

Aligning Colombia's Financial System with Sustainable Development

CURRENT PRACTICE AND FUTURE POTENTIAL
TO MOBILIZE INVESTMENT FOR
THE GREEN ECONOMY



Inquiry: Design of a
Sustainable Financial System



IFC

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Acknowledgements

The report has substantially benefited from comments by Aditi Maheshwari from IFC and Nick Robins from the UNEP Inquiry. In addition Peter Cruickshank, Mahenau Agha, Sandra Rojas and Lani Sinclair provided important strategic, production and editorial support.

IFC's engagement in this initiative has been in partnership with Germany's Gesellschaft für Internationale Zusammenarbeit (GIZ).

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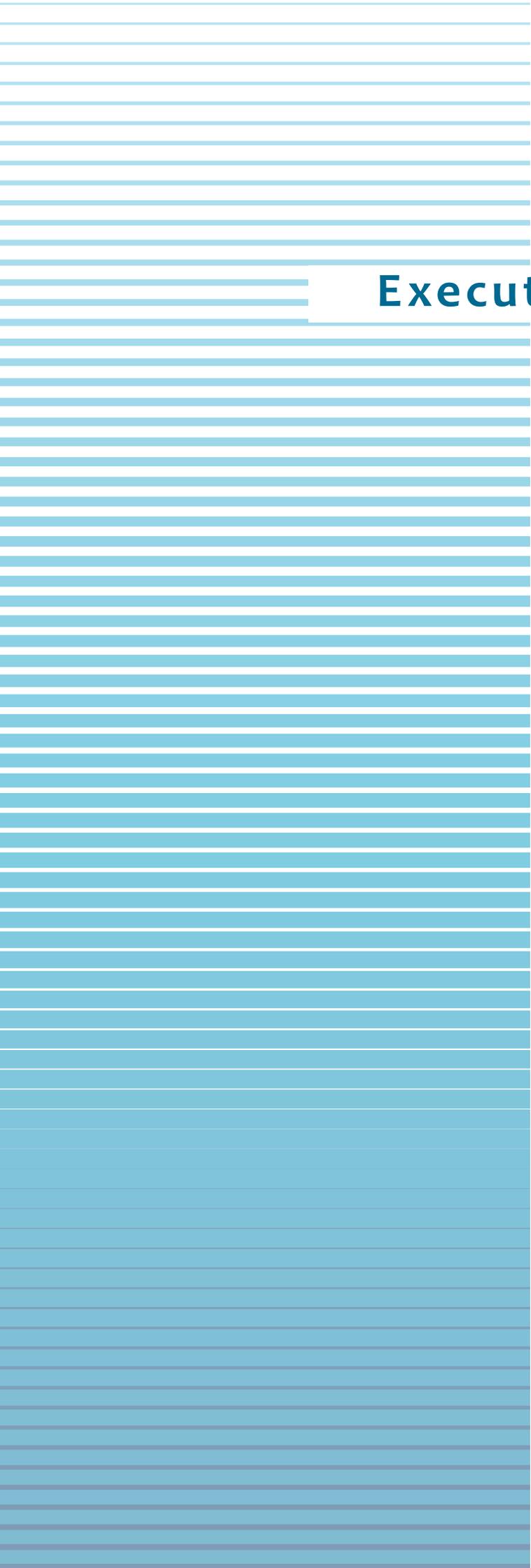
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Executive Summary

A range of factors is driving increasing focus within the financial system on the linkages with sustainable development. With a new set of Sustainable Development Goals from the United Nations (UN) to be agreed upon in September 2015 and the Climate Change Conference of the United Nations Framework Convention on Climate Change (UNFCCC) coming up in Paris at the end of 2015, national and international organizations are interested in providing enabling conditions for a greener economy.

In this scenario, the financial system plays a fundamental role in mobilizing capital to a greener economy and creating general awareness about the importance of this shift and the opportunities it creates. Domestic policies and frameworks play a critical role, and almost three-quarters of climate finance, one of the components of sustainable finance, originates and is being invested in the same country.¹

Sustainable or green finance, terms that will be used interchangeably in this document, refers to the capability of the financial system to integrate environmental, social, and governance (ESG) criteria in the investment or credit decision-making process, and to allocate resources in projects, financial assets, or portfolios with a positive impact on sustainable development challenges.

