ACCELERATING INNOVATION IN SUSTAINABLE FINANCE

Removing Roadblocks and Unlocking Value

A report for the United Nations Secretary-General

United Nations Global Compact

TABLE OF CONTENTS

FOREWORD BY SANDA OJIAMBO

INVESTING IN A BETTER WORLD

The Sustainable Development Goals set forth by the United Nations present a golden opportunity for businesses around the world. There is acute demand for clean energy, ample food, quality health care and the other SDGs. The companies and investors who can help deliver these goods, services and benefits stand to reap rich rewards – not only in the present but in the brighter future that awaits us all in a world free from want and abundant in opportunity.

Many companies and investors have already seen the light and seized the day. Forward-thinking corporate boards are insisting that management consider sustainability when making business decisions. And mounting empirical evidence shows that betting on a better world is a smart move. Sustainability funds generated median returns of 12.6 per cent in 2023, besting the 8.6 per cent returns garnered by traditional funds, according to Morgan Stanley's most recent Sustainable Reality report. [1]

Yet despite this opportunity, there is a huge and widening shortfall in financing the achievement of the SDGs – especially in the developing world, where some have estimated that gap to be as high as $30 trillion.

The United Nations has always envisioned the private sector as its partner in advancing the 17 SDGs. There aren't enough resources in the public sector or international development banks to pay for everything that is needed. That makes the private financial sector a pillar of the Secretary-General's core strategy to achieve the SDGs.

Investors of all stripes – banks, pension funds, insurance companies and asset managers – are needed to finance treatment plants where people need clean water, solar farms where people need electricity and factories where people need jobs. In many cases, no arm-twisting is needed, as investors increasingly want to see a share of their capital deployed for the greater good.

Nonetheless, obstacles stand in the way. In many places around the world, financial markets operate with little oversight and transparency, creating uncertainties that dissuade investors. Companies must also seek profits and, in some instances, the risks of investing in new markets or technologies need to be mitigated by development banks or other means.

Finally, sustainable investment isn't a universally accepted principle, although it certainly should be. More companies and financial gatekeepers need to be aware of the investment opportunities in this space.

To address these issues, the UN Global Compact prepared this report in partnership with the UN Department of Economic and Social Affairs and other agencies. It is based upon more than 55 consultations with stakeholders across the UN system and the broader financial value chain. It will:

- Identify roadblocks hindering progress in sustainable finance and strategies to overcome them.
- Present a blueprint for how sustainable finance investments can be encouraged through a mix of incentives and risk mitigation measures.
- Call for institutional changes needed to put sustainable investment at the center of business decisions, and not an afterthought.

Private enterprise already provides people with food and shelter, financial services, personal transportation and the means to earn a living. The technology sector has led a digital revolution that is improving the lives of billions of people.

Now, private enterprise can play an even bigger and more valuable role in expanding these and other goods, services and benefits to the people who need them most. Investing in renewable energy, women's economic inclusion, ending poverty and reaching other objectives outlined in the UN's 17 Sustainable Development Goals can both reap rich rewards and deliver positive outcomes.

This report offers a focused framework and innovative models of how that can happen.

SANDA OJIAMBO

Assistant Secretary-General and CEO,
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PREFACE

This report was prepared by the United Nations Global Compact in collaboration with the UN Department of Economic and Social Affairs and with support from S&P Global and the UN Global Compact Board. It comes in response to the request by the Secretary-General for comprehensive recommendations on how the UN can help unlock the power of private financial markets towards achieving the Sustainable Development Goals.

The recommendations here are based on an analysis of how sustainable finance has been deployed around the world through our original research and dozens of consultations with major companies, financial institutions, development banks, Government agencies, market regulators and others.

Accelerating Innovation in Sustainable Finance builds upon the work of others but advances the discussion by identifying the roadblocks that have hindered sustainable investment and how they can be overcome. It also showcases the sometimes surprising examples of how sustainable finance has been deployed to great success.

As the report notes, there is much more work to be done. Our hope is that *Accelerating Innovation in Sustainable Finance* can be both a practical roadmap and an inspiration.

The research team was comprised of Claire Baumann, Jerome Lavigne-Delville, Carleigh McFarlane, Nicolò Ciocci, Jordan Kaplan, Till Trefzger, Hana Churay, John Corrigan, Matt Austin, Erin Dunne, Alexandra Gee and Benjamin Porte.

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EXECUTIVE SUMMARY

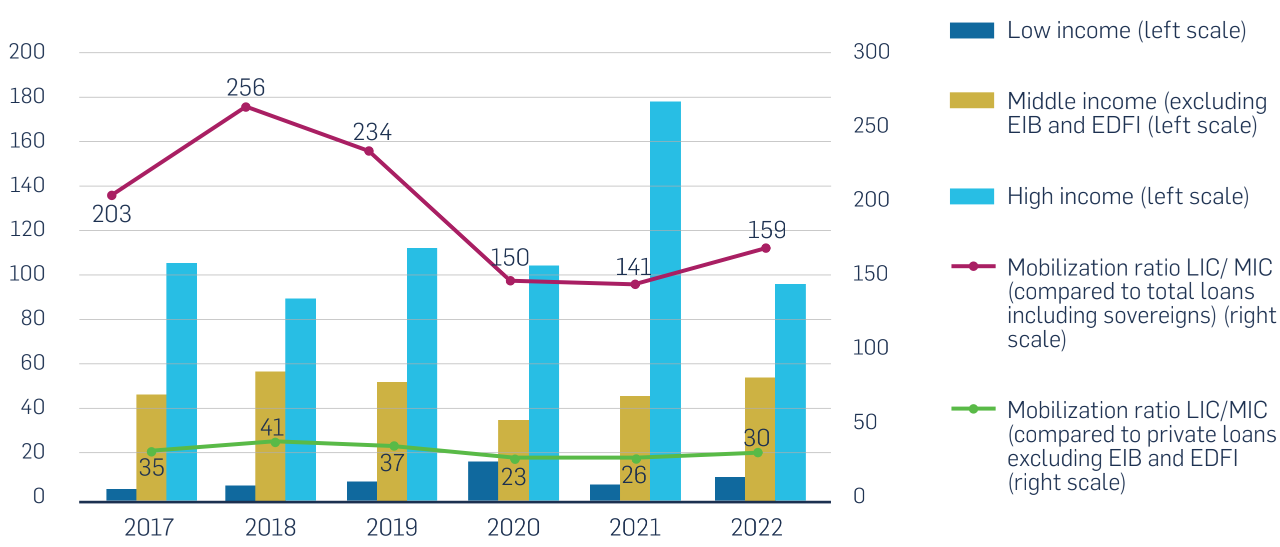
THE OPPORTUNITY TO HARNESS CAPITAL MARKETS

To achieve the UN's Sustainable Development Goals (SDGs) by 2030, an infusion of private-sector investments is needed. This comes with distinct opportunities for delivering growth and the potential to unlock innovation in sustainable finance.

Sustainability issues have shot to the top of business agendas over the past decade, in step with increased regulatory and investor pressure for climate action. The enthusiastic support from CEOs of multinational companies committed to sustainability has fueled a surge of innovation in financial tools and products with outcomes linked to sustainability. Global sustainability investing assets reached US$30 trillion in 2022 and are estimated to reach US$40 trillion by 2030. The market for outcome-based financial products now stands at US$7 trillion in total issuance, with green and use-of-proceeds bonds and sustainability-linked loans driving the growth.

Despite this progress, there is still a massive shortfall in investments to achieve the SDGs, which some estimate at US$30 trillion in developing countries alone.[2] At the same time, developing countries are burdened with nearly one-third of the US$97 trillion in public debt globally[3] and with borrowing costs rising at twice the rate.[4] Most private investment in developing countries has gone to middle-income countries with perceived stable Governments and lower risks of default at the expense of lower-income countries.

Mobilization of private sector by country income level



Standard & Poor's. EIB--European Investment Bank. EDFI--European Development Finance Institution. LIC--Low-income countries. MIC--Middle-income countries.

International financial institutions such as the World Bank, which controls less than US$2 trillion in assets, can't close the gap alone.[5] With domestic public investment limited by the debt crisis, there is growing urgency to tap into the private financial sector – both globally and at the country level. We need pension funds, asset managers, insurance companies and other institutions, which control US$200 trillion of financial assets globally, to invest in the SDGs in a way that creates strong local economies and financial returns while protecting the environment and building opportunities for people worldwide.

Governments require capital markets to finance longer-term programs, such as building water treatment plants, establishing health clinics in impoverished villages or expanding educational opportunities for girls. Private and public-sector efforts must be combined to achieve the SDGs, and they must be supported by well-functioning financial markets.

Harnessing private capital for sustainability outcomes and the SDGs faces acute challenges in today's market. Increased borrowing costs and market fragmentation have created complications for financial products that are linked to the SDGs, such as green and sustainability-linked bonds. In certain places, corporations and investors are also facing pushback against infusing ESG factors in business and investment decisions. Morningstar reported a record US$8.8 billion in net withdrawals from sustainable funds in the United States alone in the first three months of 2024, citing high interest rates, middling returns in 2023, greenwashing concerns, and the continued politicization of ESG-focused investing.[6]

And while the sustainability landscape has matured, uncertainties remain around sustainability definitions, standards and targets as well as the understanding of real versus perceived risks, especially for developing countries and new technologies. With all these factors at play, it's not surprising that Foreign Direct Investment has slowed.

Yet, the data is clear: sustainability as a pillar of investing is here to stay. More than half of individual investors say they plan to increase their allocations to sustainable investments in the next year, while more than 70 per cent believe strong ESG practices can lead to higher returns.[7] Most of the growth is related to new climate science findings and the prospects for positive financial performance of sustainable investments.

But there is a caveat – investors want to see their holdings aligned more closely with their intended impact outcome such as specific environmental or social objectives.

What's more, while the managers who control private capital have a fiduciary duty to generate sufficient returns to cover their clients' liabilities, they must also have strong incentives to participate in sustainable finance and investment, particularly in developing markets and with new technologies. In our consultations with the investor community, key thematic questions emerged, including:

1. Are my investments truly aligned with the intended outcome? Should I be concerned about greenwashing and how can we properly hold businesses accountable?
2. I want to maximize the sustainability impact of my investments, particularly in emerging markets, but I don't have enough data and information to quantify the risk and returns. How can Governments, multilateral institutions and private sector partners help clarify and mitigate risk and improve the return profile of these investments?
3. How can public and private-sector players collaborate more closely to increase adoption of sustainability to unlock private capital and reform systems to achieve these shared goals?

