3.5: Sustainable Financing

Banks, credit unions, independent credit agencies, venture capitalists, and insurance companies are financial intermediaries that raise capital from investors and provide financing to operations with public and personal borrowing. Along with the wave of positive economic, social, and environment impact projects, government and financial institutions' attention has been drawn to the integration of green policies and practices for the financial services industry's operations, product offerings, distribution, and customer access to services. The insurance industry provides an excellent example of a proactive approach to ecologically friendly sustainability by offering green insurance to manage and reduce climate change risks.

Industry Principles and Standards

As a steward of the global economy, credit managers of financial institutions can base lending decisions on social, economical, and environmental guidelines that support sustainable businesses and their operations. There are two primary industry standards: the Equator Principles and the Wolfsberg Principles.

The Equator Principles. The **Equator Principles** promote social and environmental policies to increase the positive impacts on ecosystems and communities, offering a consistent approach to environmental sustainability and social management. Equator Principles relate to the management of social and environmental issues in project financing. An Equator Principles Financial Institution (EPFI) is a financial institution that has adopted and integrated all 10 Equator Principles. For any project financing deals above $10 million, EPFIs only provide financing to projects that are socially responsible and environmentally sound. The Equator Principles are used for establishing procedures and standards related to an EPFI's project financing activities. Currently, 65 international banks have become signatories to the Equator Principles.

The Wolfsberg Principles. With the concerted effort of 11 of the world's largest private banks and the anticorruption organization Transparency International, the Wolfsberg Anti-Money Laundering Principles for Private Banking (Wolfsberg Principles for short) were established in 2000. The **Wolfsberg Principles** provide guidelines specifically dealing with antimoney laundering, antiterrorism funding, and the identification and examination of unusual or suspicious activities. The principles also cover diverse policies that pertain to knowing your customers, especially for relationships between high net worth individuals and the financial institutions. So far, they are the best set of nonbinding guidelines concerning appropriate dealing between private bankers and global clients. Wolfsberg Principles deal primarily with appropriate monetary dealings between bankers and their customers.

A sustainability development program in banking would involve the adoption and incorporation of the Wolfsberg Principles and the Equator Principles into the banking business practices. The adoption of both of those principles by financial institutions gives rise to the opportunity for the provision of funding to ecologically friendly, socially disadvantaged, and economically underserved communities and sectors.

Sustainable Development Labeling Project. Significant progress has also been made to improve the quality of investment information provided by financial institutions. For example, French bank Caisse d'Epargne has recently launched a sustainable development labeling system, Bénéfices Futur, to rate savings, loan, and insurance products based on the impacts of financial risk, social responsibility, and ecological changes.Groupe Caisse d'Epargne (2008). The labeling system ranks bank products based on green marketing of products, accessibility of products, and the bank's investments in and donations to socially responsible sectors and projects that support public interest causes. The labeling system also rates financial products that help to identify gaps between actual and perceived coverage and specify deductibles and effective time periods. Caisse d'Epargne's sharing of the labeling system with other banks facilitates the spread of sustainability efforts in the banking industry.

Categories of Sustainable Financing

Green financing. Sustainable financing can be classified as either **green financing** or social financing. Greenfinancing enables investors to finance green projects less expensively, by offering attractive financing, a lower interest rate or tax incentives, and rebates for environmentally friendly investments and investment in green funds or bonds. An **energy-efficient mortgage (EEM)** is an example of a green finance opportunity. In the EEM case, lenders can make an adjustment to the loan-to-value and stretch debt-to-income qualifying ratios for borrowers with energy-efficient houses because of the projected monthly energy savings. For widespread adoption of green projects, financial institutions, residents, builders, and local government need to be equipped with affordable sustainability knowledge and practical information on how to finance those projects.

Social finance. Apart from being green, sustainable finance also involves social finance activities that enhance local communities and social development. **Social finance** enables the channeling of investment capital to deliver positive social, economic, and environmental returns for the long run and for a global community. These channels include, but are not limited to, community investing, social enterprise lending, sustainable business, philanthropic grant making, and program-related investments. The Center for the Development of Social Finance is a nonprofit education and research organization that strives to expand awareness of social finance.

