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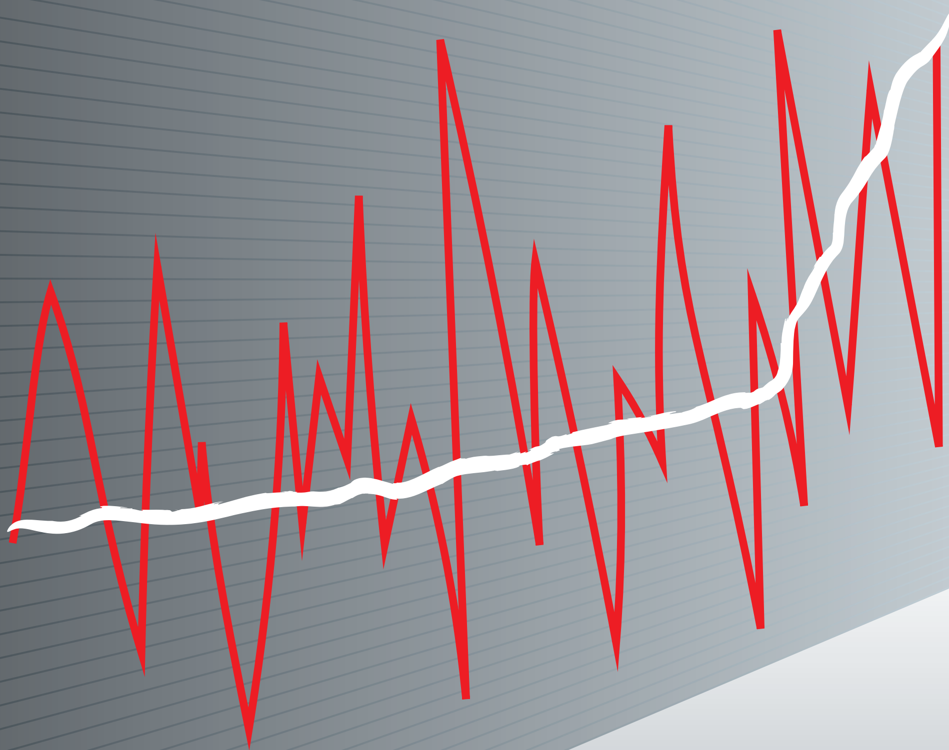

FINANCING SUSTAINABLE DEVELOPMENT

MOVING FROM MOMENTUM TO TRANSFORMATION IN A TIME OF TURMOIL

Inquiry: Design of a Sustainable Financial System

The Inquiry

The Inquiry into the Design of a Sustainable Financial System has been initiated by the United Nations Environment Programme 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. Established in January 2014, it published the first edition of 'The Financial System We Need' in October 2015. The Inquiry's mandate currently extends to the end of 2017, with work focused on deepening and taking forward its findings.

The UNEP Inquiry is pleased to work in association with the UNEP Finance Initiative.

More information on the Inquiry is at: *www.unep.org/inquiry* and *www.unepinquiry.org* or from:

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This report

Simon Zadek and Nick Robins are the Inquiry's co-Directors, and the lead authors of this report. It draws on a meeting on Financing Sustainable Development co-hosted with UN Women in New York on 24 August 2016.

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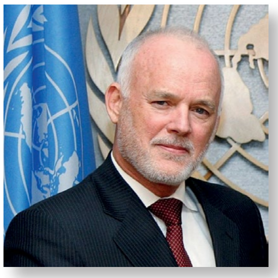
FOREWORD



The seventy-first session of the United Nations General Assembly must accelerate momentum on the 2030 Agenda for Sustainable Development and realizing the urgent ambition of the Paris Agreement. Key to achieving such momentum is the mobilization of the necessary finance. Yet today, we are simply not on track to secure this finance, endangering current and future generations.

It is not enough to just wish there was adequate public finance, or to wonder why the large amounts of private finance seems so hard to persuade to invest in the right things. As the Addis Ababa Action Agenda on Financing for Development highlighted, we have to be practical, but we also have to be ambitious. Most of all, we have to move beyond yesterday's limiting approaches and reset our thoughts and actions.

Unlocking finance for sustainable development is a challenge of our times that we must address head on. *Financing Sustainable Development: Momentum to Transformation* highlights real options to do just that. Far from being distracted by the many immediate problems we face, it shows us how we can work beyond today's turmoil, or even how to build on its momentum. Grounded in the innovations being taken forward by policymakers and market players from around the world, it shows us that it is possible to reshape global finance to meet the needs of sustainable development.