The *Accelerating Innovation in Sustainable Finance* report aims to chart a practical course forward.

"At the end of the day, we're all governed by incentives. When you think about economic incentives, I think they need to be heavier, especially in a higher interest rate environment, and especially as we think about things related to a more sustainable future, particularly on themes of environmental sustainability."

– Alec Ross, The New York Times best-selling author of "The Industries of the Future and The Raging 2020s" and professor at the University of Bologna Business School

This report was prepared by the United Nations Global Compact in collaboration with the UN Department of Economic and Social Affairs and with support from S&P Global and the UN Global Compact Board. It is the result of our consultations with more than 55 private-sector partners, relevant UN agencies, regulators, philanthropies, multilateral institutions, experts in global finance and stakeholders across the financial value chain. Three overarching and mutually reinforcing themes emerged as key system-level levers to unlock innovation in sustainable finance:

Transparency

Transparency and quality data improves efficiency in capital markets, including for sustainable investments, as it reduces disinformation, improves market liquidity and leads to lower capital costs and better access to finance through new financial products.

Risk and Returns

Investors are increasingly seeking out investments that align with their expectations for both financial and impact returns in addition to matching their risk tolerance. This creates a need for investment opportunities that match their risk, return and impact equilibrium.

Integration

Scaling sustainable finance requires the integration of sustainability in all facets of capital markets activities, from how companies manage resources and invest in new projects to the way banks and investors allocate capital in the economy and society.

Global sustainability investing assets reached US$30 trillion in 2022 and are estimated to reach

US$40 trillion by 2030

In discussing these barriers in dozens of consultations, we found a consensus that Governments, business leaders and multilateral organizations must come together and review what is working, what's not and what can be scaled. Together, and only together, we can put in place the foundations for more sustainable financial markets:

- **Connect fiduciary duty to sustainability:** The fiduciary duties that govern the actions of financial and non-financial company executives and directors, asset managers and investment advisors should include sustainability considerations. These financial gatekeepers should be given the authority and support to commit to sustainability, and should be held accountable for their actions.

- **Scale public-private partnerships:** This relationship between Government and businesses needs to be carefully cultivated to increase dialogue, apportion risk among industry players to achieve common goals and share resources and best practices.

- **Converge standards for greater transparency, accountability and harmonization:** This includes driving towards the creation of a global baseline of standards from which to build local guidance and disclosure for a well-functioning sustainable finance marketplace.

- **Harness private capital through innovative financial instruments and increased the participation of multilateral development banks:** Multilateral development banks should take a leading role in mobilizing private outcome-based finance, developing blended finance solutions tailored to emerging markets and technologies, and providing technical assistance to companies and governments.

While there are clear challenges, there are also ample opportunities and momentum to revolutionize finance for a more equitable world. Together, the UN Global Compact, the Principles for Responsible Investment, the Global Investors for Sustainable Development and the UN Environment Finance Initiative represent more than 30,000 private sector organizations covering the entire financial value chain making for a powerful alliance dedicated to the SDGs and ready to lead the change.

This report presents promising innovations in sustainable finance in step with replicable models for Governments, businesses, investors and financial institutions to take action within their own areas of influence.

Roadblock Addressed	Innovation	Further Develop	Accelerate and Scale
Transparency	Harmonize and align global and local standards for sustainability reporting.	■	□
Transparency	Leverage open-source platforms and AI to address data and reporting gaps.	■	□
Transparency	Develop national sustainable investment priorities and pipelines for the private sector.	■	□
Risk & Return	Develop and expand risk-sharing tools and partnerships.	■	□
Risk & Return	Develop the market for outcome-based finance to incentivize sustainability.	□	■
Risk & Return	Match investor profiles with sustainable investment in emerging markets and technologies.	□	■
Risk & Return / Integration	Make sustainability a fiduciary duty for all market participants.	□	■
Integration	Harness corporate capital through sustainability-aligned investment.	□	■
Integration	Expand partnerships beyond public and private to public-public and private-private.	□	■

Transparency   Risk & Return   Integration

"We need to find a way to make sure that we can connect the people who are saying we have money to give with the people who are willing to take that money. What can the UN do to facilitate that?"

– Dilip Pal, CFO, Safaricom

HOW THE UNITED NATIONS CAN LEAD THE WAY ON SUSTAINABLE FINANCE

The UN may be best known for its humanitarian efforts and peacekeeping missions, but for decades it has also been a powerful force for sustainable finance. In fact, the UN's extensive reach and relationships across regulatory bodies, multinational corporations and global philanthropy groups provide a unique view into the obstacles that exist in securing the investment capital needed to address global challenges – from climate to gender equality.

Harnessing sustainable finance and devising strategies to overcome current market challenges must be a top priority if the world is to achieve the SDGs by 2030. The task grows more difficult with each passing year. There were 23 million more people in extreme poverty in 2022 than there were in 2019,[8] according to a recent UN report. In those three years, 100 million more people joined the ranks of the hungry. These sobering statistics add new urgency to leverage the scale and efficiency of the capital markets to finance the unprecedented level of investments required to build a better world, especially for the millions of people being left behind.

The Fourth International Conference on Financing for Development in Seville, Spain next year will provide global leaders with an exceptional opportunity to accelerate the transition to sustainable finance. Governments, multilateral development banks and businesses will gather with a shared mission to take down barriers and unlock capital for the SDGs. At the center of it all is the United Nations. For more than three decades, the UN has worked with key actors in the financial value chain – including investors, banks and companies – to integrate sustainability at the core of financial markets.

- The **Principles for Responsible Investment** (PRI) is a United Nations-supported international network of more than 5,000 financial institutions working with a combined US$120 trillion in financial assets to embed sustainability into their investment decision-making and ownership practices.

- **The UN Environment Programme Finance Initiative** and the UN-convened **Principles for Responsible Banking** and **Principles for Sustainable Insurance** provide another forum for policymakers and financial professionals to address sustainability challenges and develop solutions. The goal is for the banking sector to align its financing – estimated at US$480 trillion globally – towards the achievement of the SDGs.

- The **UN Global Compact** was launched in 2000 to integrate sustainability into the mission and management of corporations. It has grown to become the largest corporate sustainability initiative worldwide, with more than 24,000 companies participating, and it features the first-ever UN initiative to enact corporate CFOs advocating for the SDGs.

What is sustainable finance?

Sustainable finance refers to financial activities and investments that support economic growth while contributing to long-term sustainability goals, such as combating climate change and promoting equitable development. It also refers to the practice of including and mainstreaming SDG considerations into every investment, whether or not the investment is targeting one or more of the SDGs.

The UN also champions sustainable development by the private sector through other initiatives, including the Global Investors for Sustainable Development Alliance, which seeks to implement the Secretary-General's Strategy for **Financing for Development** through the private sector, the SDG Impact Standards of the United Nations Development Programme, the UN Capital Development Fund and the Sustainable Stock Exchange initiative.

These myriad efforts are responsible for much of the gains we have made in the past 20 years to integrate sustainability into some of the core functions of the capital markets, demonstrating the UN's powerful influence to bring together public and private sectors to accelerate the allocation of resources aligned with the SDG framework.

Despite this progress, however, the war chest to combat the world's most pressing problems, especially in developing nations, remains woefully short of resources. Achieving many of the SDGs has stalled. These times call for the UN to marshal all its platforms, signatories and coalitions in a united campaign to fully align global financial markets to the cause of sustainable finance.

Such a mandate falls squarely within the UN's mission to lift the fortunes of people around the world – a mission that cannot be achieved without changes in the way investments are conceived and deployed.

Sustainable Investing – or Sustainable Development Investing (SDI) – refers to commercially minded investments that are designed to intentionally deliver positive social and environmental outcomes — aligned, for example, with the SDGs.

***Accelerating Innovation in Sustainable Finance* report terms**

Innovation: New or modifications to proven financial mechanisms, technologies or strategies that promote environmental sustainability and social responsibility while enhancing economic growth.

Call to action: A plea for stakeholders — such as Governments, businesses, investors and financial institutions — to actively engage in and commit to practices that advance the SDGs. This report contains concrete steps to further integrate sustainability into financial systems and investments.

TRANSPARENCY

Sustainability-related rules and regulations have become commonplace around the world, and many companies have started to report more systematically on sustainability, especially in developed markets. Nearly all of the world's 250 largest companies now report on ESG matters.[11] However, daunting challenges remain, including interoperability of global and local standards, poor data quality and comparability, difficulties in Scope 3 emissions reporting and lack of capacity, all of which lead to lower adoption rates in emerging markets.

Weak transparency is perhaps the biggest roadblock for sustainable finance. Investors and stakeholders often have to contend with either too little sustainability information or with information that isn't relevant to the business or its stakeholders. Transparency is particularly hit or miss in emerging markets, according to the International Finance Corporation (IFC).[9]

Solving for transparency is critical as it helps ensure the accuracy of information, improves market liquidity and leads to lower capital costs and better access to finance. As sustainable investing continues to grow – reaching US$30 trillion in 2022 – sustainability data not only supports better financial analysis and investment decisions but also fosters innovation in sustainable finance, enhancing access to capital for companies committed to sustainability. In emerging markets, transparency can help reduce actual and perceived risks around weak public institutions, governance and heightened social and environmental challenges.

Developing an international standard for sustainability reporting is long overdue. The concept of compatible accounting standards arose in the 1950s as a stronger global economy emerged and cross-border capital flows increased in the wake of World War II. While accounting standards took decades to be adopted globally, we now have the opportunity to marshal all of our modern resources, including the technology of today and cooperative global forums, to fast-track these efforts.

Interoperability, in this context, refers to the ability of different global and local sustainability standards and systems to work together seamlessly, allowing for consistent and comparable data and reporting across various jurisdictions and frameworks.

"Private-sector investors expect transparent quarterly reporting around governance, as that will give them comfort around long-term investments in sustainable development."

