A **UN ENVIRONMENT – WORLD BANK GROUP** INITIATIVE

ROADMAP FOR A **SUSTAINABLE FINANCIAL SYSTEM**

EXECUTIVE SUMMARY

Inquiry: Design of a Sustainable Financial System

November 2017

UN Environment

The United Nations Environment Programme is the leading global environmental authority that sets the global environmental agenda, promotes the coherent implementation of the environmental dimension of sustainable development within the United Nations system and serves as an authoritative advocate for the global environment. In January 2014, UN Environment launched the Inquiry into the Design of a Sustainable Financial System to advance policy options to deliver a step change in the financial system's effectiveness in mobilizing capital towards a green and inclusive economy – in other words, sustainable development.

This report is the third annual global report by the UN Environment Inquiry. The first two editions of 'The Financial System We Need' are available at: *www.unep.org/inquiry* and *www.unepinquiry.org*.

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The World Bank Group

The World Bank Group is one of the world's largest sources of funding and knowledge for developing countries. Its five institutions share a commitment to reducing poverty, increasing shared prosperity, and promoting sustainable development. Established in 1944, the World Bank Group is headquartered in Washington, D.C.

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Historically the financial system has responded to the needs of the time. A global consensus has arisen that sustainable growth will be one of the greatest challenges of the 21st century—as demonstrated by the United Nations (UN) Sustainable Development Goals (SDGs) adopted as part of its 2030 Agenda for Sustainable Development—along with the measures to combat climate change and adapt to its effects that are part of the Paris Agreement. As in previous structural transformations, the financial system will play a major role in this process: the full potential of the financial system needs to be harnessed to serve as an engine in the global economy's transition toward sustainable development.

The objective of this Roadmap is to propose an integrated approach that can be used by all financial sector stakeholders—both public and private—to accelerate the transformation toward a sustainable financial system. This approach can bring policy cohesiveness across ministries, central banks, financial regulators, and private financial sector participants to focus efforts.

The ultimate vision that the Roadmap seeks to reach is one of a financial system that integrates sustainability considerations into its operations, including the full costing of positive and negative externalities that sustainability implies, leading to a reorientation of the flow of resources toward more inclusive and sustainable activities.

THREE DRIVERS OF CHANGE

The ongoing transition toward a sustainable financial system is taking place through the interaction of three types of initiatives:

1. *Market-based initiatives.* Through the development of collective initiatives such as the Sustainable Banking Network (SBN) and the United Nations Environment Programme – Finance Initiative (UNEP FI), private and public finance institutions have worked to integrate environmental and social risks and opportunities into their business lines and approaches.

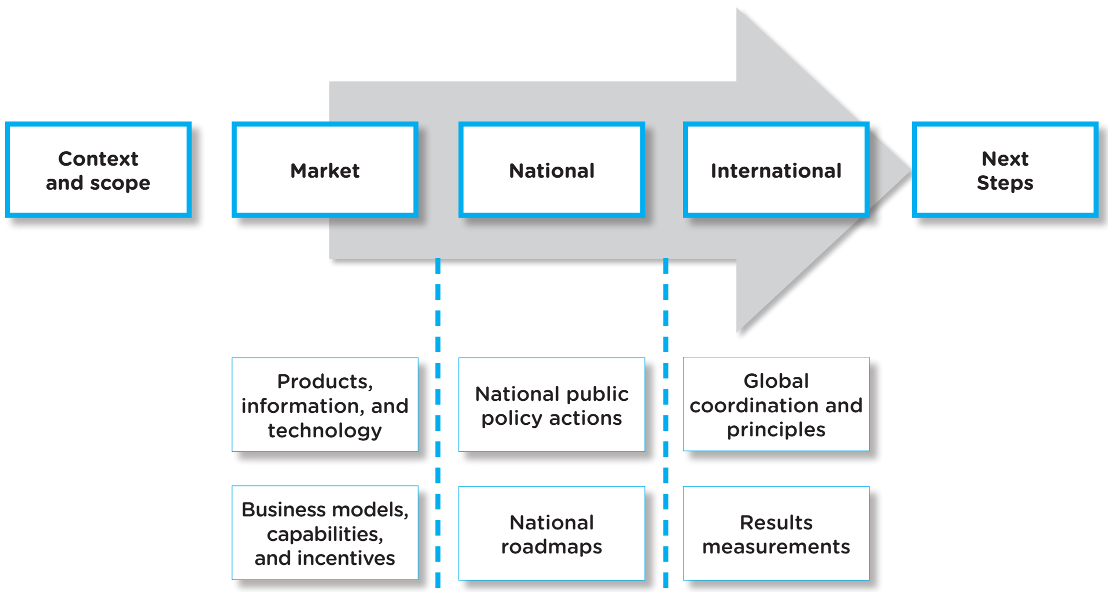
2. *National initiatives.* The initial momentum for sustainable finance has been driven by country-level initiatives that, in many cases, arose from national planning processes to implement climate change policies or other long-term strategic development initiatives.

