Financing the low-carbon economy

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2015 marks the 150th year since HSBC first opened its doors in Hong Kong.

It was founded with a clear purpose – to finance trade between Asia, Europe and the Americas – and to help our clients to grow strongly and sustainably.

Throughout those 150 years, in common with other banks around the world, HSBC helped finance some of the great scientific and financial shifts that mankind has seen.

The industrial revolution, the mechanised age and the dawn of the microchip were all driven by the marriage of technology with innovation.

But it was the financial system that made them possible, and which spread their benefits across regions and continents, building prosperity and improving the lives of millions.

Today we are on the verge of another great economic and social shift – one which I believe will be at least the equal of all of those that I have already mentioned.

And if climate change is a by-product of that same ingenuity that has immeasurably improved living standards, it is the ability to innovate that will help us overcome the problems that it causes.

The job of financing that change is unprecedented in scale and must be shared across the financial system.

So I want to give some thoughts today on how we can spread that burden and ensure that every section of the global economy is able to make the contribution that necessity demands.

We already know that 2015 will be a pivotal year.

There are grounds for cautious optimism that this UN summit and COP21 in Paris will lead to a global agreement on tackling climate change.

In the private sector, we strongly support these negotiations. As a member of the WEF Climate Leaders CEO Group and a signatory to their open letter to policymakers, I have already added my own voice to the call for action.

But joint commitments are just the beginning. We have to deliver on them too.

That delivery comes at a considerable cost.

The World Economic Forum estimates that $5tn of infrastructure funding is required every year between now and 2020. But it will take an extra $700bn a year to make it sustainable.

HSBC estimates that we are $300bn a year short of this $700bn target. That is a funding gap roughly the size of the economy of Singapore.

So we have to meet the twin challenges of providing the finance to fund the changes we need; and channelling it to where it’s needed.

What is already clear is that no one sector of the global economy can do this alone.

We can’t assume that the answers will come from more developed economies, or that governments alone can bring about change.

It requires a truly global effort that spans public and private sectors, new and old industries, and developed and developing markets.
The public sector has two roles to play - to direct resources at its disposal and to create the conditions to unlock private sector investment.

Creating the right incentive frameworks to support the low carbon economy is critical and we welcome the progress that has already been made.

But some frameworks are easier to create than others, and we need to balance the need to reach agreement over the most effective solutions with the urgency required to make the biggest difference in the shortest time.

Carbon pricing has long been discussed as an important incentive for sustainable investment and a means to raise revenue for low-carbon funding.

It’s right that we should try to assign monetary value to greenhouse gas emissions to provide the effective signals for the market to change, but reaching agreement is far from straightforward.

If it can’t be achieved quickly then we need to consider other regulations that can have the same effect.

One way might be to reallocate the 4.9 trillion dollars of fossil fuel subsidies that the IMF estimates are distributed globally each year.

Another might be to encourage the linkage of regional carbon pricing schemes, as we have recently seen between California and Quebec.

Taken together, these could raise the kind of sums that the public sector needs to provide.

The private sector has to deliver too.

That means raising the money it needs to transform the way it operates, while adopting sustainability as a pivotal metric in investment decisions.

A true public-private partnership means sharing the burden as well as the reward, and bearing the risk as well as the cost.

There are three major barriers to private sector investment in better infrastructure and low carbon energy.

The first is policy uncertainty.

Infrastructure has a long lead-time which extends far beyond the average political cycle.

Investors want to invest, but they need the assurance that any project commitment can withstand a change of government.

This doesn’t have to mean an inflexible commitment in all circumstances, but it does mean that any conditions for withdrawal are clearly defined.

The second is a poor understanding of climate risk.

The time-lag between the emission of greenhouse gases and the problems they cause makes it hard to factor in when investors allocate capital.

Increasing the visibility of climate risk would reduce the incentive to maintain a heavy carbon footprint in an investment portfolio, and at the same time incentivise companies and financial institutions to measure and reduce their own carbon footprint.

China is taking a lead by examining linking capital requirements to climate risk, while France has already mandated disclosure.

But this creates a separate problem for central banks and regulators who need to know about and respond to the risks to financial stability posed by exposure to high carbon infrastructure for example or to other “stranded assets”.

The work that the FSB is doing on climate risk is very welcome, but the job of propagating its findings to investors falls as much to banks and insurers as to public sector bodies.