–Doug Peterson, President and CEO, S&P Global

The establishment of the International Sustainability Standards Board (ISSB) in 2021 and the release of its inaugural standards in 2023 marked a good first step towards a global baseline for sustainability reporting as it addresses demands from investors for comparable and accurate disclosure on "sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects."[10]

Similarly, the European Commission took a major step by adopting the European Sustainability Reporting Standards (ESRS), which require large and publicly listed companies operating in the EU to disclose information for investors to understand the sustainability impact of the companies in which they invest. The U.S. Securities and Exchange Commission has also moved to enhance and standardize climate-related disclosures by publicly listed companies.

As we continue to push for more sustainability reporting, we also need to leverage data from Governments, scientists, academics and others to meet the need for information that can guide decisions. Applied responsibly, Artificial Intelligence and open-source platforms can help fill the short- to medium-term data and reporting gaps, but definitions and standards will need to be widely adopted to provide credibility to sustainable investing and practices.

"The cost of wasted capital is astonishing when you look at the lack of transparency and disclosures in the marketplace. So I'm certainly a believer in quality data and information, and transparency is important. It's more a question of right-sizing the time and the effort for getting there."

– Madeline Patterson Smith, Global Director of Sustainability Impact Reporting, Griffith Foods

Key Transparency Recommendations

1

Harmonize and align global and local standards for sustainability reporting, using the SDGs as a North Star. Encourage nations to develop sustainable investment roadmaps.

Transparency is only beneficial when it is accurate and comparable. The sheer number of sustainability reporting protocols creates confusion and increases costs for companies and investors. "Robust and effective sustainability reporting, which meets the needs of investors and other stakeholders, won't be achieved without well-harmonized and aligned global standards," the International Finance Reporting Standards Foundation has said. According to the Global Impact Investing Network, investors aren't sure how to measure impact, let alone verify it. The disconnect between sustainability and financial reporting causes a host of problems, including fueling accusations of greenwashing and slowing down the growth of sustainable finance and investments.

One world, one set of interoperable standards

Much work has been done in recent years to consolidate global sustainability standards, yet different organizations still claim to set standards on sustainability reporting. This creates additional burdens for companies and creates confusion for investors and other stakeholders looking for reliable measurements of performance. The confusion is compounded by differing reporting objectives, with some focusing on both financial and societal impacts of sustainability (double materiality), while others concentrate solely on financial impacts (single materiality).

The absence of global standards has long hindered effective sustainability disclosure. While much progress has been made in the consolidation of sustainability reporting standards, more efforts are needed to ensure interoperability of global standards. This is an area where the UN can use its standing to bring together all relevant stakeholders to follow a "gold standard" for sustainability disclosures that are based on international norms adopted or endorsed by the international community and that will be sought out and coveted by the private sector.

For a model of how this might work, look at how the ISSB collaborated closely with the European Financial Reporting Advisory Group to ensure that IFRS and ESRS standards are as consistent as possible and to avoid duplication in reporting against both sets of standards.

Another important priority is to ensure that sustainability reporting continues to reflect the two-way relationship between business and sustainability – that is, how companies affect the economy, society and the environment and how sustainability issues impact the performance of companies. This includes establishing the principle of impact materiality as an essential concept of corporate reporting and ensuring that, over time, it is considered systematically alongside financial materiality.

The Impact Disclosure Taskforce is a private partnership among investors and banks to develop a guidance on impact disclosure and create a data platform to facilitate the flow of information between issuers and financiers. The goal is to use the principles of impact measurement and monitoring as a means to attract sustainable pools of capital including: i) intentionality; ii) measurability; iii) ambition; and iv) targeting the most acute development gaps.

Addressing sustainability reporting in emerging markets: The IFC and IFRS Foundation partnership

The International Finance Corporation (IFC) and the International Financial Reporting Standards (IFRS) Foundation, each a leader in their respective fields, recognized a pressing issue in the sustainability reporting landscape: the lack of consistent and comparable reporting standards. This problem was identified through their work with clients, investors and other stakeholders in sustainable finance and corporate reporting.

To tackle this challenge, the IFC and the IFRS Foundation launched a partnership in 2024. This collaboration aims to create a unified framework for sustainability disclosures, enhancing transparency and comparability across these markets.

The partnership's core objective is to integrate the International Sustainability Standards Board (ISSB) standards with local reporting requirements. This ensures that companies in emerging markets can follow globally recognized best practices while addressing local needs. The approach includes guidelines that show how businesses can adopt these standards effectively.

The initiative will feature training programs and workshops delivered through the UN Sustainable Stock Exchange initiative as well as a support network of local and international experts to help countries and companies prepare for the integration of the new standards.

By enhancing the framework for sustainability reporting, the IFC and IFRS Foundation partnership aims to enhance the attractiveness of emerging markets to global investors. This initiative not only improves the quality of sustainability data but also builds investor confidence by ensuring that companies' sustainability practices are transparent and accountable.

It is imperative that businesses adopt integrity-driven ESG reporting practices that extend beyond compliance to ensure data accuracy, comprehensiveness and verifiability. Investors and stakeholders not only need credible and comparable sustainability data from companies, but they also need information that is specific to the industry and geography where they operate. This includes, for example, specialized climate-related disclosure such as an entity's plans to transition to a lower-carbon economy.

While duplicative reporting standards should be consolidated, global standards should also be adapted to different types of entities (e.g. financial vs. non-financial), industries and geography, requiring more specialized and interoperable reporting standards that are consistent with global standards.

Delivering local sustainability guidelines

Establishing a global baseline of reporting standards will take time. In the interim, we need to provide guidance to national governments, particularly in emerging markets where, despite recent progress, sustainable standards, reporting and overall adoption remain limited. At the same time, while a common framework is required, it should also take into account regional differences and local development priorities. Emerging markets face unique challenges in adopting comprehensive sustainability reporting practices. Tailored support and capacity building are crucial to bridge the gap and ensure global availability of sustainability data.

Establishing local investment priorities

Beyond data availability, investors are looking for a clear signal from nations seeking investment that their Governments are committed to sustainable development. Aligning national investment plans with the SDGs can allay these concerns, providing a better roadmap for investors and helping them match their strategies with long-term sustainability goals. Countries can create investment paths for sustainable development through a variety of tools, including policy frameworks, incentives and classification systems, or taxonomies.

One opportunity for countries is to use their national commitments to climate mitigation and adaptation under the Paris Agreement, known as their Nationally Determined Contributions, or NDCs, to promote climate investment opportunities for companies, projects and Government initiatives.

In collaboration with the UN, some countries have adopted **Integrated National Financing Frameworks** to set financing priorities as part of a comprehensive national sustainable development plan and strategy. The frameworks are designed to address the significant challenges developing countries face in securing private investment for SDG-aligned Government programs. Key issues include debt capacity limits, country-specific risks and a shortage of Government-sponsored projects. Bridging the financing gaps also requires the availability of sufficient grant and concessional finance for technical assistance, capacity building and blended finance.

Nepal is one of many countries that adopted an Integrated National Financing Framework. The Himalayan nation had struggled to attract private investment, making it difficult to fund its sustainable development initiatives. By providing technical assistance and capacity building, the UN Development Programme helped Nepal develop comprehensive financing strategies tailored to its specific needs. These strategies included refining Framework instruments to attract more private investors and facilitating access to capital. This approach can be complemented by sustainability-linked loans and bonds, encouraging real economy investments.

The United Nations Development Programme (UNDP) launched Climate Promise 2025 to challenge nations to do more to stem global warming in the third generation of NDCs. The objective is not just commitment but acceleration through finance, using Integrated National Financing Frameworks to turn NDCs into an investment framework. This includes sectoral decarbonization roadmaps to measure businesses' plans against NDCs. Beyond climate, the new Global Biodiversity Framework and the Convention on Biological Diversity promise to make this possible for wildlife preservation efforts as well. Also, countries can leverage their National Action Plans on Business and Human Rights and Responsible Business Conduct. Governments should prepare, publish and report on transition plans in order to inform and be informed by private-sector transition plans.

"These calls to action should avoid putting extra burdens or pressure on jurisdictions that are already in a difficult position. And that's both frontier and emerging market countries."

- Leila Fourie, Group CEO, Johannesburg Stock Exchange

Morocco's road to sustainable investment

Morocco shows how Governments can align their Nationally Determined Contributions with sustainable investment roadmaps and incentives to engage the private sector. The Moroccan Green Plan has been instrumental in transforming the agricultural sector into a sustainable industry by integrating climate objectives into national policies. The plan includes financial incentives, such as tax breaks and subsidies, to encourage private-sector investments in renewable energy projects, water conservation and sustainable farming practices.

These efforts have been supported by substantial public and private investments, with the Agricultural Development Fund increasing financial incentives by 112 per cent, generating significant economic and social benefits. This has helped fuel annual agricultural GDP growth of 5.25 per cent and the creation of more than 342,000 jobs. Morocco's NDC targets a 45.5 per cent reduction in greenhouse gas emissions by 2030, emphasizing innovative solutions like carbon capture in the phosphate industry and renewable energy for water desalination plants.

This approach demonstrates the importance of integrating the contributions from national development plans with financial incentives to attract private-sector investment, thereby achieving both climate and economic goals.

Trade deals and sustainability

Trade and investment policies can play a crucial role in aligning sustainability frameworks across jurisdictions. These frameworks help multinational corporations and investors navigate different regulatory environments, promoting cross-border investments in sustainable projects.

A notable innovation in this space is the inclusion of environmental, human rights and labour rights considerations in the legal frameworks that govern trade and foreign investments at the country, regional and global levels. This includes country investment regulation (separate from domestic investments), trade agreements (e.g. the Africa Trade Agreement and World Trade Organization), tax reform and anti-corruption efforts. For example, the WTO Investment for Development Framework supports emerging markets to adopt sustainable development investment policies.

Sustainable investments can also be promoted by countries' investment promotion agencies by focusing on investments that respect higher labor standards and support healthy job markets and avoid investment promotion through tax incentives that can result in lowering benefits for the host country.

Another opportunity is to develop sustainable taxonomies with the private sector and ensure that this categorization is broadly adopted in the private capital markets, including by data providers and credit rating agencies.

