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Changing Finance to Catalyze Transformation:

How financial institutions can accelerate the transition to an environmentally sustainable economy

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How financial institutions can accelerate the transition to an environmentally sustainable economy

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A full list of acknowledgments can be found here.

About GEO for Business

The United Nations Environment Programme [UNEP] and its global partners are proud to offer this series of stimulating briefs about the environmental challenges and business opportunities that demand transformational change at a global scale. These business briefs are meant to communicate the science of the environment to a broad business audience and provide possible pathways and roadmaps that business can follow to address these environmental challenges. The audiences these briefs hope to reach include companies in the supply chains of major multinationals, multinationals themselves as well as small to medium-sized enterprises. The themes of the first five briefs include:

- how to transform in a time of uncertainty,
- how to transform business models towards a fully circular model,
- how to transform global food systems,
- how to build environmentally sustainable and resilient infrastructure,
- and the role finance needs to take in a transforming world.

Key Messages

The financial sector has an essential role to play in addressing global environmental and social crises. A dramatic transformation of energy, food and waste systems is needed to achieve the goals of the Paris Agreement and Agenda 2030. This transformation requires a transition towards sustainable businesses models and related production and consumption. How more than US$400 trillion in global financial assets is allocated over the next decade will play a critical role in determining the alignment of companies with the UN Paris Agreement objective of "holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels", and the UN Sustainable Development Goals (SDGs). The stability of the climate, nature, the economy, society and the financial system are at stake.

Financing is starting to be directed towards helping public and private markets make this sustainability transition. This has two major consequences on company access to finance. First, financing of new projects (debt and/or equity) will be more readily available for sustainable projects, and second, existing financial portfolios will be restructured to favour companies with environmentally sustainable business plans and performance.

Sustainability in business strategies is becoming an additional decisive factor, and an imperative for businesses to access third-party financing for debt and equity. This represents a paradigm shift in the private sector and will result in winners and losers across and within sectors during the transition to an environmentally sustainable economy.

As sustainable finance becomes mainstream, financial institutions increasingly require companies across sectors to integrate sustainability into their operations and supply chains. Non-financial companies need to understand how the financial system is changing to address environmental challenges, and how their businesses are positioned for the shift in capital allocations to transition to an environmentally sustainable economy.

To align financing with the SDGs and goals of the Paris Agreement, the financial sector needs:

- **To accelerate the transition to an environmentally sustainable economy through financial products and services.** Approaches to align with global goals include developing and scaling sustainable financial products and supporting clients that are transitioning to sustainable business models. Key areas for financing transformation include shifting food systems to regenerative agriculture, developing future-proof infrastructure, and transitioning to circular economy business models across sectors. Levers for change include scaling up sustainability performance-based financial products, integrating sustainability data into financing solutions, and company engagement. Channeling sustainable financing to small-and-medium-sized enterprises and considering gender equality performance indicators are important aspects of ensuring financial inclusion.
- **Public support can be directed to catalyse private finance through multilateral development banks (MDBs) to de-risk investments in developing countries**. Making financing more commercially viable and growing technical capacity to support operational commitments can lead to product innovation within private financial institutions to create 'blended finance products' that provide complementary finance. Unlocking the huge potential for financial institutions will require greater liquidity and increased uptake of these financial instruments.

- **Greater capacity to integrate environmental sustainability factors into core business processes and decision making.** Collective action by banks, insurers and investors through voluntary initiatives is driving change in financial systems by developing the frameworks, strategies, tools and expertise to solve challenges and develop common approaches to address sustainability-related financial risks and opportunities. Alliances are ratcheting up ambition and developing pragmatic guidance to align financing with the goals of the Paris Agreement. Industry-wide uptake of resulting approaches is required to align the financial system with the 1.5 degrees limit. Financial institutions need to ensure staff have the requisite knowledge, skills to drive transformation in the economy.
- **Transformational leadership is needed to embed sustainability in governance, incentives, skills, resources and culture across operations.** Effective integration requires embedding environmental and social sustainability objectives in roles at senior organizational levels, with effective governance to steer the alignment of financing with environmental and social priorities. Environmental and social sustainability-oriented outcomes need to be at the core of executive incentive plans. Leadership needs to ensure ambitious and pragmatic mind sets to deliver strategies with environmental and social outcomes across portfolio sectors, to implement targets to align portfolios with the UN Paris Agreement and the SDGs.
- **Transparency and accountability for environmental impacts.** Corporate disclosure frameworks using performance indicators based on science need to enable financial institutions to measure and manage the environmental impacts of lending, investment and underwriting portfolios. Disclosure requirements on companies are increasing as expectations are growing for financial institutions to understand and address the environmental and social impacts of lending, investment and underwriting portfolios through the companies they are financing. Transparency and accountability are critical to ensure global financial assets contribute to positive impacts aligned with sustainable development and climate stability, and reduce negative impacts such as environmental degradation, pollution and waste.
- **To ensure responsible advocacy to catalyze the requisite enabling environment for financing aligned with sustainable development.** The financial sector needs to support an enabling environment to address environmental sustainability challenges through policy and regulatory frameworks in finance and specific market sectors. They can prepare their organisations for monitoring by financial regulators of climate- and nature-related risks to the financial system and management of a stable transition to an environmentally sustainable economy.

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1. The scale of the challenge

The sixth Global Environment Outlook (GEO-6), published in 2019, before the global pandemic, assessed the state of the global environment, the effectiveness of the policy responses in addressing these environmental challenges and the outlook for the future if we stay on the path that we are on versus if we decide to achieve the environmental goals that countries have already committed to. Unfortunately, GEO-6 paints a bleak picture of the future if we continue providing energy using today's fossil-based energy sector, producing food through today's food system and managing waste the way we currently manage it.[1] Some key facts include:

- Air pollution currently causes 6-7 million premature deaths each year.
- Global greenhouse gas emissions have increased every year since the UN Framework Convention on Climate Change (UNFCCC) was negotiated and global average temperature is now more than 1°C above that in pre-industrial times.
- The Living Planet Index, a measure of global biodiversity, has declined by more than 60 per cent since the 1970s.
- 8 million tons of plastics enter our oceans each year, mainly from land-based sources.
- 50 per cent of habitable land is used for food production and 77 per cent of that land is used for meat production.
- 70 per cent of all freshwater extraction is used for food production.
- About 1/3 of food is lost or wasted globally.
- Deforestation rates have declined, but they are still
- Sea level rise, which will damage protective walls, create more flooding and salt-water intrusion, and inundate low-lying, coastal cities.
- Temperature increases on land, which will negatively impact food production through lengthier and more frequent droughts.
- More frequent and intense wildfires, damaging or destroying properties and homes.
- More frequent and intense hurricanes and cyclones, damaging or destroying infrastructure with the financial cost borne by national economies and the insurance industry.
- Antimicrobial resistance in humans, mainly as a result of overuse of antibiotics in our food system, could be the leading cause of death in 2050.

In its summary for policy makers, the GEO 6 recommends that environmental issues are best addressed when dealt with in conjunction with related economic and social issues, including consideration of gender equality and equity. A dramatic transformation of energy, food and waste systems is needed to:

- Eliminate about 90 per cent of fossil fuel use by 2050.
- Reduce the environmental impact of the global food system by about two-thirds.
- Design circular economies to achieve near-zero-waste by 2050.

This scale of transformation requires a dramatic shift in the models of businesses and related production and consumption. These models are influenced