3. *International initiatives.* Cooperative efforts carried out by the G20, the G7, the UN, and the Financial Stability Board (FSB) have all addressed different aspects of sustainable and green finance while at the same time increasingly involving the private sector. This effort has been complemented by the multilateral development banks (MDBs) and other international financial institutions (IFIs) that are continuing to actively promote sustainable finance with initiatives ranging from the adoption of sustainable practices in their core financial activities to the launching of new products aimed at driving capital to sustainable and green applications.

STRUCTURE OF THE ROADMAP

The Roadmap document is structured in five chapters that use the three drivers of transformation toward sustainable finance as its organizing principle (Figure ES.1).

FIGURE E.1 Roadmap Structure



Source: UN Environment/WBG Roadmap Team.

MARKET-DRIVEN TRANSFORMATION

Markets have led the development of sustainable finance products, information, and technological innovations. More recently financial institutions (FIs) have started turning to adapt their business models, skills, and incentives to embed sustainability into their core strategies. The process of market transformation needs to be accelerated to meet global sustainability demands. This will require enhanced coordination with national and international initiatives to facilitate the process of FIs transitioning toward sustainable finance as well as additional regulatory prodding to increase the pace of change.

Products, Information, and Technology

Sustainability considerations are transforming the real economy, and the financial sector is evolving to respond to that reality. FIs are realigning existing products as well as creating new ones to match the risk-reward and maturity needs of sustainable investments. The expected financing needs are large: a review of the Nationally Determined Contributions (NDCs) and other policies in 21 developing countries that represent 48 percent of global greenhouse gas (GHG) emissions finds an initial investment opportunity of US$22.6 trillion from 2016 to 2030 in key sectors. Although these estimates refer to levels of investments, most of these resources are intended to flow through the financial sector as bank lending, project finance, institutional investing, or equity investing.

Further growth in the supply of sustainable finance requires addressing important information gaps. Information relevant to sustainable finance will be critical to ensure the alignment of incentives, results measurement, proper valuation of assets, and effective risk management. Current efforts to move to a more advanced disclosure paradigm are uneven across asset classes and jurisdictions, but consensus is building around methodologies for the disclosure of certain types of information (such as the carbon footprint of investment portfolios). Measuring flows and stocks of green financial assets requires converging on criteria and methodologies to identify these assets in FIs and investors' portfolios. Identifying these assets is not only critical to assessing the evolution of the financial sector towards sustainability, but also permits measuring the risk performance of, for example, green assets, and contrasts them with non-green ones.

Digital finance, or innovative financial technology—*fintech*—has emerged as a powerful disruptor that is rapidly reshaping the real economy and the financial sector on a global scale. Digital finance has the potential to deliver environmental outcomes and support a transformation in financing for sustainable development by, for instance, mobilizing capital for critical priorities and mainstreaming social and environmental factors throughout the financial system. Ultimately, the impact of digital finance will depend on a number of policy and regulatory innovations that enable scaling and minimize its potential negative unintended consequences, such as cyber security risks.

Business Models, Capabilities, and Incentives

Sustainability considerations should be established as a key strategic pillar by shareholders and the senior management of FIs. Sustainable finance requires a strong commitment from owners and managers to make sustainability considerations a primary component of business strategy, not a niche area associated with other initiatives that—while also important, such as corporate social responsibility and environmental risk management—are not at the core of most FIs' business strategies. Putting sustainability considerations front and center requires incorporating sustainability strategies into the process to allocate resources—both the firms' own capital and intermediated resources—in support of creating new sustainable businesses lines, fostering the growth of existing ones, and moving away from activities not aligned with sustainability.