More than 30 jurisdictions around the world, including the EU and China, use taxonomies to define sustainable activities, to support regulation, to facilitate capital mobilization and to enhance risk management and transparency. While most sustainable finance taxonomies focus on the environment and climate, some countries have now introduced social and transition taxonomies. These taxonomies ensure that investments align with national and international sustainability goals and promote responsible economic growth.

This is a positive development, but care needs to be taken to ensure these taxonomies work across borders, making the comparability of investments easier and more consistent.

It's important to not add to the burden of already stretched Governments in developing markets. One example of such an effort is the Common Ground Taxonomy, a comprehensive mapping and comparison that supports the interoperability between the EU and China taxonomies and the convergence of sustainability definitions.

Countries can also integrate sustainable development priorities in policies for cross- border investments, including regimes applicable to foreign direct investments (FDI).

Transparency Calls to Action

Standard setters and regulators need to converge towards a dynamic but shared definition of sustainability and move towards the adoption of double materiality that includes a finance and impact perspective.

Governments need to adopt and adapt global sustainability reporting standards taking into account the local context. They should also work with the UN and development institutions on technical assistance and capacity building.

Governments should prepare national sustainable development and transition plans and work with their finance ministries to create sustainable investment roadmaps and incentives designed to encourage investment, including taxonomy for sustainable investments that are country-specific and globally aligned.

Key Transparency Recommendations

2 Leverage and scale open-source platforms and technology, including blockchain and AI - as it matures - to help fill gaps and improve the quality of sustainability data and improve overall financial integrity in emerging markets.

A key innovation opportunity for the sustainable finance sector lies in using existing and developing new open-source, AI-powered sustainability data platforms that expand access to critical sustainability information. When applied responsibly, such platforms could help address gaps in sustainability disclosures, particularly in emerging markets. To properly apply these tools, definitions and taxonomies will be critical to ensure accurate AI-generated insights.

Leverage big data through open sustainability platforms

Initiatives to share sustainability data from development banks and similar organizations are helping to improve transparency in sustainable finance, particularly in emerging markets. This includes efforts to create the Net-Zero Data Public Utility, a climate data repository to be integrated in the UN Framework Convention on Climate Change's Global Climate Action Portal. It also includes efforts by the World Bank and other development finance institutions to share historical data on emerging market investments, including financial returns, default and recovery rates, to help private investors better assess investment risks and opportunities and reduce perception of risk.

World Bank and DFIs historical data on financial returns

The World Bank and other Development Finance Institutions (DFIs) now share historical data on financial returns, default and recovery rates in emerging markets to help private investors better calibrate investment risks and opportunities. The data, which covers several decades of lending to the private sector, Governments and municipalities, helps counter misperceptions that investment in emerging markets is risky. It shows that default and recovery rates – the core component of risk ratings – can be lower than expected in emerging markets.

This includes the Global Emerging Markets Risk Database (GEMs), established in 2009 by the European Investment Bank and the IFC. It now brings together 25 multilateral development banks and development finance institutions with the shared objective of mobilizing more private-sector investment in emerging markets and developing economies by regularly publishing default and recovery statistics. GEMs is refining its methodology and exploring deeper granularity to provide even better value to investors.

It also includes the IFC Portfolio Default Rate Analysis, an analysis of default rates in the private loan portfolio of the IFC, covering nearly 40 years of data and most developing economies.

The open-source nature of these platforms supports ongoing improvements and transparency, as contributions from a global network of developers and experts enhance data quality and analytical methods. Customizable analytics and easy integration with existing financial systems through application programming interfaces make these platforms practical for financial institutions. By addressing the challenge of obtaining reliable emissions data, these platforms and technologies can ease the way for increased sustainable investment and finance in emerging markets.

Sustainability databases

The **Global Reporting Initiative** (GRI) maintains an open-source database of sustainability reports from thousands of companies worldwide.

The Principles for Responsible Investment (PRI) maintains a database that asset owners and investment managers can search and request access to private transparency reports and assessment reports from other signatories via the web-based Data Portal platform.

Net-Zero data public utility

The Climate Data Steering Committee was founded by French President Emmanuel Macron and Michael R. Bloomberg, UN Special Envoy for Climate Ambition and Solutions, in 2022. This initiative aims to support UN climate goals and accelerate climate action by enhancing the private sector's climate data reporting and disclosure. The Committee's noteworthy achievement was creating the Net-Zero Data Public Utility, a centralized repository to provide transparent, standardized, global, company-level greenhouse gas emissions data.

The platform works with the UN Framework Convention on Climate Change's Global Climate Action Portal, also launched in 2022, ensuring the data's widespread accessibility and usability. Overseen by the Committee and its advisors, the platform is continually updated and enhanced. By centralizing critical climate data, the platform facilitates informed decision-making and drives global momentum towards achieving a net-zero economy, supporting both corporate climate reporting and broader environmental accountability. It is a centralized repository of global company-level greenhouse gas emissions data to accelerate the transition to a net-zero economy.

"Fundamentally, artificial intelligence is the tool. So you can't start off with artificial intelligence. You have to start with what your objectives are and then match the tool to it in a way that integrates it to do what you actually want to do."

– Wayne Moodaley, MBA Programme Director, Graduate School of Business, University of Cape Town

Use AI to enhance and analyze sustainability data in emerging markets

Safely applied, AI "can accelerate progress towards the SDGs, enhance decision-making and drive innovation," according to UN Deputy Secretary-General Amina J. Mohammed.[12] Open-source, AI-powered platforms are emerging as a solution to effectively consolidate, standardize and analyze unstructured sustainability data in emerging markets and beyond.

News articles, multilateral development banks' project disclosures, financial reports and bond prospectuses can serve as crucial research tools in assessing sustainable development performance.

AI applications, such as machine learning algorithms and cloud computing, have recently led to innovations in the analysis of unstructured text data on a massive scale through the use of natural language processing techniques.[13]

These applications can bring about new data sets and insights to help investors, financial institutions, credit rating agencies and regulators better understand the risks, especially in emerging markets, and streamline the sustainability data collection and disclosure process, reducing costs, enhancing efficiency and improving data quality, including hard-to-obtain data such as Scope 3 greenhouse gas emission reports. AI is a powerful tool, but it is not a silver bullet for addressing the complexities of ESG data needs. While AI can enhance data analysis and identify patterns, it relies on the quality and completeness of the data it processes. Comprehensive ESG reporting still requires human oversight to ensure accurate and meaningful insights.

To advance sustainable finance, it's essential to harness the power of AI while managing its potential risks. With clear guidelines for responsible use and effectiveness, AI and big data stand to enable sustainable finance within emerging markets that have previously suffered from a lack of data resources.

Using AI for enhanced ESG data analysis

OS-Climate is an open-source collaboration involving companies including Allianz, Amazon and Microsoft, focused on building a data and analytics platform for assessing climate-related financial risks and aligning investment strategies with climate goals. This platform uses AI and big data to provide tools for scenario analysis, risk assessment and investment portfolio alignment with climate targets. It enables investors to better understand the potential financial impacts of climate change and integrate sustainability considerations into their investment decisions.

MALENA is an AI-powered tool developed by the IFC that automates the analysis of ESG data. This platform helps investors and companies assess sustainability performance and risks by providing detailed, standardized ESG insights. MALENA uses natural language processing and machine learning to glean insights from large volumes of data, with an aim of enhancing transparency and decision making in sustainable finance.

AI, open source and Scope 3 emissions.

AI and open-source platforms offer practical solutions for improving the accuracy and transparency of the elusive Scope 3 emissions data, which many companies find difficult to quantify.[14] These technologies enable the creation of real-time, comprehensive sustainability data systems that integrate information from various sources such as company reports, satellite imagery, Internet of Things sensors and public databases. AI can streamline the process of aggregating, cleaning and standardizing this data, allowing financial institutions to gain reliable insights into Scope 3 emissions and make better-informed investment decisions.

Transparency Calls to Action

Regulators should contribute to the development of open-source sustainability data platforms, work with development finance institutions to make sustainability information a public good and increase the overall data readiness of sustainability information.

Governments should encourage the responsible use of AI and invest in technologies to help bridge the sustainability data gap, especially in emerging markets, and enhance the integrity of business practices and financial and sustainability reporting.

“Unlocking private capital at scale for emerging markets requires creative thinking and a coordinated strategy. The entire architecture of the financial system – including banks, investors, ratings agencies, governments and regulators – must come together so that we can align on common objectives and approach. In doing so, it is imperative that we also find ways to better understand the risks and opportunities in these markets, leveraging development finance to align risks and mobilize private capital at scale.”

– Karen Fang, Managing Director,
Global Head of Sustainable Finance, Bank of America

RISK AND RETURN

One of the main barriers to sustainable finance, particularly in emerging markets, is a mismatch between risk and return. Contrary to common perception, investments in low-income countries aren't inherently more risky. According to the IFC, average default rates in private-sector lending in lower income countries were as low as 3.5 per cent and recovery rates were as high as 74.7 per cent. This compares with default rates of 3.4 per cent in the S&P Global Index, which represents the global investment universe. Once market participants understand the risk, the public and private sector must work together to offset it through a variety of means, including tax incentives and credit enhancements, such as first-loss capital and guarantees and blended finance.

At the core of investment management, modern portfolio theory provides a practical method for selecting investments to maximize overall returns within an acceptable level of risk for investors. However, today investors are introducing a new factor to this equation: impact. To varying degrees, investors now want their money to deliver returns not just for themselves but for the greater good. The market has to evolve to meet their demands. Some investors suggest that the theoretical models that underpin investment practice must be updated to integrate impact alongside risk and return.[15]

Thus, to align investors with the appropriate sustainable investment opportunities, investments need to achieve the right balance of risk, return and impact. Public and private players have the opportunity to play a role in mitigating risks and improving the return profiles of those investments. These measures will vary depending on the risks, including those stemming from political disruptions, currency fluctuations, climate change and advances in technology. Returns need to be made on par with the level of risk investors will accept.

As an example, barriers to private climate finance in developing markets often involve absence of adequate carbon pricing, long timeframes, high upfront capital and transaction costs and significant project and/or country risk.