Microfinancing has gained great exposure recently as a special variety of social financing. Microfinancing is access to capital for women, minorities, and low-income borrowers who are not able to access loans from traditional resources. Microfinancing provides smaller loans with favorable terms and, for some programs, requires no or little collateral. Microfinancing seeks to aid in the revitalization of urban and rural communities.

Some states have sustainable microloan fund programs for underserved sectors, low-income communities, small businesses, and farmers. For example, the Strolling of the Heifer's microloan fund offers loans anywhere from $1,000 to $10,000 for terms up to 3 to 5 years. Despite the relatively low budget, such programs are a good investment in the future health of the entire serviced region.Strolling of the Heifers (2009).

Microfinancing also involves making small loans (or microloans) to low-income businesses to stimulate economic growth in less developed countries. Grameen Bank, Kiva, and Prosper are examples of successful microfinance enterprises. Grameen Bank offers no-collateral microloans to 7.5 million women in Bangladesh. Dr. Muhammad Yunus, founder of Grameen Bank, won the Nobel Peace Prize in 2006 for this nonprofit microfinancing concept.

Both Kiva and Prosper provide Internet microcredit to support sustainable causes. Kiva enables quick access to funds for small entrepreneurs especially in Indonesia and India. The average loan from Kiva is around $110 to be repaid in 6 to 12 months with no interest charged. Fifty percent of those borrowers in India were able to graduate out of poverty with the help of Kiva.Malhotra (2008). Prosper links suppliers and demanders of funds in the developed and developing world.

Community Development Financial Institutions

As an integral member of communities, financial institutions provide support for sustainable community social and economic development and ecological conservation. Specializing in promoting economic and community development, **Community Development Financial Institutions** provide financing to small businesses and housing and community facilities projects that revitalize economically distressed communities. There are four types of community development financial institutions: community development banks, community development credit unions, community development loan funds, and community development venture capital companies.

Community Development Banks. Community development banks are for-profit banks committed to socially, economically, and environmentally sustainable community development. ShoreBank is the largest and most well-known community development bank in the United States and is the only one that takes into consideration all three dimensions of sustainability (social, economic, and environmental). ShoreBank opened in 1973 in Chicago and currently boasts $2.4 billion in assets and $4.2 million in net income with offices and businesses around the country and internationally; it is the nation's first community development and environmental banking corporation. ShoreBank defines its triple bottom line mission as profitability, community development impact, and conservation. Community development banks exist around the world, the most notable of which is Grameen Bank, as discussed under the topic of social finance.

Community Development Credit Unions. Community development credit unions (CDCU) are nonprofit, cooperatively owned, government-regulated, tax-exempt and insured financial institutions specializing in social financing. They serve low- and moderate-income people and communities by providing below-market-rate small loans to imperfect or no credit history borrowers and by offering financial education for its members. Major funding for CDCU institutions comes from banks, foundations, and other investors for deposits to support their work. Through partnerships with the private sector and participation in outreach and government programs, CDCU institutions are able to leverage community revitalization efforts. Federally chartered CDCU institutions are state regulated.

Community Development Loan Funds. Community development loan funds provide loan funds for businesses, nonprofits, and underserved areas for the purpose of economic development. Loan funds provide financing to traditionally unqualified borrowers who would use the funds for advancing sustainable actions. These loan funds require collateral, but they have flexible payment schedules. The government's sustainable development loan fund offers low interest loans up to $500,000 to businesses for green projects like utilizing sustainable resources, producing recyclable finished products, and installing pollution prevention procedures.

Community Development Venture Capital. Community development venture capital (CDVC) funds provide equity capital to entrepreneurial companies that will ultimately benefit low-income people and distressed communities. The amount of the investment funding from CDVC funds is generally less than that of their traditional counterparts. The average CDVC fund investment for small businesses was about $331,000 per company in 2000.Ward and Patterson (2003). Kentucky Highlands Investment Corporation (KHIC) runs a very successful rural economic development program. KHIC's ventures contribute at least 68% of the net growth of manufacturing jobs in Kentucky Highland's nine target counties from 1970 to 1990. The positive entrepreneurial capitalism spurs from the enhanced availability of community venture financing.Ward and Patterson (2003).