The capacity of financial sector stakeholders to use sustainability information needs to be enhanced. Differences in the familiarity, understanding, and capabilities of practitioners related to sustainability factors affect the capacities of institutions to appropriately consider and act on risks and opportunities stemming from sustainability factors. Gaps in skills, inadequate institutional frameworks, and a lack of clear leadership signals can hinder efforts to respond to dynamic market conditions, changing client demand, or new regulatory requirements, potentially posing competitive disadvantages. Because skills upgrading can pose significant costs to institutions, a lack of understanding of a clear business case for engagement on sustainability issues can further compound capacity issues. Capacity issues related to sustainable finance are also a pressing challenge for public authorities, including financial supervisors, regulators, and governments. Finally, a lack of understanding of the financial dimensions of sustainability challenges—such as investments in energy efficiency—can constrain consumer demand for sustainable finance products.

Ultimately, the success of efforts to effectively integrate sustainability information into financial decision making is significantly influenced by the incentives that shape practice within FIs. If information is available, and readily understood by practitioners, transformation is contingent upon the core values, culture, and policies of firms—which at their core are motivated by incentive structures. Increased sustainability disclosure in financial markets contributes to help align incentives *across* participants in the financial system. The cultural change needed in the transition to sustainable finance also requires an appropriate alignment incentive *within* FIs. This requires incorporating sustainability targets into the usual business key performance indicators to which officers in the institution are held accountable, as well as ensuring that initiatives such as internal carbon pricing are used to direct business units' behavior.

NATIONALLY DRIVEN INITIATIVES TOWARD SUSTAINABLE FINANCE

The multiplicity of market failures that constitute barriers to sustainable finance require governments to kick-start, sustain, and accelerate its development through the use of fiscal resources and public policy measures. A systematic approach is necessary to select government interventions; this can be accomplished through the development of national sustainable finance roadmaps with broad support across all parts of government and the private sector.

Public Finance Measures

Government responses with fiscal implications can be categorized into four categories depending on the area of involvement and instruments. Figure E.2 categorizes government interventions in support of sustainable finance that imply financial outlays or revenues forsaken. This is not meant to be a full catalog of potential interventions, but a categorization that can guide the development of specific national approaches.[1] The first (horizontal) dimension refers to whether or not actions are taken directly in support of the financial system or whether they seek to support the real sector of the economy or other parts of the government to facilitate their engagement with the financial sector. The second axis (vertical) categorizes them according to the mechanism used: direct financing, which includes risk sharing mechanisms; or activities in support of the "enabling environment" that would facilitate the operation of a sustainable financial system.

Financial Policy and Regulation

Public authorities—including governments, central banks, regulators, supervisors, and other bodies—are taking legislative, policy, regulatory, and supervisory steps to achieve a range of objectives linking sustainability and the financial system, such as:

- Enhancing market practice, including efforts that mainstream environmental factors into financial decision making and correct for market failures (such as unpriced environmental externalities);

1 For a detailed description of certain types of interventions see, for example, Morgado and Lasfargues 2017.

FIGURE E.2 Typology of Public Finance Interventions in Support of Sustainable Finance

Mechanism	Support Area: Financial Sector	Support Area: Real Sector
Financing / Risk Sharing	**I** → Matching grants → Guarantees and other risk sharing instruments → Long-term credit lines → Innovative transactions → Government investment guidelines(central bank, pension funds) → Tax-advantaged provisions for financial instruments	**II** → Grants → R&D subsidies → Tax exemptions → National procurement policies → Direct fiscal stimulus
Enabling Environment	**III** → Capacity building for financial sector stakeholders → Data provision	**IV** → Development, dissemination, and training on disclosure rules and other standards related to sustainable finance → Capacity building

Source: UN Environment/WBG Roadmap Team.

