BUILDING BRIDGES

SDG LAB

Questions and Answers on Sustainable Finance

Building Bridges and SDG Lab 2022 Primer

Questions & Answers on Sustainable Finance

Interest in sustainable finance has never been higher. At the same time, there is still considerable confusion about what it is and what it does. The purpose of this document is to help provide answers to some frequently asked questions related to sustainable finance through the lens of the SDG Lab at UN Geneva. These responses are intended to spur greater understanding and dialogue within the sustainable finance space ahead of the 2022 edition of Building Bridges, 3-6 October.

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What is Sustainable Finance?

Sustainable finance refers to the integration of environmental, social and governance (ESG) criteria into business and investment decisions in the financial sector. Going beyond the traditional focus on profits and losses, this approach considers issues such as how companies respond to the climate crisis, how they treat the planet and its natural resources, employees, customers, suppliers and shareholders, and how they respect human rights, gender diversity and other key social issues. Investors are increasingly using the strategy to evaluate financial risks, identify opportunities and express their values. In turn, many companies are reframing their operations and products to improve their ESG performance and communicating these efforts alongside their usual financial statements.

What activities fall within the scope of Sustainable Finance?

Sustainable finance is a broad category for investments that incorporate one or more ESG aspects of an economic activity or project. Environmental factors might include climate mitigation, pollution prevention, the sustainable use of resources, and the preservation of biodiversity. For companies, social considerations could refer to labor relations, workplace diversity and consumer protection. More broadly, such issues include social protection, gender equality, health and wellbeing. Governance covers a range of company policies and standards, including executive compensation, tax practices and board structures.

Sustainable finance is an overarching term, encompassing social investing, ethical investing, and climate finance, among others. The narrowest approach is exclusion, which rules out harmful outputs like coal and tobacco. On the other end of the spectrum, impact investing aims to generate measurable social or environmental benefits alongside a financial return. Another strategy is thematic investing, which focuses on predicted long-term trends, such as renewable energy and smart cities, rather than specific companies or sectors.

ESG funds dominate the market, but sustainable investing is also possible in fixed income (green bonds, blue bonds (for oceans), sustainability-linked bonds), real estate, commodities and private equity.

Why is Sustainable Finance important?

Through the people, businesses and activities that they choose to support commercially, financial service providers play a key role in the transition towards a sustainable economy and society. Sustainable finance unlocks investment for economic activities and projects that deliver better outcomes for people and the planet. In this way, it can enable the alignment of financial flows with the Sustainable Development Goals (SDGs) and the Paris Agreement on climate change. Integrating SDG and ESG factors into investment decisions can also help identify risks and opportunities that traditional analysis may not uncover. This can future-proof investments and in some cases lift returns.

How big is the Sustainable Finance market?

The UN Conference on Trade and Development (UNCTAD) estimates that the value of sustainability specific investments amounted to US$ 5.2 trillion in 2021[1], up 63 percent from 2020. From a regional perspective, Europe dominates the market for these products, which consist mainly of sustainable funds (over US$ 2.7 trillion) and sustainable bonds ($US 2.5 trillion). Despite the surge in recent years, sustainable funds account for only about 4 percent of the global fund market in terms of assets.

While emerging markets are gaining ground in these markets, most products are based in developed countries and targeted at assets in developed markets. This geographical imbalance is undermining progress toward the SDGs, which require substantial finance for developing countries.

ESG analysis is a factor in at least US$ 35.3 trillion of assets under management (AUM)[2], or more than a third of AUM in five of the world's biggest markets, according to the Global Sustainable Investment Alliance.

How much financing is needed to achieve the SDGs?

Reaching the 17 goals set forth in the 2030 Agenda for Sustainable Development requires an estimated investment of US$ 5 trillion to US$ 7 trillion per year between 2015 and 2030. Although the annual outlay amounts to less than 2 percent of the total assets held by banks, institutional investors, or asset managers, it far surpasses the capacity of public resources.