Challenging times need practical and ambitious solutions. The United Nations and its member states have a critical role to play in implementing such solutions, along with traditional partners and a new generation of allies including financial policymakers, central banks and financial institutions. Together, we can ensure that global finance is directed to delivering the financial services and resources needed to deliver sustainable development.

Peter Thomson
President of the 71st session of the UN General Assembly

MOMENTUM TO TRANSFORMATION

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SUMMARY

The 2030 Agenda for Sustainable Development and the Paris Agreement represent the most ambitious multilateral goals ever set. These goals require an unprecedented mobilization of both public and private finance – some US$90 trillion over the next 15 years. Public finance is scarce and must serve competing priorities. Progress has been made to mobilize private finance by shaping the right enabling investment conditions and crowding-in private capital with public funds.

Momentum is also growing to align at a more fundamental level the financial system with sustainable development. A 'quiet revolution' is building to embed sustainable development into tomorrow's global financial system, revealed in UNEP's 2015 landmark report, "*The Financial System We Need*". Early innovations have been championed by international coalitions of investors, banks and banking regulators, stock exchanges and insurance regulators. Both developing and developed countries have led the way in addressing national development priorities through financial system improvements. Most recently, the G20 finance ministers and central bank governors have, for the first time, explored how to improve the financial system to mainstream environmental considerations, and the Financial Stability Board has established a task force to explore how to ensure that climate-related financial risks are fully accounted for and disclosed.

Despite this positive momentum, progress remains inadequate, with an accelerating decline in all major ecosystems, and growing economic inequality and social challenges. Urgent action is needed to avoid insufficient or misplaced investments that will lock in unsustainable economies and lifestyles. Natural capital has declined in 116 out of 140 countries;[1] 6.5 million premature deaths result every year from air pollution linked to the energy system;[2] greenhouse gas emissions add energy to the Earth's system at a rate equivalent to the detonation of four nuclear bombs every second;[3] an average of 26.4 million people have been displaced from their homes by natural disasters every year since 2008 – equivalent to one person every second;[4] and one third of the world's arable land is jeopardized by land degradation, triggering economic losses of US$6.3 to US$10.6 trillion per year.[5]

Immediate priorities, informed by growing turmoil, too often dominate political and business decisions. Economic volatility and slow growth, alongside political uncertainty, can and do distract policymakers and investors from long-term goals and risk-adjusted financial returns respectively. But turmoil of some kind is a permanent feature of our political and economic landscape. Turmoil creates challenges, but it can also be turned to ambitious advantage. Sustainable development calls for transformative approaches that can thrive in turbulent times.

Current efforts to align the financial system with sustainable development demonstrate how to drive transformation through, or even by leveraging, ongoing turmoil. Post-crisis policy and regulatory changes, strengthened country leadership, and historically low returns to traditional savings and investment – these all create opportunities for advancing sustainable development considerations in financial market reform and development. Profound disruptions to the financial system through technological upheavals ('fintech'), furthermore, create new ways to mobilize

sustainable finance, particularly for developing countries with high savings rates and comparatively underdeveloped capital markets.

Transformative financing can be mobilized by bridging the 2030 Agenda and the Paris Agreement with these financial system innovations. Both require systematic national action, but with a few exceptions, decisions are still made in separate silos. Both would benefit from public-private coalitions that effectively connect ambitious policies with market innovation. Both depend on international co-operation, but together they could combine the strengths of diverse actors historically separated by mandate and approach.

Five steps are proposed to embed financing for sustainable development at the heart of tomorrow's global financial system and deliver the much-needed transformation. These steps build on country-level experience in advancing ambitious plans to ensure that the financial system fulfils its historic purpose of meeting long-term needs, engages key international institutions effectively and develops the new generation of methods and standards that can institutionalize sustainable development in the governance and practice of financial and capital markets worldwide.

ACCELERATORS OF TRANSFORMATIVE FINANCE

1. *National financial market reform and development plans* to embrace consideration of the Sustainable Development Goals and Paris climate commitments, and vice versa.
2. *Financial technology mobilized to support the accelerated alignment of the financial system with sustainable development*, particularly for developing countries.
3. *Public finance to undergo a disciplined analysis and, as required, redeployment* to align to the Sustainable Development Goals and Paris climate commitments.
4. *Investing in awareness-raising and building key capabilities*, so that the financial community can effectively implement new approaches and plans.
5. *Development of common methods, tools and standards* to enable sustainable development priorities to be measured and incorporated into financial practice.

