policies.

Progress on these proposed options would make a material difference in closing the gaps across key financial sectors and issues.

LOOKING AHEAD

The National Dialogue on Sustainable Finance has generated a broad-based agenda for market innovation and policy reform.

At the domestic level, it is important to maintain and deepen the momentum. This can be done by establishing a National Observatory on Sustainable Finance, which could assure the continuation of the work started by the Dialogue, particularly through the promotion, coordination and monitoring of suggested options. It would also encourage all actors in the financial community to make the Italian financial market more dynamic, innovative and attractive in terms of sustainability. The Observatory could promote the launch of a Green Financial Initiative, based on the experience of the London and Paris markets.

Internationally, Italy’s G7 Presidency in 2017 provides an excellent opportunity to promote green and sustainable finance with some of the country’s key partners.

ABOUT THE ITALIAN NATIONAL DIALOGUE ON SUSTAINABLE FINANCE

The National Dialogue on Sustainable Finance was launched in February 2016 to identify practical market and policy options to mobilize Italy's financial system for sustainable development and climate action. The dialogue was convened by Italy's Ministry of Environment, Land and Sea (MATTM), in partnership with the United Nations Environment Programme (UN Environment).

The Secretariat was led by Francesco La Camera (MATTM) and Aldo Ravazzi Douvan (MATTM-Sogesid TA) and Nick Robins, Mark Halle, Davide Dal Maso and Pier Carlo Sandei (UN Environment). The work of the dialogue was based upon a number of working groups led by the following: Risk analysis (Gaia Ghirardi, UniCredit); Responsibility and Reporting (Marco Frey, Fondazione Global Compact Network Italia); Banking (Raffaele Rinaldi, ABI); Capital Markets (Fabio Ferrari, Intesa Sanpaolo and Sara Lovisolo, Borsa Italiana LSE Group); Institutional Investors (Sonia Cantoni, Fondazione Cariplo and Francesco Biciato, Forum per la Finanza Sostenibile); Insurance (Pietro Negri, ANIA); Public Finance (Bernardo Bini Smaghi, Cassa Depositi e Prestiti); Measuring progress (Raimondo Orsini, Fondazione per lo Sviluppo Sostenibile).

The dialogue also benefitted from the participation of the following: Maurizio Agazzi (Fondo Pensione Cometa), Alessandro Alessandri (CDP), Isabella Alloisio (FEEM), Alessandra Bailo Modesti (Fondazione Sviluppo Sostenibile), Corrado Baldinelli (IVASS), Luciano Barsotti (ACRI), Tosca Barucco (MAECI), Marcello Bianchi (Assonime), Margherita Bianchini (Assonime), Giorgio Capurri (UniCredit), Salvatore Cardillo (Assofondipensione), Giorgia Caropreso (MATTM-Sogesid TA), Gionata Castaldi (MATTM-Sogesid TA), Edoardo Croci (Università Bocconi), Gino Del Bufalo (CDP), Alessandra Diotallevi (MEF), Fabio Eboli (MATTM-Sogesid TA), Ivan Faiella (Banca d'Italia), Davide Ferrazzi (ABI), Alessandra Franzosi (Borsa Italiana), Fabio Galli (Assogestioni), Vittoria Ghirlanda (FEEM), Ayumi Kikuchi (MEF), Antonio Keglevich (UniCredit), Francesco Lo Manno (Borsa Italiana), Michele Lanotte (Banca d'Italia), Vanessa Leonardi (MATTM-Sogesid TA), Francesco Lorenzetti (Fondazione Cariplo), Arianna Lovera (FFS), Margherita Macellari (Fondazione Global Compact), Gianluca Manca (Eurizon Capital), Federico Mannoni (MATTM-Sogesid TA), Simone Martelli (MEF), Manuela Mazzoleni (Assogestioni), Andrea Molocchi (MATTM-Sogesid TA), Sara Moratti (Prometeia), Filippo Natoli (Banca d'Italia), Alessandro Negrin (MATTM-Sogesid TA), Roberto Novelli (IVASS), Eleonora Padoan (CDP), Marisa Parmigiani (UnipolSai), Claudia Pasquini (ABI), Sabina Ratti (FEEM), Giorgio Recanati (ABI), Giorgio Righetti (ACRI), Daniela Ricci (Intesa Sanpaolo), Ambrogio Rinaldi (Covip), Giampaolo Ruggero (MEF), Lorenzo Saa (PRI), Swan Senesi (MATTM-Sogesid TA), Lucia Silva (Generali), Davide Squarzone (Prometeia), Ludovica Soderini (MEF), Romano Stasi (ABI), Valentina Tecce (Intesa Sanpaolo), Veronica Vecchi (Università Bocconi), Gelsomina Vigliotti (MEF), Davide Zanoni (Avanzi), and Maurizio Zollo (Università Bocconi).

A number of international experts also contributed to the dialogue, including Careen Abb (UN Environment), Butch Bacani (PSI), Ian Cochran (Finance I4CE), Elodie Feller (UN Environment), Sir Roger

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