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Is it cynical to believe we couldn't do better?

As recent events in Greece abruptly brought home to us, the issue of sustainability in finance is more topical than ever. Nobody is surprised that the Greek population protested volubly against the austerity package - Europe has a long history of people taking to the streets - but similar medicine must be administered throughout the developed world. The financial crisis may have its roots in the greed of politicians and bankers, but the underlying problem goes far deeper to an unbalanced view of how wealth should be created. It touches all those whose sole principle in business was earning a quick profit and who benefited from the bubble while it lasted.

The financial crisis has brought home to investors all over the world the benefits of sustainable finance. Companies and funds that have adopted "SRE" (sustainable, responsible, environmental) standards comprise a fast growing sector. Consumers are becoming aware of the issues and are choosing products and services that are managed in line with their ethical principles. This has forced many previously unresponsive companies to adopt sustainable practices. Hence, investors focus on SRE companies not just for their own sake, but because they are a promising investment option. It can become a virtuous cycle.

However, the concept of "sustainable finance" and "sustainable investment" goes beyond buying shares in a solar panel company in anticipation of good returns. The question is, what can the financial system itself do to be more sustainable?

A boost from above

At a political level, the history of sustainable development is still young. It was initiated by the phenomenon of global warming. In 1992, Agenda 21 adopted by the United Nations was the first action plan related to this issue: 178 governments committed themselves to achieving the aims of the Agenda at global, national and local levels. The main topics were social and economic development and fair access to resources by third world populations. Ten years later, the Agenda was fully implemented at the Johannesburg Summit. However, Agenda 21 did not include the financial sector. Although there is broad public consensus about what non-sustainability means in specific financial sectors, critics remain silent when it comes to a definition of sustainability. One reason for this is the fact that there seemed to be no

From left to right: Claude Turmes, Member of the European Parliament | Philippe Depoorter, Secretary General at Banque de Luxembourg | Ekkehart Schmidt-Fink, Responsible for public relations at etika | Christian Scharff, Partner at PwC | Dr. Erny Gillen, President of Caritas Luxembourg and Europe.

Definition by the United Nations

Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts:

- the concept of "needs", in particular the essential needs of the world's poor, to which overriding priority should be given; and
- the idea of limitations imposed by the state of technology and social organisation on the environment's ability to meet present and future needs.

need for sustainability in the financial sector before the recent financial crisis.

According to Claude Turmes, a member of the European Parliament representing the Luxembourg Green Party and draftsman of the recent EU Directive on renewable energies, sustainable finance is defined by three main aspects: "We have the environmental aspect on the one hand. In a world of scarce resources and overstrained ecosystems it is logical and urgent that a larger part of money is invested into projects that help tackling environmental problems. The social component is another aspect to this: we have to make sure that the return of financial products is not excessively high which would mean too much pressure on rationalising and cutting jobs. Regulation is the third element. A healthy level of capitalism is only achievable if you set yourself rules, that's why I am in favour of a regulation of financial products and the introduction of a financial transaction tax."

The cost of going green

The sudden call for sustainability does not impress those of a cynical nature. However public debate about sustainability in finance is long overdue. Turmes points out some interesting initiatives in the new multibillion euro market for green technologies: the EU Directive on renewable energies, adopted in December 2008, set a target of minimum 20% market share for renewable energies by 2020. This implies investing some 300 billion euros between now and 2020 into alternative energy sources such as onshore and offshore wind power mills, solar energy, biogas and biomass. Furthermore, energy networks have to be modernised and made more "smart" which will add investments of at least 150 billion euros. Large scale renovation of buildings, which will be a consequence of another piece of legislation on buildings, will require up to 100 billion a year over the next 25 - 30 years. All these areas are interesting for investors because these are very stable sectors.

But what can the man in the street do to invest in sustainable assets? There is no lack of financial products that invest in sustainable energies, the environment or humanitarian projects. Socially responsible investment (SRI), philanthropy, and green tech are just some of the catchwords that we commonly meet in this sphere. Labels guarantee goodwill toward such products and nowadays no bank can afford not to have at least one such product on offer. "We too have a successful SRI-fund, but clients must be aware that their real impact is limited" says Philippe Depoorter, Secretary General at Banque de Luxembourg.

Green and greener

SRI funds seem to have become a "must-have" for ethically-minded investors. "But, at the end of the day, what difference do they make to the world?", Depoorter asks. There are too many, often dubious SRI-labels that glut the market and swamp the client with choices. Furthermore, the impact of such funds is rarely measurable.

Impact financing offers a realistic alternative. In contrast to SRI funds, impact financing vehicles aim to offer financial and social benefits with a measurable impact for the investor. Favoured instruments are microfinance vehicles: social private equity funds (often in emerging countries) sometimes wrapped into SIFs (specialised investment funds). Microfinance in particular is closer to impact financing than to SRI funds, because the

money collected is passed on to finance or help finance projects in the field. Since the target institutions are known, identifying with the investment is much easier. "There's a logic in it" Depoorter says. The client is able to measure the assistance he provided to a concrete project.

Either way, people who invest in impact financing and SRI funds are by choice accepting a double bottom line. That is, they accept potentially lower returns in return for a social impact. However, researchers reported at a recent SRI conference in Luxembourg that there was no consistent proof that this was in fact the case. Microfinance investment vehicles tend to set a fairly predictable rate of return, be it a low one. Where SRI funds are concerned, there is no proof that they consistently under or out-perform the traditional market.