- Supporting market growth, including policy frameworks and standards that promote the issuance of green financial products (that is, green bonds and securities), the development of new market platforms (that is, crowdfunding and fintech), or the competitiveness of financial centers;

- Promoting transparency and efficiency, by improving flows of sustainability information through the financial system through voluntary guidance, labeling schemes, or mandatory requirements;

- Strengthening risk management, often by integrating environmental factors (such as physical and transition-related climate risks) into the prudential oversight of FIs, supervising financial markets, and providing sector and system-level stress testing;

- Facilitating flows and services, with investment and lending to priority sectors, restrictions or limitations on financing, insurance requirements, or the provision of financial services as a way to promote inclusion and support development;

- Clarifying legal frameworks, including the fiduciary responsibilities of FIs, with respect to long-term risks and opportunities (such as climate change); and

- Enhancing conduct and behavior, with codes of conduct and guidelines for environmental issues and compacts with FIs.

National Roadmaps

A growing number of countries are developing sustainable financial system policy frameworks. However, these are often not joined up or focused in a strategic way. National sustainable finance roadmaps have been launched in many countries over the past year. These identify system-wide needs, barriers to scaling up, and priority actions. Examples of these countries include Argentina, China, Indonesia, Italy, Mongolia, Morocco, Nigeria, Singapore, and South Africa. The specific mix of policy-led, market-led, and public-private initiatives in each country is a function of national development priorities and, as such, varies considerably. However, all have at their core the development of long-term, systemic plans to enhance the ability of the financial system to mainstream sustainability factors into decision making and to mobilize predominantly private capital for sustainable investment.

Based on an analysis of existing national roadmaps as well as engagement with stakeholders in other countries currently undertaking this process, roadmaps for sustainable finance are more likely to enjoy broad support and increase their opportunity of success if they include key components grounded in a systematic assessment of overall needs, estimation of required financing, identification of barriers, and identification of suitable policy measures whose progress and impact can be readily measured.

INTERNATIONAL COORDINATION AND SUSTAINABLE FINANCE

Meaningful global action requires global principles that can guide concerted international, national, and market-driven progress toward a sustainable financial system. Achieving sustainable development is, by its own nature, a global challenge because no country can be on a long-term sustainable path alone given the interconnectedness of problems such as climate change, communicable diseases, and biodiversity loss. International collective action is therefore critical to ensuring the alignment of ongoing efforts to support the development of sustainable finance. Maximum impact can be accomplished by embedding sustainability considerations into existing financial sector principles and standards.

Global Coordination and Principles

Establishing general principles does not imply standardization but rather an alignment of efforts. It is important to emphasize that agreeing on certain principles is very different from trying to standardize measures to develop a sustainable financial system across countries or even across different parts of the financial sector. Certainly the needs of developed countries with deep financial markets are very different from those of developing countries with substantial financially underserved populations. Similarly, efforts to develop sustainable banking in the retail segment are very different from efforts targeting large institutional investors and capital markets. The aspects to be considered in developing these principles (Box E.1) aim to follow the approach previously used in other components of the financial sector to guide and facilitate the development of initiatives and policies aligned toward a common global goal. Agreement on these principles does not imply the creation of new standards but rather the incorporation of sustainability consideration into existing ones.

BOX E.1 Key Considerations for Developing Principles of Sustainable Finance

System-wide

- Make a statement defining the long-term objective of the financial sector in the context of sustainability.
- Agree on an approach to incorporate sustainability considerations to ensure the effectiveness, efficiency, and soundness of the global financial system.

Disclosure

- Establish approaches and methodologies to disclose the sustainability impact, opportunities, and risks arising from financial sector activities as well as the sustainability risks affecting the financial sector.
- Consider including sustainability information from the financial sector into the policy-making process to ensure that both the financial sector and the other relevant sectors (for example, environment, education, and so on) are directed toward sustainability objectives.

Business practices

- Price sustainability impacts, risks, and opportunities and incorporate them into financial institutions' strategies, governance, and business decision-making processes.
- Develop transition plans toward sustainable finance, with financial institutions identifying activities to be increased as well as business lines that need to be reoriented toward sustainability.

Financial instruments

- Agree on criteria to identify financial instruments and specific transactions aligned with sustainability objectives.
- Define mechanisms to promote innovative financial mechanisms, including through active regulatory encouragement, to increase the depth of sustainable financial markets.