The coronavirus pandemic significantly rolled back progress on the SDGs, widening what was already a US$ 2.5 trillion annual financing gap for developing countries. The UN now estimates the yearly gap in SDG financing at US$ 4.3 trillion[3].

While international investment in sectors relevant for the SDGs in developing countries rebounded in 2021, most of the growth went to renewable energy. Investment in other SDG-related sectors including infrastructure, food security, water and sanitation did not return to pre-pandemic levels.[4]

What is SDG-aligned finance?

ESG investing typically focuses on conduct and operations: Does the business produce goods in an environmentally responsible way? Is it treating its workers well? Does it engage positively with the community? Are its governing bodies ensuring gender balance? SDG-aligned finance is more concerned with purpose. It recognizes that impact matters as much if not more than volume: What products are produced and for whom? Do they help or harm society? Do they consider multiple positive benefits, across social, environmental and governance-related outcomes?

The UN and other international organizations have urged businesses and investors to adopt the SDGs as the framework for sustainable finance. Covering a wide range of themes, the 17 Goals encompass 169 targets tracked by 231 indicators for engagement on all dimensions of sustainability.

Many companies include a commitment to the SDGs in their sustainability reports. Some institutional investors such as pension funds are also using the SDGs as a basis for their sustainability strategies. Likewise, leading fund providers have launched funds dedicated to the goals, and some use the SDGs to gauge the impact of portfolios.

However, measuring the impact of a product or service is complex and there is no consensus or universal approach on how to do this or for what counts as an SDG investment. The UN SDG Impact offers private equity funds and bond issuers guidance on how to contribute to the goals.

How is Sustainability measured?

There are few market standards for what constitutes an ESG stock, bond or strategy. Investors rely on third-party reports and ratings to measure and evaluate sustainability performance, but the methods and scope vary widely. The lack of consistent, comprehensive, and comparable data has raised concerns that companies and asset managers can misrepresent their sustainability performance.

Regulatory initiatives to bring more transparency for investors focused on ESG issues have prompted a wave of proposed new standards in 2022:

- The new International Sustainability Standards Board published a first set of global guidelines on corporate sustainability disclosures for public consultation. It also proposed rules that would require publicly traded companies worldwide to disclose climate-related risks, assuming that jurisdictions adopt them.

- The UN-supported Taskforce on Nature-Related Financial Disclosures published an early version of its new framework for reporting impact on biodiversity.

- The European Commission published technical standards on implementing ESG-related disclosure requirements under two new sets of rules, the Sustainable Finance Disclosure Regulation and the EU Taxonomy Regulation.

- The U.S. Securities and Exchange Commission has proposed new climate-related disclosure and labeling requirements for funds with an ESG focus.

- In Asia, China has unveiled voluntary guidelines for companies to report ESG metrics and Hong Kong regulators have increased their focus on climate reporting standards.

How can developing countries attract sustainable investment?

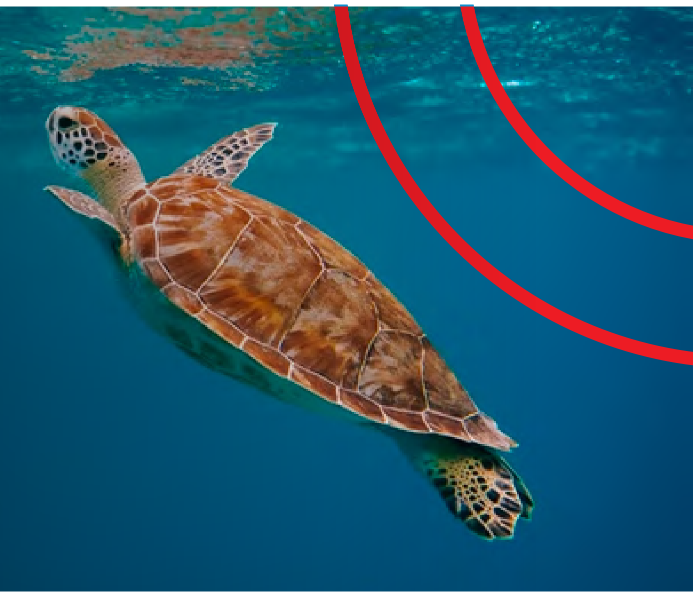
Mobilizing resources, both domestic and global, to support sustainable development remains a major challenge for many developing countries. Risk perceptions and their limited market size are two of the biggest barriers. Many low-income countries do not have structures in place to advance these approaches. There is also limited understanding of how sustainable investments can help drive financial performance. For their part, investors and companies often have little information about possible SDG-focused private sector investments or how to align existing investments in support of local SDG priorities. UNDP works with individual countries to transform their SDG priorities into investor roadmaps that point to impactful investment areas. The SDG Lab supports these efforts through its Pipeline Builder, which seeks to streamline and boost financial flows to projects aligned with national sustainable development strategies.