Opportunities in Luxembourg

Although most Luxembourg funds have been developed for international distribution, the domestic market is quite active in the SRI area. For instance, the Luxembourg NGO etika provides an alternative savings account, which was developed in collaboration with the Banque et Caisse d'Epargne de l'Etat. Savers give up 0.2% of their interest income but in return receive a report on how their money is spent. The 0.2% of income is used to support social and ecological projects. Hence etika is able to make loans to chosen projects in Luxembourg at a rate that is 0.7% below the market. Examples of such projects are bio-farming, rehabilitation of unemployed persons, economic development of rural zones or development aid projects. This savings account has become so popular that there is a shortage of suitable projects. Nevertheless, "This can only be seen as awareness raising, an opportunity to take off the classical (financial) glasses and put on a different pair in order to see that other possibilities exist", admits Ekkehart Schmidt-Fink, responsible for public relations at etika.

In 2007 and again in 2009, etika published a Guide to ethical investment in Luxembourg, which reviewed the credentials of some 200 SRI investment funds. Schmidt-Fink remarks that the path to recognition of etika, founded 1996, had been rocky. Prejudice by the banking sector towards the ideals of the founding members was as strong as the prejudice of the founders towards the business community.

But sustainability has to go a step further. The financial sector itself has to become sustainable. A healthy financial system is a necessary precondition for

a functioning market. This means healthy all through the system, starting with exemplary behaviour at the level of theindividual, via corporate governance-guidelines in financial institutions through to international legislative norms.

Making "ethical investment" obsolete

Corporate social responsibility should not be confused with donations and honorary posts, comments Christian Scharff, Partner at PricewaterhouseCoopers and responsible for Human Resources Services. For him, corporate social responsibility means providing the conditions for a happy, hence productive, workforce.

Scharff recognises the importance of ethics in companies, especially when worst case scenarios such as lay-offs occur: "It is very important to have a long term vision as a company. You have to ask yourself questions, like what about the motivation of the people who are still working at the company and what about retention? If the economy is picking up again, people will

IMS: Institut pour le Mouvement Sociétal

Banque de Luxembourg and PricewaterhouseCoopers are two of the one hundred members of IMS Luxembourg (Institut pour le Mouvement Sociétal/Social Movement Institute), an association created in 2007 that is engaged in promoting corporate social responsibility in Luxembourg.

The objective of the founding companies (which included PwC) was to share experience and convince other companies in the Greater Region of the social importance of sustainability in the management of their firms.

think about the tough times and say: when something went wrong here, they were quick to kick people out. This behaviour is something employees won't forget." It has not yet dawned on company managers that ethical standards are not something you pay for. "We have to stop thinking that corporate social responsibility causes extra expenses. We can even make profit with it. At an environmental level, there is money to be saved enhancing water, paper and electricity consumption."

For Christian Scharff, young job seekers need to demonstrate a range of characteristics. On the one hand, they should stand out for their personality and good professional skills that are worth developing. On the other hand, they should show an interest in something beyond this. "This is also of interest to us, because it throws light on the open-mindedness and independence of the candidate." For these employees PwC provides the initiative "my project", which offers the possibility of taking part in social or humanitarian projects for 120 hours of their working time.

According to Scharff, the corporate social responsibility train is leaving the station now. In three or four years it will be too late to start adapting. Not only the market, but employees, clients and even authorities anticipate the arrival of a new behavioural norm. "One day Corporate Social Responsibility considerations will be an obligation".

Dr Erny Gillen, president of Caritas Luxembourg, never doubted that fact. "Every institution, be it a bank, a welfare organisation or a handicraft business needs employees who embody a set of ethical principles that are true for themselves and for their companies." This implies agreement about what kind of moral principles are to be followed. It is the task of stakeholders to set down and implement guidelines for the company.

Practice what you preach

Even more important to Gillen is the demand for sustainability in our society. "We cannot jeopardize our future or the future of our children. The financial system is only an instrument for economic activity, the means to an end. That end is to provide life to society and to business. The financial system has added hugely to the success of people's lives: we cannot go back to a barter system. But because people have forgotten the purpose of money, money has suddenly taken on a dynamic of its own. We must go back to basics and bring money back into the society and the economy."

Gillen continues, "If finance is the means to an end then somebody must define that end, and such an objective cannot be found within the financial sector itself. This is a political exercise, which has not been undertaken. It is a political problem and not just a financial problem."

Gillen believes that it is time to redefine the term "investment". The basic idea should be: which product do I believe in and want to support? Unfortunately we have developed the attitude: where can I get back the most money? That is no longer an investment: the only objective is to make more money for myself. "This way of using money to make money is not morally sustainable".

Unfortunately the debate about sustainability is already dying down. "Too many statistics show that business is picking up again (...) so people have the wrong impression that this whole question is already obsolete". They fall back into their pre-crisis habits, convinced that the crisis was not caused by anything fundamentally wrong with the system, but was an anomaly that can be ignored. "That is regrettable and risky, because I'm not sure if we can cope with the next crisis as well as we did with this one." "If we do not change the system, the next crisis will be bigger", adds Gillen.

Ethics first, sustainability will follow

Although sustainability is by its nature a positive term, issues related to this subject always have a negative flavour: global warming, pollution, hunger and poverty at the environmental level; crisis, greed and unemployment at a financial or political level. But the linking word is a positive one: ethics. If ethical behaviour can (re)establish itself in our culture and society, sustainable behaviour will follow. Sustainability in finance is important because the financial system plays a major role in an efficient society. Each of us can play an active part in shaping society. It is a chance not to be missed. (EK)