Understanding these risks, especially for emerging markets, is a steep hurdle for many financial market participants. Investors cannot easily forecast expected returns relative to their duration expectations. Banks may require higher levels of capital reserves to absorb greater risk associated with those investments. And market participants may not have the capital, time and local financial tools to develop the pipeline for sustainable investments. We've heard throughout our consultations with asset managers, credit ratings agencies and financial institutions that this contributes largely to a larger flow of sustainable finance towards developed markets relative to emerging markets.

SDG Loan Fund

The SDG Loan Fund is a US$1.1 billion blended private debt fund that provides high-impact loans to companies and projects aligned with the SDGs. Managed by Allianz Global Investors and the Dutch development bank FMO, the fund allows institutional investors to co-invest with development funds in loans for financial institutions and intermediaries. It tackles three target sectors: agribusiness, financial institutions and renewable energy. Backed by a US$25 million guarantee from the MacArthur Foundation and a US$111 million first-loss investment by FMO, the fund reduces risk for commercial investors, demonstrating how blended finance can mobilize private investment through multi-stakeholder collaboration.

Contrary to common perception, investments in low-income countries don't inherently carry high risks. According to the IFC, default rates in private-sector lending in these countries were as low as 3.5 per cent and recovery rates were as high as 74.7 per cent. This compares with default rates of 3.4 per cent in the S&P Global Index, which represent the global investment universe.

In many cases, of course, the risks are higher in low-income countries and in emerging technologies, but this is something investors may accept in return for a potentially bigger payoff.

The key is an accurate assessment of risk alongside the appropriate level of short-term incentives. If the risk becomes an obstacle, the public and private sectors must work together to spread it out among the different stakeholders and provide the incentives to maintain investor interest. This can be accomplished through a variety of means, including tax incentives aligned with development outcome and expanded use of public-private partnerships, in which public or philanthropic funds take a first-loss position on certain investments.

Compounding the risk-return imbalance – both perceived and actual – can be a timing mismatch between investors' time horizon and sustainability investments. Returns on sustainable investments may take longer than traditional investments to realize, making them less certain and requiring more discounts. Sustainability risks also tend to materialize in the longer term, while risk ratings are assessed over a one- to two-year period. Public markets tend to value cash flows only a few years out, making it difficult to assign a financial value to sustainable investments and ultimately leading to a higher cost of capital.

Another roadblock is policy uncertainty. Long-term credible policy setting by Governments is crucial to help move investors and companies away from short-term investing towards long-term investing.

Financing the clean energy transition

Emerging markets and developing economies are expected to see soaring demand for energy in coming years to meet basic needs from cooking family meals to powering up new factories that will provide jobs in frontier economies.

Unless it's clean energy, however, the burgeoning demand for electricity will exert a heavy toll on the environment. Everyone wants clean energy in theory but, in practice, lower-income countries often lack the technical expertise, resources and institutional capacities to move in that direction.

Enter the Climate Investment Funds (CIF), founded in 2008 to finance clean energy projects in developing economies and for which the World Bank acts as a trustee. One of the CIF's newer initiatives is the Global Energy Storage Program, launched in 2020 as a multilateral funding mechanism for energy storage. Through the program, CIF has so far invested more than US$275 million for 14 projects, which is expected to generate an additional US$3.3 billion in public and private investments. To date, CIF has allocated more than US$1 billion in financing for energy storage.

Another CIF program is the Clean Technology Fund, which supports the piloting and scale-up of promising low-carbon technologies in developing countries through low-cost finance for renewable energy, energy efficiency, sustainable transport and green industry projects.

Recent projects include a solar battery storage project in India's state of Chhattisgarh, one of the nation's poorest regions and one that relies heavily on coal to generate energy.

Inaugurated in February 2024, the plant offers a combination of solar energy and battery storage, catering to peak demand for three hours every evening and displacing fossil-fuel power.

Key Risk and Return Recommendations

1 Scale mechanisms and approaches to better manage and allocate risk for sustainable investments such as development finance and private philanthropy taking first-loss positions.

Joining forces for climate and nature

At COP28 in 2023, multilateral development banks and international organizations announced the Joint Declaration and Task Force on Credit Enhancement of Sustainability-Linked Sovereign Financing for Nature and Climate.

This initiative aims to provide long-term fiscal solutions to developing countries dealing with climate change and nature preservation issues rather than relying solely on short-term debt relief. The Task Force, led by the Inter-American Development Bank and the U.S. International Development Finance Corporation, focuses on enhancing credit mechanisms to support sustainability-linked sovereign financing. Participants in this initiative include the Agence Française de Développement, Asian Development Bank, African Development Bank, European Investment Bank, Green Climate Fund and the Global Environment Facility.

The primary goal is to create innovative financial instruments that reduce borrowing costs and attract private-sector investment. These instruments include credit guarantees, political risk insurance and sustainability-linked bonds, which help mitigate risks for investors and encourage investment in nature and climate projects. By pooling resources and expertise, the Task Force aims to mobilize significant private capital to support sustainable development in low-income countries, thereby enhancing their ability to meet climate and nature goals while ensuring economic stability and growth.

Some investors will be reluctant to invest in developing markets simply because they are unfamiliar with them or because they perceive them to be too risky. In fairness, in many developing regions there is a paucity of the market information and data required to give investors a clear picture of the risk/return ratio (see Transparency section).

Improving transparency and making market information more widely available and accessible will have a compounding effect on the sustainable finance market. It will allow investors to better separate real and perceived risks and build investor confidence in sustainable finance and emerging markets more broadly. As already noted, open-source, AI-powered platforms are emerging as one of many solutions to consolidate, standardize and analyze sustainability data effectively, which will be valuable for investors and businesses to better understand and account for risk.

> **"There is a tendency to say there's not enough bankable deals, actually it's just that a lot of opportunities have not yet been structured.**
>
> **- Brooks Preston, Managing Director, Macquarie Group**

Mitigating genuine risks

When risks are known and understood, capital providers can make sustainable investments more viable by making adjustments, including in how the investments are structured. Blended finance, for example, combines capital from philanthropists, Governments and private investors to support high-impact but hard-to-fund initiatives.

In effect, blended finance acts as an insurance policy for private investors and companies – if things go wrong, the public and philanthropic investors will take most of the hit. Innovation and a deeper commitment, particularly from those who provide capital at favorable terms, are required to expand the availability and benefits of blended finance as a tool in sustainable finance.

Financial institutions and other companies are increasingly interested in using blended finance to support sustainable investments focused on emerging markets and new technologies. But many cite onerous compliance requirements and long timeframes as a barrier to scale the use of blended finance.

Philanthropic groups and foundations can also play a bigger role in what's known as catalytic philanthropy, committing their resources to expand the pool of first-loss funding positions and catalytic capital that can lessen the risk of sustainable investment for the private sector. One example is from the TCX Fund, in which DFIs and donors created a fund for the specific purpose of spreading risk for investors looking to hedge currency risk.

Catalytic capital from DFIs, donors and philanthropic institutions can also play a critical role in supporting the development of local capital market institutions in emerging economies, which are best positioned to understand and manage the risks of the local market and investment environment and can serve as valuable partners of international investors. Domestic and regional institutions, like the African Guarantee Fund (see Box below), can drive local expertise, tailored financial products and capital in local currency towards sustainable investment over the long term.

African Guarantee Fund: A risk-sharing partnership

Rigorous and restrictive requirements hinder small- and medium-sized enterprises (SMEs), particularly women-focused businesses, from access to credit, excluding them from economic growth.

Established in 2011 by the Governments of Denmark and Spain and the African Development Bank, the African Guarantee Fund (AGF) is a non-bank financial institution dedicated to promoting inclusive economic development throughout Africa. By providing loan guarantees and other financial products to African financial institutions, the AGF provides SMEs increased access to financing. Additionally, the AGF supports capacity-building initiatives in its client financial institutions.

AGF has been a key risk-sharing mechanism in the region to enhance collaboration and spur economic growth. For example, AGF and Ecobank, the leading pan-African banking group, signed a transformative US$200 million risk-sharing agreement aimed at boosting entrepreneurial ventures, notably women-owned SMEs. The partnership was launched in 2013 with a US$50 million guarantee covering seven countries. It gradually expanded to 14 countries by 2018, with a cumulative disbursement of US$230 million. The renewed partnership now extends to 27 countries within Ecobank's African network and offers 50 per cent coverage for qualifying SMEs across all targeted markets.

By leveraging the AGF's proven risk mitigation capabilities and Ecobank's extensive network and financial expertise, the collaboration addresses the challenges SMEs face in accessing affordable financing, particularly in enabling women-focused businesses access to credit. Key outcomes include an enhanced 75 per cent guarantee cover for gender financing and green transactions, greater lending capacity to SMEs contributing to job creation and risk mitigation, allowing for financial inclusion and increased economic activity.

Risk and Return Calls to Action

Development finance and private philanthropy should prioritize catalytic financing, including first-loss financing, to mitigate risk and increase private-sector investment in sustainable development, without impacting assistance for sustainable development priorities in the public sector, and incorporating key anti-corruption safeguards.

Governments and development finance institutions should partner with private-sector companies to create streamlined risk-sharing solutions for sustainable investments in emerging markets or technologies, including through the use of concessionary funding, guarantees and tax incentives.

Governments should work with credit rating agencies to refine and/or develop products and benchmarks that properly account for the longer-term risks and opportunities associated with climate and sustainability.

2 Develop and enhance the market for outcome-based financial products, such as sustainability-linked and use-of-proceeds bonds and loans, to incentivize sustainability outcomes in the public and private sectors.

A recent key market innovation for achieving the SDGs is outcome-based financing. Essentially, this is where a bank, pension fund, Government agency or other institution agrees to lend money or extend credit on the condition that it be used for specific sustainability investments (so-called use-of-proceeds finance) or that the borrower will meet ambitious targets related to sustainable development (sustainability-linked finance).

Outcome-based financing offers enormous potential benefits for sustainable development. Some estimate that this market – which stands at US$7 trillion today - could reach more than US$30 trillion in the next 10 years. Currently, use-of-proceeds bonds represent the largest segment of the outcome-based financing market at US$3 trillion, followed by sustainability-linked loans at US$1.5 trillion.

There are obstacles to further growth in this market, however. While these transactions have generally been successful, investors are questioning whether the actual benefits measure up to the promises being made, and issuers are re-assessing the cost-benefit equation.