The third barrier is the lack of transparent, detailed, consistent disclosure to allow investors
to make informed investment decisions based on sustainability.

Earlier this week, HSBC’s Asset Management business signed the Montreal Carbon Pledge. This commits us to measure and publicly disclose the carbon footprint of our clients’ investment portfolios on an annual basis.

It also means that the ability to obtain the data we need to fulfil our pledge becomes a crucial part of the investment decisions we make.

Creating a common, unified standard around reporting and certification—what it should look like and how regular it should be—is essential to making this work.

Pressure to make this happen should be top-down and bottom-up—agreements like the Montreal Pledge should encourage companies to provide the disclosure that investors need, but coordination from the public sector would provide firm momentum to an otherwise piecemeal process.

The ability to channel green finance to both the public and the private sectors will be underpinned by strong, deep and efficient capital markets.

We have to bring the green bond market up to scale.

This will only happen if we create the right incentives and eliminate disincentives within the regulatory system.

The appetite for this investment category is more and more obvious.

Over the last three years the green bond market has grown ten-fold from 3 billion to 37 billion dollars, and in the last year alone we have seen a tripling in issuance.

But this is still a long way short of the $700bn of climate finance that we need to raise annually.

Increasing the corporate appetite for green bonds is one part of the solution.

At first the market was driven almost entirely by the public sector. Before 2013 there was not a single corporate green bond. But last year corporates represented a third of the market.

Corporates not only add depth to the market, they also broaden the geographic range of potential investment opportunities, and offer a choice of yield and maturity options.

Where possible, banks and other large corporates need to take the initiative in helping the green bond market to evolve to meet expanding demand and introduce new types of investor.

In June last year HSBC helped the International Finance Corporation issue the world’s first renminbi green bond, adding a new denomination on top of the euro and the dollar.

This was a highly significant step.

China’s huge pool of savings and limited investment opportunities create the perfect match for a global green bond market hungry for new entrants.

Chinese investors have a huge pool of savings but relatively few opportunities to invest.

And the Chinese government has been increasingly vocal in the need for sustainability to be one of the foremost considerations for Chinese businesses and Chinese investors in the future.

As the green bond market moves from a niche sector to the mainstream, it will only increase the number of financing and investment options and advantages for all market participants.

I’d like to say a final word on the role of business more generally.

Lots of businesses—including HSBC—are still figuring out precisely what their role needs to be. It’s why attending gatherings like this is so important.
But I think it would be extreme folly to mistake inaction on the part of business for a broader unwillingness to act.

The vast majority of the clients that I encounter on a regular basis – whether in Asia, Europe or the Americas - desperately want to do more to make their business more sustainable and climate-friendly.

They want to do their part.

But they also lack a clear understanding of what they need to do and how they can do it.

One of the things that HSBC has done is to set up and support a Climate Change Centre of Excellence to provide the research to help our clients and others comprehend the problems we all face – and also to uncover and bring to market the financial technology to help us meet the challenge.

There is also great pressure on investors and banks to withdraw finance from carbon intensive sectors.

I don’t agree that this is always the best route to adapt to climate risk.

We have to work with clients and support them through a just and orderly transition to a lower-carbon future – not walk away and ignore the problem.

That is not to say that we can’t take steps to tackle the most significant contributors to climate change.

HSBC has introduced policies to restrict lending to companies that cause deforestation or build and run inefficient coal-fired power plants.

But these are voluntary steps that can be made more effective by public sector backing through national regulations and incentives.

It’s through measures like these that Governments and businesses can work together to reduce the flow of finance to the high-carbon economy in a way that creates a smooth transition to a low-carbon future.

Let me end on a note of optimism.

There’s no question that the task of providing the finance needed to make the transition to a low-carbon economy is equal in magnitude to any of the great financial shifts in the last 150 years.

But the financial system has time and again been the equal of any of the challenges put before it.

By applying the same ingenuity to the problems of our own age, we can surpass the achievements of our forebears - but only if we demonstrate the same spirit of partnership, reciprocity and understanding that has been so apparent in recent discussions.

I have been greatly heartened by the conversations I have had over the past few weeks, and I’m truly optimistic that we travel to Paris with an excellent chance of concluding a successful round of negotiations.

HSBC stands ready to play its full part, and to work with all of our peers and partners to build the climate-friendly future to which we all aspire.

Thank you.