

Sustainability and the Financial Services Sector: From Risk to Opportunity

The growth of the SRI market and the development of corporate social responsibility, including legislation, have motivated or obliged companies - depending on the point of view – to address sustainability. The financial services sector is no exception. However, it must be acknowledged that despite a willingness to comply with the law, many in the financial sector have yet to understand the implications of sustainability for their business – the risks and even more so, the opportunities.

The financial sector is at the heart of the economy and therefore at the heart of the sustainability issue. The anti-CSR argument – banks don't pollute, employees in the sector are paid well, there are no third-world factories – is shortsighted. The implied companies, those which produce goods and pollute in Europe or in developing countries, do so only with the tacit agreement of the financial sector which lends to, invests in or insures those same firms.

It is important to recognize that as the sustainability movement took off in the 90's, there was more direct focus on those sectors with the strongest social and environmental impacts – Oil & Gas, Chemicals, Textiles, etc. For several years, the so-called environmentally-clean and socially-advanced industries such as the Telecom and Financial sectors were seen as good investments especially for those funds which relied on negative screening. Today, the picture is much more complex – life-cycle analyses have demonstrated the problems that the rapid turnover of computer equipment pose for the environment, not to mention the social consequences of the sector bust. And even if the conclusions are not universally recognized, the financial sector – insurers, asset managers and lending institutions – directly impacts the social and ecological fabric by means of its financial clout.

An example of a financial group working to confront the challenges of sustainability is the Norwegian company Storebrand. A small caps company with 1,500 employees, Storebrand plays an important role in its domestic market. Created in 1767 by the king to insure against forest fires, today the company is organized into 3 business units. Storebrand Life controls 30% of the life insurance market and 70% of the private retirement funds and directly impacts 10% of the Norwegian population. Storebrand Investments manages €20 billion, including 10% of the Mutual Fund market. Its banking unit includes Norway's most popular Internet bank and a well-established private bank.

In the mid-90's when Storebrand began what developed into its CSR policy, few companies were openly discussing the issue, and those, like Storebrand, in the nascent phase of developing a sustainable strategy, were there primarily for business reasons. The approach to sustainability began with the observation that as insurers, the environment was beginning to be a risk - there was an increase of climate-related claims against its insurance policies. The only solution was to reduce the risk or manage its impacts. The financial motivation was to manage the risk more efficiently, and to create tools that would allow us to better apprehend forthcoming market changes. Moreover, as these environmental crises often led directly to social problems such as loss of jobs, the risk issue was quite prominent.

The insurance sector – to focus more specifically on this sub-sector - has always dealt with issues of risk assessment and risk management, and as such is relatively well positioned to address the emerging subject of sustainability and the corporate role within. Insurance finds itself at the crossroads of business and sustainability in that it suffers the consequences of

environmental impacts, it finances the future of the economy and it has already developed the tools to measure non-financial issues.¹ The insurance sector is composed of various businesses, which have differing relationships to the sustainability concept. It is, therefore, not surprising that in September 2001, the Association of British Insurers (ABI) published a report entitled “Investing in Social Responsibility”. The ABI guidelines state that a company can put itself at risk if it fails to respond appropriately to social, ethical and environmental concerns. It calls on companies to address these issues in their annual reports, in which they confirm that they have assessed these significant risks are managing them so as to preserve or even improve corporate value.

An earlier sector initiative was the UNEP Finance Initiative started in 1992. Three years later, the Insurance Industry Initiative (UNEP III) was created. UNEP III now has almost 90 partner companies (insurance, re-insurance and pension companies) from 24 countries. A Statement of Environmental Commitment has been written with three central engagements: General Principles of Sustainable Development, Environmental Management and Public Awareness & Communication.² Three Working Groups (Asset Management, Climate Change and Environmental Management & Reporting) have been formed to address sector issues and develop strategies and standards. One example is climate change. Risks to the industry from dramatic climate change in the next 10 years will force both companies and insurers to re-think their approach to insurance, though for the moment, neither group seems overly prepared. Working in this direction, Storebrand is part of the UNEP Climate Change working group, in addition to holding the Chair for UNEP III.