The other big issue is risk. This is where multilateral development banks and other organizations can help, providing a financial cushion to limit the potential losses private investors can face in the least developed countries. Outcome-based finance can be particularly beneficial in least developed countries, but measures are needed to overcome hurdles including high-interest rate environments, underdeveloped capital markets and more challenging risk profiles.

Innovations in outcome-based finance

Including regulatory-linked KPIs in Sustainability-Linked Financing Framework

In 2023, Enel, an Italian multinational utility, updated its Sustainability-Linked Financing Framework (SLFF), unveiling a net set of challenging KPIs among which the company included a KPI associated with the EU Taxonomy. This KPI commits the company to align 80 per cent of its CAPEX to the EU taxonomy criteria for the period 2023-25.

The innovative KPI was adopted by Enel in two consecutive sustainability-linked bonds issuances in the Eurobond market in 2023 and 2024 of respectively 1.5 billion euro and 1.75 billion euros as well as in an innovative development finance operation with the European Investment Bank (EIB). The latter operation, launched in 2022 and enhanced in 2023, saw the agreement of Enel, the EIB and SACE, the Italian Export Credit Agency, on a total 900 million dollars sustainability-linked, multi-country, multi-business and multi-currency facility to promote Enel Group investments in Latin America. The facility was linked to KPIs associated with GHGs reduction and to EU Taxonomy KPIs. Enel represented the first sustainability-linked operation by the EIB and SACE and the largest financing of the EIB to a private sector entity outside Europe. More specifically, the partnership had a de-risking effect, allowing for both bigger volumes and more competitive funding – thus resulting in a bigger impact for the energy transition and digitalization in the region in line with the Sustainable Development Goals (SDGs).

The operations described set a precedent in the industry, demonstrating how companies can leverage sustainable finance instruments to fund projects that meet strict environmental criteria such as the ones outlined in the EU Taxonomy.

Tires and science-based targets

Pirelli, an Italian tire manufacturer, needed more capital to finance the reduction of carbon emissions to meet global sustainability standards. The company also needed to enhance its ability to integrate environmental responsibility into its operations. This included revamping its supply chain, optimizing production processes and investing in innovative materials and sustainable practices throughout its value chain.

To address these challenges, the company launched a €600 million sustainability-linked bond in 2021. The bond will finance a 42 per cent reduction in Scope 1 and 2 greenhouse gas emissions and a 9 per cent reduction in Scope 3 emissions from raw materials by 2025, as verified by the Science Based Targets initiative. These commitments align with the Paris Agreement's goal of limiting global temperature rise to 1.5 degrees Celsius.

Innovation to shore up credibility of outcome-based finance

The following actions and innovations can significantly increase the credibility of outcome-based financing:

- **Linking outcome-based finance with companies' science-based targets and transition plans, and country development priorities.** To improve credibility, issuers of sustainability-linked finance have started to link their instruments to science-based targets (e.g. the Science-Based Targets initiative or SBTi) or to Governments' own commitments and targets under the Paris Agreement (e.g. the NDCs) or the Convention on Biological Diversity. Companies should also consider linking their use-of-proceed and sustainability-linked bonds to their climate transition plans.

- **Aligning with sustainable finance taxonomies.** One model is the European Union, which recognizes green and sustainability bonds or loans as taxonomy-aligned if issuers can demonstrate that the proceeds are used to finance activities or assets covered in the European Taxonomy for Environmentally Sustainable Economic Activities.

- **Hybrid sustainability-linked and use-of-proceed strategies.** Some companies, countries and development banks are testing hybrid financial strategies to leverage both performance targets and allocation of funds into predetermined areas. This approach can increase the transparency and credibility of companies' sustainable finance portfolio and increase the opportunity to qualify for sustainable taxonomies and investment funds. For example, some companies have issued bonds featuring separate use-of-proceed and sustainability-linked tranches, allowing a combined strategy while retaining each instrument's respective purpose and focus. Companies and sovereign issuers also increasingly address both their investment plans and sustainability targets in hybrid financing frameworks, allowing for issuance of both use-of-proceed and sustainability-linked bonds as part of comprehensive outcome-based financing strategy.

Ecuador's debt-for-nature swap

Ecuador, a nation renowned for its rich biodiversity, faced the dual challenges of substantial national debt and the urgent need to protect its natural heritage, which includes the Galapagos Islands. Ecuador pioneered an innovative debt-for-nature swap, a financial mechanism that restructures national debt obligations while promoting environmental conservation. This initiative led to the creation of the Galapagos Bond, a US$1.6 billion instrument that facilitated the reduction of Ecuador's national debt by US$1.1 billion. The savings from this debt reduction were redirected towards the conservation of the Galapagos Islands, a UNESCO World Heritage site and one of the most biologically diverse areas on the planet.

The success of this initiative was made possible through the collaboration of the Ecuadorian Government, the Inter-American Development Bank (IDB) and various international partners. The IDB played a crucial role by providing credit enhancements and guarantees, making the bonds attractive to private investors. This partnership exemplifies the potential of combining outcome-based financing with traditional development finance to create impactful and sustainable solutions for emerging markets.

This debt-for-nature swap not only provided Ecuador with access to cheaper finance but also ensured the growth of the market for outcome-based finance. The funds saved from reduced debt obligations were channeled into concrete environmental outcomes, creating a sustainable financing model that aligns with economic and environmental goals. By leveraging financial innovation, Ecuador set a precedent for other emerging markets, showcasing how national debt burdens can be alleviated while fostering significant investments in critical sustainability projects.

Ecuador's debt-for-nature swap highlights the importance of comprehensive policy mechanisms and cross-cutting solutions that address multiple sustainability goals. It underscores the value of proven financial instruments in driving real progress and the necessity of geographical representation in sustainability initiatives. This case study serves as an ambitious example of how innovative financial solutions can support long-term environmental and economic benefits, demonstrating the potential for scalability and replication in other regions facing similar challenges.

Outcome-based finance can also help Governments, cities, banks, companies and others raise capital for the SDGs and sustainable economic development more broadly through publicly traded bonds or loans from commercial and development banks.

In turn, with a broader range of market participants and more transactions, outcome-based finance can become a new investment asset class offered to institutions, individuals and pension funds looking to invest money that will improve the lives of millions of people.

Modern portfolio management and financial structuring techniques can help improve the risk-adjusted return of outcome-based finance through diversification and matching different investors with their unique risk profiles.

Development banks can also play a key role in supporting continued expansion of the market. They can use outcome-based finance more systematically in their own financing as well as their lending to prove out the new investment models. Infusing outcome-based finance elements more widely into their lending can help the market grow in size, credibility and reputation. Outcome-based finance can also be used in combination with blended finance to support countries and corporations working to achieve the SDGs, particularly in emerging markets.

A boost for green bonds

Green bonds have been a go-to tool for financing environmentally sustainable investments since 2007, but policy makers agree that they are far from reaching their potential, especially in those countries without well-established capital markets. The Global Green Bond Initiative (GGBI), jointly led by the European Commission and a consortium of European development finance institutions including the European Investment Bank (EIB), aims to fix that.

The GGBI seeks to spur green investments of up to 15 billion to 20 billion euros by providing technical assistance to green bond issues in emerging markets and developing economies and by encouraging private investment through a dedicated de-risked fund which will serve as an anchor investor in green bonds from these countries.

"Our idea and our offer are that we first of all share directly expertise and know-how on how you develop these green bond markets," European Commission President Ursula von der Leyen said at the 2023 Summit for a New Global Financing Pact. "Nobody issues more green bonds than the European Union."

"Of course, we also have to push the investor side," she added. "We are now committing EUR 1 billion to basically give private investors the certainty they need to step up their investments. And this could attract around US$15 to $20 billion of sustainable investment."

The EC, EIB and their partners see the program as not just an opportunity to spur green investments but also to develop and strengthen local capital markets in developing countries.

Uruguay's Sovereign Sustainability-Linked Bond solution

Uruguay struggled to integrate its financial strategies with sustainability goals, causing environmental harm and missed global climate targets.

As a solution, Uruguay created a Sovereign Sustainability-Linked Bond (SSLB) Framework linking financial performance to clear, ambitious sustainability goals.

Many countries and companies face similarly significant challenges in aligning their financial activities with sustainability objectives. Traditional financial instruments often lack the necessary incentives to drive environmental improvements. Additionally, there is frequently insufficient transparency and accountability in reporting progress towards sustainability goals. Developing effective sustainability-linked financial mechanisms is complex, requiring extensive expertise and cross-sector collaboration, which can be a barrier for many organizations.

Uruguay's SSLB Framework addresses these issues by tying the country's bond financing strategy to its climate and nature targets under the Paris Agreement. The framework focuses on two KPIs: reducing greenhouse gas emissions per unit of real GDP and maintaining the area of native forests. These KPIs are backed by quantitative targets set for 2025, aligning with Uruguay's Nationally Determined Contributions.

The innovative two-way pricing structure of the SSLB adjusts the bond's financial terms based on the achievement of these KPIs, creating a direct financial incentive for meeting sustainability targets. This approach ensures that the cost of capital is linked to environmental performance, encouraging the Government to pursue its sustainability goals aggressively. Additionally, the framework includes robust reporting and independent verification mechanisms, ensuring transparency and building investor confidence.

The development of Uruguay's SSLB Framework involved collaboration across multiple governmental ministries and international organizations, such as the IDB and the UNDP. This multi-stakeholder approach provided the necessary expertise and support to create a credible and effective framework. By adopting similar principles, other countries and companies can integrate their financial strategies with sustainability goals, providing clear incentives for achieving environmental targets and ensuring transparency and accountability.

"There are risks that private asset managers are not willing to take alone, which often require blending in capital from other sectors through the development and deployment of emerging technologies. This is the case for almost the entire next generation of energy technologies."

– Oliver Libby, Managing Partner, H/L Ventures

How China's Ant Group is financing a path to net zero

Chinese fintech giant Ant Group, which owns the popular payments platform Alipay, has committed to integrating ESG (environmental, social and corporate governance) into its DNA. To that end, the Hangzhou-based company in 2023 converted a US$6.5 billion credit facility into a loan it can use to pay for ESG initiatives, including applying green computing algorithms to improve server efficiency in its leased data centers.