Since 2012, the G20 Development Working Group has been focusing on inclusive green growth and has asked the International Finance Corporation (IFC) to support its efforts to mobilize private investment, including from institutional investors, in this regard. Supported by Germany's *Gesellschaft für Internationale Zusammenarbeit* (GIZ), IFC is working with the G20's GreenInvest Platform to create the enabling environment and engage domestic investors in countries to support this agenda. The

United Nations Environment Programme (UNEP) recently initiated the “Inquiry into the Design of a Sustainable Financial System” (UNEP Inquiry) to advance design options that would deliver a step change in the financial system’s effectiveness in mobilizing capital toward a green and inclusive economy. Working in partnership, IFC and UNEP are exploring this topic in Colombia.

This document has been commissioned by the IFC and the UNEP Inquiry to explore the state of green finance in Colombia within the wider economic and financial sector context, and at the same time, to identify challenges and potential solutions that would enhance the application of environmental, social, and governance (ESG) criteria in the financial sector decision-making process and mobilize more investments for the transition toward a green economy.

The project involved two major steps: first, it undertook a holistic mapping of the Colombia green finance landscape with regard to the relevant stakeholders and the relevant types and volumes of finance, as well as current and planned financial policies, regulations, and standards; second, it then identified the challenges that prevent increased green capital flow, and discussed how these might be overcome.

The consulting team conducted more than 32 interviews with the heads of relevant institutions in the financial sector - specifically, private pension funds, private equity funds, insurance companies, commercial banks, development banks, asset managers, financial associations, government and regulatory agencies, and private standard setters, underpinned by desktop research based on public information sources.

ECONOMIC AND ENVIRONMENTAL CONTEXT

Colombia is one of the most dynamic emerging economies and has consistently improved its economic development indicators. In fact, GDP has grown at average rates of 4.7 percent (2003-2013), the inflation rate has dropped below 4 percent for the last five years, and foreign direct investment has multiplied by 10 in the last 10 years. However, in 2013, the oil and gas industry represented nearly 50 percent of exports, 16 percent of fiscal income, and 5 percent of GDP, which shows the importance of this carbon-intensive sector for the economy. Moreover, Colombia ranks as the 51st country in terms of the highest greenhouse gas (GHG) emissions per capita. In addition, the country is vulnerable to extreme weather events: over the past 40 years, natural disasters in Colombia have caused \$7.1 billion² in losses, with severe floods in 2011 causing an estimated of \$4.9 million³ in damage.

GREEN GROWTH POLICIES IN COLOMBIA

The Colombian Government has implemented three kinds of long-term development policies for green growth: strategic policies, operational policies, and specific incentives.



The strategic policies include the OECD Declaration on Green Growth and the National Development Plan 2014-2018 (in process of approval by the Congress) that defines a crosscutting strategy of Green Growth. The operational policies include the “Institutional Strategy for the Articulation of Policies and Actions Related to Climate Change” (CONPES 3700) that creates the National System for Climate Change (SISCLIMA) and the SISCLIMA Financial Committee. This category also comprises the Intended National Determined Contributions (INDC) and the National Green Business Plan at the Ministry of Environment. Finally, the government has developed specific incentives for green investments, such as economic incentives, tax-related incentives, and research and development (R&D) incentives.

Based on this policy framework, it is possible to determine a general estimate of the challenge that the Colombian economy faces in order to make the transition toward a greener economy. The National Development Plan 2014-2018 baseline document indicates total financing needs from the Green Growth crosscutting strategy of \$3.8 billion, mainly from public sources. Moreover, CONPES 3700 (Climate Change Strategy) also outlines general estimates for climate change adaptation and mitigation financing needs, using some of the main strategic projects at the country level. According to this estimate, the climate change component alone will require around \$3.2 billion, primarily from public sources; the full amount including private sources would be much larger.

GREEN FINANCE EXPERIENCE IN COLOMBIA

The Colombian financial system has reached a relevant size within the economy while enjoying a healthy position, characterized by controlled non-performing loan rates properly provisioned, solvency ratios above minimum requirements, and solid profitability measures.

Moreover, the financial system has made sound advances in the integration of ESG criteria into the decision-making process. The governance criterion has the longest trajectory of implementation, followed more recently by the environmental factor. The “Código País” experience related to governance criteria is an interesting example of how a new topic can be integrated into the financial sector agenda, creating general awareness, and becoming a useful tool to strengthen risk analysis. However, new and emerging sustainability risks (different than transparency, corruption, and governance structure risks) such as stranded assets risk, climate risks, and social risks, among others, have not been fully integrated into the financial institutions’ risk assessment.

Commercial and development banks present the most relevant advances in green finance among the financial subsectors. However, there is still a gap in integrating green finance into the banks’ core business. Banks are using relevant frameworks for integrating sustainability criteria into their decision-

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