The SDG Lab is also focused on cross-sector collaborations (e.g., finance sector and development community) to open up new opportunities for partnership and, ultimately, to decrease investment risks and promote an impact accountability system.

In addition, the SDG Lab is committed to bringing Member States to the dialogue between finance and development communities, including Building Bridges, for a better understanding of national priorities and to highlight progress in creating enabling environments.

As one of the founding partners of Building Bridges, SDG Lab has played an instrumental role in bringing together Geneva's finance and sustainable development communities to work towards driving more capital to the SDGs at country level.

What is the UN doing to help?



The United Nations is a leading voice in advocating for and mobilizing more investment for the SDGs. Drawing on its global expertise and convening power, it advises, coordinates and monitors the activities of numerous stakeholders – from asset owners, financial institutions and exchanges to regulators and policymakers.

The Secretary-General's "Roadmap for Financing the 2030 Agenda for Sustainable Development" and the Global Investors for Sustainable Development (GISD) Alliance are among several UN initiatives to accelerate financing for sustainable development.

The new UN Global Sustainable Finance Observatory will manage a global database of sustainable finance products, conduct assessments of self-labeled sustainable products and establish a pool of sustainability ratings on capital markets.

SDG Impact produces in-depth reports on investment opportunities and market intelligence on conditions in target markets and sectors.

The UNDP Sustainable Finance Hub offers a comprehensive package of methods and tools to help countries plan, manage and finance development aligned with the SDGs.

The UN Global Compact provides the guidance and resources finance executives need to transform their business models and incorporate the Sustainable Development Goals.

How can we fill the SDG financing gap?

Sustainable investing needs to transition from a niche to a mass market where ESG considerations are fully embedded in business models and culture. Ultimately all financial flows – public and private – should be aligned with the SDGs and more capital deployed in economies that need it the most. To this end, the United Nations has called for restructuring the international financial and debt architecture to support SDG budget plans in low-income countries.

But the challenge of financing the SDGs goes beyond mobilizing money. It's also about impact. Much of ESG investing is concerned with mitigating risks to long-term financial performance. There is a growing awareness that sustainable finance needs a greater focus on companies and projects that contribute explicitly and directly to the 2030 Agenda. This requires financing models that look at the complex and interconnected nature of the agenda. It also calls for more collaboration between financial providers, companies and governments to identify opportunities to generate positive impact alongside competitive financial returns.

“Building Bridges is a unique place where representatives from the development community, from national governments and the finance community can meet each other, work together and find common solutions.”

Tatiana Valovaya.

Director-General
United Nations Office at Geneva

“We aim to build a bridge from an economic system that has damaged the planet to one that sustains and regenerates it.”

Patrick Odier.

Chairman
Building Bridges

*Footnotes

(1) UNCTAD, World Investment Report, Capital Markets and Sustainability, page xvi
(2) Global Sustainable Investment Alliance, Global Sustainable Investment Review, p. 5
(3) UNCTAD, World Investment Report, Foreword, page v
(4) UNCTAD, World Investment Report, “International tax reforms and sustainable investment,” page 4

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