Collaboration and alignment of efforts

- Develop mechanisms to promote and allow collaboration and sharing of information between financial sector participants on approaches, methodologies, and business practices for sustainable finance.
- Seek alignment of international and national policies, standards, and results measurement to ensure consistent global approaches that fit national needs

Results Measurement

To deliver the required transformation in the financial system, a performance framework is needed so progress can be measured. This framework would allow governments, IFs, and citizens to identify successful approaches, as well as areas lagging behind, thereby laying the basis for strategic adjustments in both policy and practice. Over the past five years, increasing efforts have been placed on how to measure the contribution of the financial system to sustainable development, specifically in the environmental dimension. Measuring progress to a sustainable financial system involves gaining an understanding of three core performance characteristics:

1. *Effectiveness.* The degree to which the market prices sustainability factors in asset valuations

2. *Efficiency.* The costs of running the financial system that delivers the flows of finance aligned with sustainable development requirements

3. *Resilience.* The strength of the financial system in the face of disruptions related to unsustainable development such as air pollution, climate change, or water scarcity

Understanding performance against these characteristics requires a focus on three key dimensions:

1. *Architecture.* This covers the principles, norms, standards, rules, regulations, and policies that directly or indirectly contribute to the sustainable development of finance. Metrics are needed that measure the degree to which the "rules of the game" are aligned with sustainable development needs.

2. *Markets.* This covers the behavior of market participants and the degree to which they are integrating environmental, social, and governance factors into their activities and the transparency with which they describe their sustainability efforts.

3. *Flows and stocks.* This covers the allocation of capital and financial services to both sustainable and unsustainable assets.

NEXT STEPS

Maintaining the momentum of the ongoing transition toward sustainable finance requires concrete actions to support the implementation of many of the measures described in each one of the chapters. This process is anchored in a continuing consultation process over the next 24 months combined with a series of actions that will benefit from that process, leverage ongoing initiatives, and support the design and implementation of new ones. Some of these initiatives will be coordinated by UN Environment and the World Bank Group, while in some other cases, part of the consultation process aims to identify the international, regional, and national institutions that may be better placed to lead each activity. Table E.1 summarizes the vision of the outcomes associated with each one of the areas discussed in the Roadmap along with an outline of proposed next steps to achieve those outcomes and their expected timing. *Short-term* initiatives are expected to be completed by the end of 2018. *Medium-term* initiatives will be completed within the next 24 to 36 months.

TABLE E.1 Summary of Next Steps and Timing

Area	Short-term initiatives	Medium-term initiatives
Products, information, and technology	• Leverage existing partnerships to develop and implement methodologies to identify green assets. • Support embedding market-relevant sustainability information into the financial data ecosystem. • Support additional research into the risk performance of green assets. • Support the implementation of the TCFD recommendations in a pilot group of countries. • Establish a cooperative platform and/or industry task force of leading fintech companies, working with others to influence enabling business, policies, and standards to effectively connect fintech and sustainable development.	• Design and execute a set of key transformational transactions that can trigger new sustainable finance products. • Establish "challenge prizes" or other types of innovation funds to stimulate the development of new products and technologies in support of sustainable finance.
Business models, capabilities, and incentives		• Leverage existing market-led initiatives—such as the Sustainable Banking Network—or create new ones, to expand the skills of FIs necessary to embed sustainability considerations overall strategy and into day-to-day operations. • Develop a framework to align institutional incentives within FIs to sustainability considerations, including developing an understanding of the needs of financial sector users.
National public policy actions	• Review and classify different types of fiscal and policy interventions to create a framework to diagnose market failures and identify responses at the national level.	• Incorporate sustainability considerations into national fiscal frameworks, including a review of the effectiveness of fiscal interventions and subsidies in support of green activities and expenditures in unsustainable activities, including fossil fuel subsidies.
National roadmaps	• Support the development of national roadmaps in key countries.	
Global coordination principles	• Launch a consultation process to converge in the next 24 months in a set of global principles for sustainable finance.	• Promote the inclusion of sustainability considerations into global financial sector oversight and cooperation frameworks.
Results measurement		• Develop a results measurement framework for sustainable finance. • Promote the inclusion of sustainability data as part of global financial reporting frameworks (for example, central bank reporting to the IMF).

Note: FIs = financial institutions; IMF = International Monetary Fund; TCFD = Task Force on Climate-related Financial Disclosures.

Notes

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