Aligning the financial system with sustainable development is ultimately a policy choice. Ensuring that the financial system serves the needs of sustainable development is a policy choice, which in turn will shape how financial ministries, central banks, financial regulators and standard-setters define and deliver their core mandates. At a global level, these policy choices have already been made, as the 2030 Agenda and Paris Agreement reaffirm the centrality of sustainable development in underpinning viable and inclusive economic strategies and practices. Now these goals and commitments must be embedded across the financial system so that market actors can ensure that capital flows become consistent with sustainable development.

PLACING SUSTAINABLE DEVELOPMENT AT THE HEART OF THE FINANCIAL SYSTEM

The 2030 Agenda for Sustainable Development and the Paris Agreement represent the most ambitious multilateral goals ever set. Achieving these goals requires an unprecedented mobilization of both public and private finance, some US$90 trillion over the next 15 years.[6,7] Public finance is scarce and must serve competing priorities.[8] Momentum is therefore building to mobilize private finance. Early stage developments have focused on shaping the right enabling investment conditions and crowding-in private capital with public funds.[9]

Public finance is essential for realizing the Sustainable Development Goals, and private finance has a role to play when commercial investment opportunities arise. International development funding and domestic public resources are required to fund critically needed developments.[10] Some of these public funds need to be used directly, such as for official development assistance and domestic social welfare payments. In agriculture, for example, the bulk of an estimated annual investment gap of US$260 billion in developing countries will be commercially fundable, but public funds are needed to tackle rural poverty and hunger.[11]

Public funds will always, however, be inadequate to finance sustainable development. Developing countries in particular have severe fiscal constraints, as increasingly do developed countries. Public funds can also be used to crowd-in private capital where commercial opportunities exist, but returns are insufficient to catalyse financial flows, thereby making more extensive use of scarce public resources.[12] Much of private investment in clean tech is, in fact, crowded-in through the use of innovative public financing instruments and renewables feed-in tariffs.[13]

It is increasingly understood that the financial system itself also needs to be reshaped to mobilize sufficient capital for sustainable development.[14] Efforts to build bridges between the finance system and sustainable development have gained considerable momentum. Formal initiatives such as the Addis 'Financing for Development' process have raised awareness and strengthened the resolve to act together.[15] Governments are responding to the 2030 Agenda and the Paris Agreement by developing domestic plans and laying the foundation for enhanced international cooperation. Private financing is increasingly active in many key areas. In 2015, for example, largely private investment in renewables represented almost two-thirds of the net additions to global power capacity in 2015, and the market size of electric vehicles expanded 60% in 2014.[16]

Leading private sector financial institutions also recognize that sustainable development is key to their success. Integrating environmental, social and governance factors can reduce risk and enhance returns as well as expand opportunities for new financial products (such as green bonds). Coalitions have emerged to catalyse and leverage this emerging market leadership, such as institutional investors through the UN-backed Principles for Responsible Investment,[17] insurance companies through the UNEP-hosted Principles for Sustainable Insurance,[18] and the UNCTAD-hosted Sustainable Stock Exchanges initiative.[19] Impact-focused alliances have also blossomed, such as the Portfolio Decarbonization Coalition of Investors,[20] committed to decarbonizing some US$600 billion in asset portfolios.

Exciting developments signal progress in mainstreaming sustainable development into the fabric of financial and capital markets. Private financing is catalysed not only by the pipeline of opportunities but also by the shape of the financial system itself. The UNEP Inquiry into the Design of a Sustainable Financial System highlighted in its 2015 global report, *"The Financial System We Need"*, why and how – in practice – the rules and norms governing the financial system can drive the market responses required to deliver positive sustainable development outcomes.[21] The Inquiry has identified over 200 innovative measures taken by financial policymakers, central banks, financial regulators and standards bodies, to better reflect social and environmental factors – a number that is increasing on a weekly basis.

Private Sector Collaborative Commitments

- ***Banking***: Banks accounting for 70% of project finance in developing countries have signed the Equator Principles.[22]
- ***UNEP FI***: With 200 banking, insurance and investor members,[23] has helped to create many key initiatives, including the PRI, PSI and the SSE.[24]
- ***Investors:*** Investors with US$60 trillion are committed to the UN-backed Principles for Responsible Investment (PRI).[25]
- ***Insurance***: 20% of insurance premiums now covered by companies supporting the Principles for Sustainable Insurance (PSI).[26]
- ***Stock Exchanges***: 57 stock exchanges with total market capitalization of US$36 trillion have committed to the Sustainable Stock Exchanges initiative (SSE).[27]