THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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Vladivostok, Russian Federation

Meeting Paper 6-E

Issues on Climate-Smart Financial Services

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PURPOSE	For consideration.
ISSUE	Issues on climate-smart financial services
BACKGROUND	JICA, which undertakes technical assistance on various issues, including financial inclusion, is one of the partner institutions in the Advisory Group, and is proposing some ideas on promoting climate-smart financial services as part of the financial inclusion agenda.
PROPOSAL	Study more deeply policies, institutional frameworks and good practices for climate-smart financial services as part of work on inclusive finance.
DECISION POINT	Include the proposals among issues for the Advisory Group's discussions in 2013.

Issues on Climate-smart Financial Services

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Inclusive finance has to fulfill both financial sustainability and **social responsibility**, the latter of which includes consumer protection, poverty reduction and **environmental responsibility**. Environment should encompass not only surrounding or regional one but also **global** one. Now climate change is the most pressing global environmental issue.

However, poor households or micro/small entrepreneurs are **not interested** in borrowing or saving for the purpose of improving global environment although they are the most **vulnerable** to the coming climate change. Hence, financial institutions do not have sufficient motivation to promote climate-smart financial services to their clients.

JICA's past experience shows that even large companies were reluctant to borrow funds for environmental compliance or improvement. Only when an investment is profitable with **efficiency gains**, which contribute to better environment at the same time, they borrow. Similarly, MFI clients may use financial services for investing in a solar panel, which contributes to the alleviation of climate change, only when it is the best financial option for their daily life. Then, how can we find out the **financially best solution** to clients, not only without damaging our planet but also with **alleviating climate change**? Who is responsible for identifying such a **co-benefit solution** with financial services to consumers? What are the roles of financial institutions, governments, donors and investors? What are policy, institutional and technological options?

Also, poor households and entrepreneurs may use financial services for **adaptation to climate change** if they understand that their life is or will be affected adversely by climate change. For example, poor farmers may borrow funds and invest in expensive seeds which are more resilient to climate change or buy a crop insurance product in preparation for possible extreme weather once they are **convinced with the benefits**. Then, how can we make clients understand an imminent threat to their modest life and the necessity of preparation by using appropriate financial services? Who is responsible for persuading clients towards **smart behavior** from the viewpoint of climate change adaptation? What are the roles of financial institutions, governments, donors and investors? What are policy, institutional and technological options?

People, including the poor, may claim that additional costs for adaptation should be **subsidized** by the public sector, or rich countries which have mainly caused climate change so far. In the case of JICA-supported reforestation programs in India, the extremely poor villagers were ready to join reforestation works and to maintain forests in a sustainable manner while enhancing their livelihood with microfinance activities until the timing of harvesting forest products, because they understood that they had been responsible for degrading village forests with their malpractices. If climate change, not the behavior of villagers, is presumed to cause the degradation of forests, it is quite doubtful for poor villagers to participate in rehabilitating forests, with certain cost and risk sharing, as an adaptation measure. In many cases we do not know exactly who is to blame for such a situation that requires adaptation. When causes are known, how much subsidies can be justified, and who should bear **additional costs**?

In spite of all these thorny issues, policies, institutional frameworks and good practices for climate-smart financial services have to be studied deeply due to the reasons that; first, all of us cannot avoid tackling the issue of climate change immediately; second, the exact clients whom we are trying to support with inclusive financial services are the most vulnerable to climate change and need urgent attention; third, **climate-responsible financial services involving the masses** have a possibility of contributing to solving the climate change issue together with other policy interventions; and last, as in the case of reducing poverty, if inclusive finance becomes responsible enough to promote the poor's adaptation to climate change, or even to promote the poor's and the industry's great contribution to the alleviation of climate change, it could induce the more environmentally, as well as socially, responsible behavior of **the mainstream financial sector**, which is required to be more ethical at this juncture.

Needless to say, climate-smart financial services have to be envisaged from the perspective of **poor clients** with due consideration to the global environment and our future generations who will inherit that environment.