Ant Group's sustainability-linked loan was the largest in the Asia-Pacific loan market and the third-largest globally, according to Bloomberg, citing Dealogic. The loan is believed to be the first of its kind in the Chinese tech sector, and Ant Group said the money will be used to help the company achieve net-zero carbon emissions by 2030.

In 2023, Ant Group began using Sustainability Accounting Standards Board industry standards as a guiding reference for its sustainability reporting. The company, founded by Jack Ma, has also strengthened its climate-related disclosures with reference to ISSB requirements, including detailing how its executives and senior management tackle climate-related decisions as well as the establishment of an early warning platform to monitor extreme weather's impact on business operations.

"This is where development finance can really step up. The development banks and agencies have a catalyzing and co-investing role to play through first-loss protections, guarantees and credit enhancement."

– Gavin Power, Executive Vice President and Chief of Sustainable Development and International Affairs, PIMCO

Risk and Return Calls to Action

Banks and investors should incorporate outcome-based financing within investment and loan portfolios, thereby mainstreaming the use of sustainable financial products.

Multilateral development banks should lead the development of outcome-based financial instruments by:

- creating and investing in dedicated funds
- developing blended finance products to offer enhanced returns tied to the achievement of specific outcomes
- providing technical assistance to Governments and companies to build the necessary skills and knowledge to engage in outcome-based financing, including outcome measurement and verification
- taking small holdings in sustainability-linked and use-of-proceed bonds and loans as anchor investors

Key Risk and Return Recommendations

3

Match investor profiles with sustainable investment opportunities. This can take shape for emerging markets and emerging technologies alike.

Focusing on the “double return” of sustainable investments

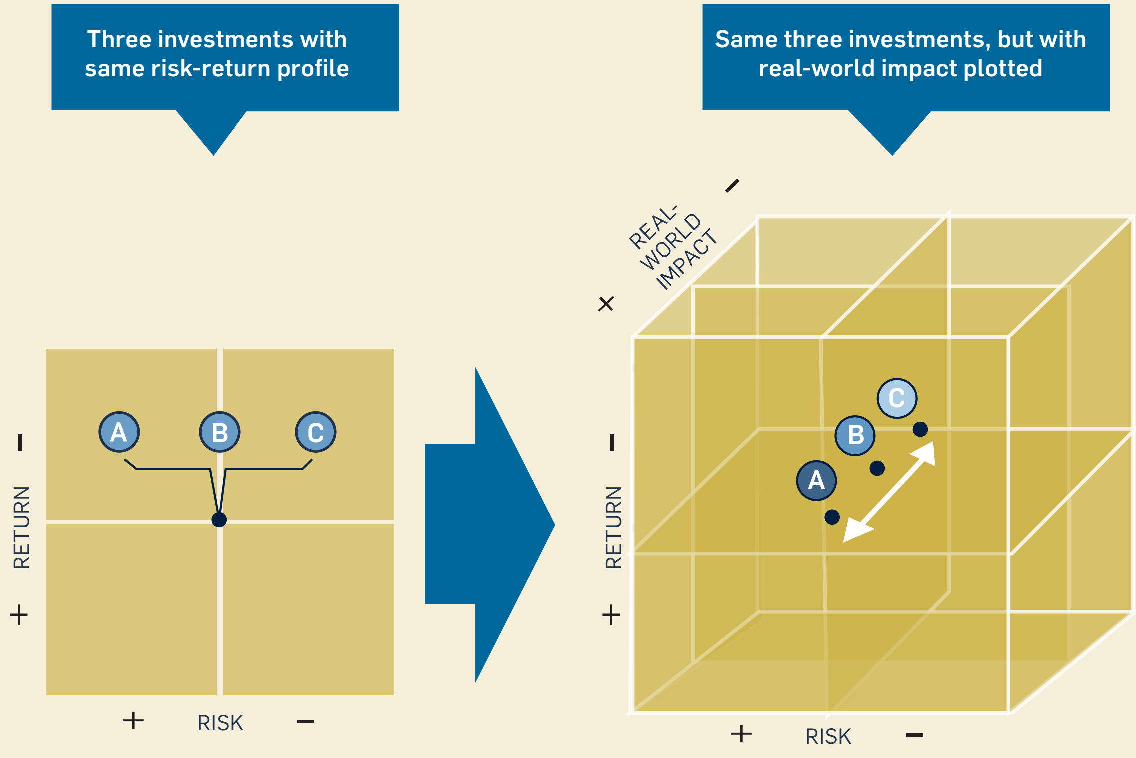
Focusing on the potential return of sustainable investments is key to balance higher risks and to attract investors. The solution is to leverage the dual nature of sustainable investment returns – financial returns and impact returns.

First, sustainable investments can yield higher financial returns. By overlaying impact metrics with traditional risk-return analyses, investors gain insights into potential ESG risks but also insights into opportunities for returns that may have otherwise been overlooked. More than half of individual investors say they plan to increase their allocations to sustainable investments in 2024, citing as a main factor the financial performance of sustainable investments, according to Morgan Stanley research. In addition, higher risks in emerging markets are an opportunity to get higher returns on investments and can be attractive for investors looking for strong growth outside of traditional markets.[16]

Second, sustainable investments yield a new type of return on investment, focused on sustainability impact. By integrating impact in the traditional risk-return framework, we create a more holistic assessment of long-term value and returns for investors – one that can effectively offset higher investment risks and address investor preferences.

Capturing investor’s sustainability preferences

Active investment managers increasingly include sustainability preferences as they design custom investment portfolios for their clients. This includes proactive efforts to understand end-investors’ interest in sustainability outcomes. It also includes methods to assess the sustainability outcomes of investments alongside risk-adjusted returns, providing a three-dimensional model to assess the relevance of investments based upon end-investors’ specific preferences.



Source: PRI

Recent studies[17] demonstrate that investors are no longer solely focused on traditional financial returns. They now want their portfolios to achieve something more, including environmental stewardship, social equity and sound governance practices. By integrating ESG considerations into asset allocation, investors aim to mitigate risks associated with climate change, regulatory pressures and social unrest while also capturing opportunities in emerging sustainable markets. This approach involves using ESG scores to optimize portfolios, balancing return, risk and sustainability preferences.

This shift towards sustainability-aligned investments underscores a growing recognition among investors that sustainable practices are integral to achieving both financial success and positive societal impact, leading to better knowledge of investment opportunities that enable investors to choose among investments with similar risk-return characteristics by selecting those with better sustainability outcomes.

Shifting to a dual approach to return on sustainable development investments is an opportunity to better match investors with investment opportunities, and to increase the overall size of the market. Investors have very different priorities – not just in terms of their return expectation and risk appetite, but also in terms of sustainability preferences.

Both individual and institutional investors are increasingly adding impact or sustainability-related preferences to their risk-return objectives in the mandate of asset managers or investment advisors. The table below provides a broad classification of investor types, based on their risk, return and impact expectations.

Table: Classifying investors' risk, return and impact profiles

IMPACT INVESTING Investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. Impact investors often target specific sectors or issues, such as clean energy, affordable housing or healthcare access.	**Emphasizes** Impact over financial outcomes. **Priority** Impact
SUSTAINABLE INVESTING Investing to achieve financial returns while incorporating ESG considerations. This approach emphasizes long-term value creation and risk mitigation through responsible investment practices. The positive social and environmental outcomes are seen as complementary to the financial objectives	**Emphasizes** Impact alongside financial outcomes. **Priority** Both impact and financial outcomes
ESG INVESTING Investments incorporating Environmental, Social and Governance factors into the decision-making process. It involves analyzing a company's ESG performance and practices to assess its overall sustainability and risk profile. ESG integration aims to incorporate these factors into traditional financial analysis, helping investors identify companies that exhibit responsible business practices.	**Emphasizes** Financial outcomes by using long-term sustainable goals as a means of offsetting risk. **Priority** Financial outcomes

Risk and Return Calls to Action

Governments, multilateral development banks, companies and asset managers should collaborate to build a pipeline of sustainable investment opportunities.

Investors should incorporate impact metrics into the conventional risk-return framework, enabling a comprehensive evaluation of long-term value that both offsets heightened risks and aligns with contemporary investor priorities.

"In Europe and Asia, sustainability is being woven into the corporate decision-making process. It may not be fully front and center, but it's definitely there ... In the U.S., if you look at the practices of corporates, most of them have a pretty advanced level of sustainability reporting and practices."

– Doug Peterson, President and CEO, S&P Global

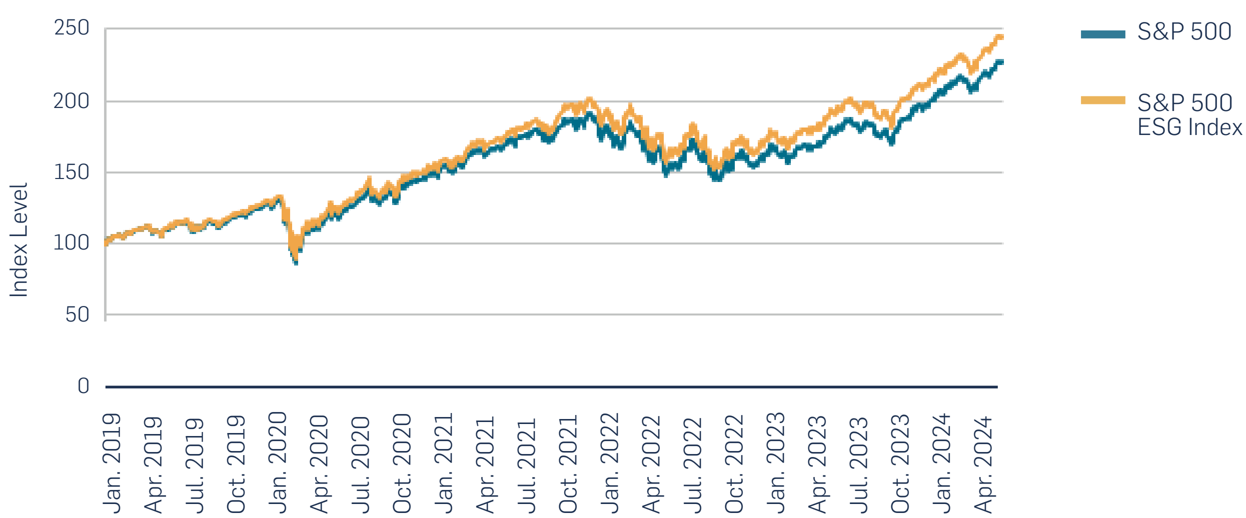
INTEGRATION

Sustainable business practices generate higher value over the long term. According to Institutional Investor, the S&P 500 ESG Index (for investments in firms focused on environmental, social and governance factors) has outperformed the S&P 500 by a cumulative 15.1 per cent over five years.[18]

Despite this, our consultations with private-sector players have made it clear that voluntary requirements and guidelines alone won't move the needle. Some CEOs have made sustainable finance a central focus, only for priorities to shift following a leadership change. Greenwashing has also emerged as a genuine threat to achieving the SDGs, in part because some companies might see a reputational risk in committing to a project that does not have substantial credibility. The evidence is clear – voluntary requirements and guidelines alone won't move the needle.