The financial sector has at least three areas that must be addressed in its response to CSR: its internal management, its products and its investments. Like a production plant or construction site, a bank or insurance company has the responsibility to manage how its business operations impact the environment and its social setting. Since 1995, Storebrand has developed an environmental and then CSR action plan in order to coordinate its approach to sustainable issues. Its most recent report published in May 2003 divides its principle indicators into 3 areas: financial worth, social responsibility and environmental issues. Using the business tool the Balanced Score Card, CSR has been integrated into its management systems. As a result of this strategic approach to sustainable development, the group has qualified for both the DJSI and FTSE4Good indices and in a study of the insurance sector carried out by the German agency Oekom Storebrand rated first.

As with internal management, financial groups must use sustainability to rethink its products, and if one part of the business equation is risk, then its counterpart is opportunity. The sustainability question offers new opportunities for financial groups to be innovative in developing new products, especially in the area of environmental technology. Companies bringing new environmental technologies to market often face difficulties securing financing, due to the extensive number of risks involved and/or the extended payback periods. Banks and insurers can facilitate the development of new, sustainable technologies by correctly pricing premiums to reassure investors.

Another example of product development involves re-thinking client relationships. In 1997, Storebrand developed and implemented a program to improve the environmental situation of

¹ In his essay, *Le Secteur des Assurances: un acteur clé pour le développement durable*, Eric Loiselet cites 6 roles that insurance plays: victim, investor, powerful shareholder, innovator, evaluator and polluter.

http://www.terra-nova.fr/Publications/Assurance-DD_Banques-Strategie.pdf

² <http://www.unep.ch/finance/stat-in.html>

the repair shops that were clients. The goal was to sensitize the repair industry to its environmental impacts and to offer concrete opportunities for improvement, such as recycling. Objectives included increasing the use of recycled parts and decreasing the negative effects of the chemicals used, especially the paint. This latter had very real consequences such as a high turnover and lost work time due to sick days. Developing new work methods and finding alternative products had a direct impact on the work environment of the employees. For the shop owners, the result was the reduced cost of repairs, and more importantly, the dramatic reduction of employee health problems with non-toxic paints. Storebrand could charge lower premiums, but with a reduced risk profile.

The third factor in our CSR strategy and in our approach to risk management has been sustainable investing. If environmental damage and social issues can have an impact on the liabilities of our balance sheet, then it could equally have an effect on our assets. In a sense, the Risk-Liabilities hypothesis could be extended to include how to reduce risk in managing money. The key question 1996 was how to incorporate such issues into the investment process of our funds management; the response was the creation of an internal department of extra-financial analysts, Socially Responsible Research. This decision to develop social and environmental indicators and an analytical methodology made it possible to screen for risk, as well as to evaluate the opportunities that sustainability offers. SRI favors companies which have begun such a process (EMS, training of employees to address changing environmental/social issues, sustainability included at the highest levels of decision-making, etc...). In this case, SRI screening becomes a long-term opportunity and not merely a short-term cost. In 2001, the SRI methodology set up by Storebrand Investments was cited as one of the top three among 77 asset managers by the Swedish think-tank Mistra.

A parallel challenge for the financial services sector managing their assets sustainably is real estate. Whether destined for corporate use or for housing, real estate has a veritable impact on the environment and on the social fabric of a community. Moreover, it offers an opportunity for competitive advantage in that both market demands and regulatory requirements will become more exigent. For the moment, few have considered the branding benefits from being able to offer socially- and environmentally-friendly products and services in this area. In our case, our real estate portfolio responds to internal environmental norms as we foresee that the market will continue to move in this direction.

As a financial institution and as a long-term investor, Storebrand's investments directly impact both the environment and our society. Investing can be via the companies in which our assets are invested or for others in the sector, via the projects that are funded with different lending instruments. It is in our interest to promote a strong and sustainable economy so as to insure competitive returns in the long-term. Promoting SRI – and urging others in the sector to do likewise – moves the economy in a direction that will be sustainable for our clients when they actually cash in their retirement funds.

The changes predicted for the economy in the years to come will certainly merit the risk analyses that have already begun but should likewise offer as many opportunities to those actors prepared to look. Sustainability might very well prove to be an excellent vector for better vision.