Some experts believe there's been a recent slowdown by companies and investment decision makers in integrating sustainability into their decisions. Therefore, it's crucial to focus on adopting unified standards and enforcing them simply to ensure that the SDGs are achieved. Even more can be accomplished by promoting partnerships between private enterprise and non-profit organizations on sustainable finance, which can give companies the incentives they need to implement costly measures that advance the SDGs.

Performance of the S&P 500 ESG Index and the S&P 500



Source: S&P Dow Jones Indices. Data as of June 28, 2024. Index performance based on total return in USD. Indices were rebased to 100 on Jan. 28, 2019.

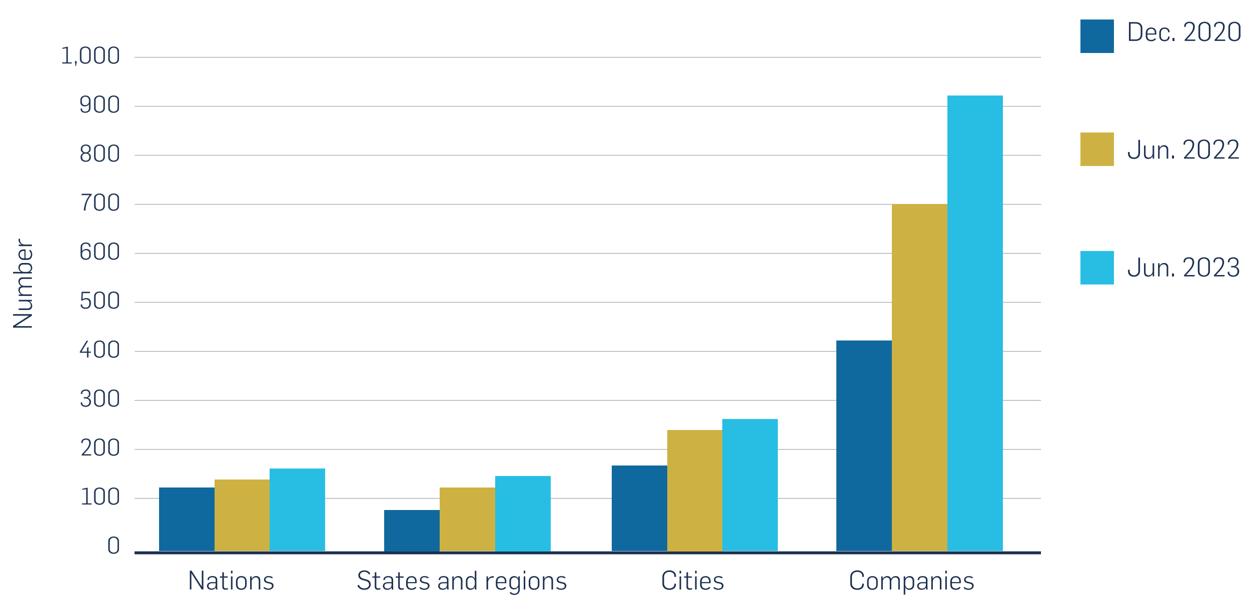
Key Integration Recommendations

1 Make sustainability a fiduciary duty for market participants, including corporate executives and board directors, asset managers and investment advisors.

These recommendations aim to embed sustainability practices across the financial value chain, making sustainability a fiduciary duty of corporate officers and directors, asset managers and investment advisors, and orienting companies, financial institutions and institutional investors around the shared objective of financing sustainable investment. It is also key to brokering more collaboration among various actors in the sustainable finance value chain, including in the public and private sectors.

The fiduciary duties that govern the actions of financial and non-financial company executives and directors, asset managers and investment advisors should include sustainability considerations. These financial gatekeepers should be given the authority and support to commit to sustainability, and they should be held accountable for their actions.

Net-zero targets have increased globally at all levels



Source: Net-Zero Tracker S&P Global Ratings.

Executive and strategic integration of sustainability

Standards and regulations are increasingly calling upon executives to integrate sustainability in corporate strategy and investments. This is reflected in a growing practice to adopt high-level strategic goals related to sustainability.

This includes setting strategic targets aligned with science-based sustainability goals, requiring boards of directors and executives to focus on sustainable investments and practices. As an example, science-based targets and other established metrics could be used to align bond issues with specific outcomes, a measure that can be deployed to discourage greenwashing. Asset managers should also be required to provide clients with a better understanding of their investment choices with regard to sustainable practices.

Science-based sustainability goals play a crucial role in enhancing integration within corporate frameworks by providing clear, measurable targets rooted in empirical data and research. These goals redefine the traditional concept of fiduciary duty from a narrow focus on short-term financial returns to encompassing long-term value creation that includes ESG factors. This paradigm shift underscores the importance of incorporating robust scientific insights into decision-making processes and using them to set strategic sustainability targets unique to each company.

Another successful factor in sustainability integration in executive leadership is to tie executive performance evaluations and compensation to the achievement of sustainability goals. According to the *Wall Street Journal*,[19] more than half of S&P 500 companies incorporated climate-related metrics into executive compensation plans in 2023, twice as many as had done so two years earlier. By continuing this trend of tying executive compensation to sustainability objectives, companies (and the people who run them) stand to drive meaningful action on corporate sustainability practices.

In particular, the role of Chief Financial Officer is critical to ensure that companies make the right investments to support sustainability goals and strategies and integrate sustainability targets and KPIs in corporate finance. CFOs also have an important role to play in leveraging corporate governance and control mechanisms to strengthen the monitoring and reporting of sustainability performance. The UN Global Compact CFO Coalition for the SDGs and its partner organization Accounting for Sustainability highlight the central role of corporate investment in delivering on sustainability strategies.

Beyond the C-suite, sustainability requires engagement and buy-in across all levels of the organization, including frontline employees and middle management, fostering a culture where sustainability is embraced as a core value and integrated into daily operations and decision-making processes.

Separately, banks should assess and manage sustainability impact in their loan portfolio to ensure proper risk management and avoid higher regulatory capital requirements, as climate and other sustainability risks can impact the performance of the loan portfolio. Banks should also establish strategies to allocate capital in areas that drive positive impacts in areas such as climate and nature protection, financial inclusion and health, and they should establish financial incentives for clients to minimize environmental and social impacts and drive positive development impacts.

Sustainability should also be built into institutional investors' and asset managers' fiduciary duties to invest with care and loyalty to their clients. This includes taking into account sustainability factors that can impact financial returns and therefore the achievement of investment objectives. For example, large institutional investors should assess the systemic risk of climate change across investment portfolios, and investments in renewables should be made based on a cheaper cost of energy. It can also include pursuing sustainability goals when it is part of a client's investment preferences or when it is the stated objective of a financial product.

"All investors benefit from an enabling responsible investment policy and regulatory environment. While the global responsible investment ecosystem has matured rapidly over the past decade, policy and financial market reform is still needed to reward leading practices."

– David Atkin, Chief Executive Officer, Principles for Responsible Investment

The European Green Deal: Embedding sustainability in financial regulation

The European Union in 2018 moved to steer its diverse economy towards sustainable investments to ensure resiliency in the face of climate change and other global challenges. The resulting European Green Deal was aimed at shifting capital flows to ensure that the economy could stand up to climate change, natural disasters, environmental degradation and social disorder. The European Green Deal states that the EU will become climate-neutral by 2050.

To achieve these goals, the EU deployed an ambitious regulatory framework, embedding sustainability at the core of the industrial and financial activities of all economic actors based in the EU or non-EU players that do business there.

- The EU taxonomy is a cornerstone of the EU's sustainable finance framework and an important market transparency tool. It helps direct investments to the economic activities most needed for the transition, in line with the European Green Deal objectives. The taxonomy is a classification system that defines criteria for economic activities that are aligned with a net zero trajectory by 2050 and the broader environmental goals other than climate.[22]

- The Sustainable Finance Disclosure Regulation imposes rules on the publication of information on the sustainability of an investment, aiming to make it easier to compare financial products for investment services providers and asset managers.

- The Corporate Sustainability Reporting Directive requires businesses to publish regular reports on the environmental and social risks they face, and how their activities impact people and the environment. It is based on the concept of double materiality, and its goal is to provide clarity to better evaluate EU companies' sustainability performance and the related business impacts and risks.

- The Corporate Sustainability Due Diligence Directive "establishes a corporate due diligence duty." The core elements of this duty are identifying and addressing potential and actual adverse human rights and environmental impacts in the company's own operations, its subsidiaries and, where related to its value chain(s), those of its business partners. In addition, the Directive sets out an obligation for large companies to adopt and put into effect, through best efforts, a transition plan for climate change mitigation aligned with the 2050 climate neutrality objective of the Paris Agreement as well as intermediate targets under the European Climate Law.

Similarly, the U.S. Securities and Exchange Commission has proposed rules that would require companies to disclose detailed information about climate-related risks and governance, with the intent to provide investors with consistent and decision-useful data. Offering incentives such as tax benefits or enhanced market listings to companies that exceed these baseline requirements can further encourage robust data transparency and foster a culture of accountability and sustainable business practices.

Sometimes lifting an outdated policy can be an effective change in itself. Sustainability impacts – negative or positive – should be reflected on banks' and insurance companies' capital requirements, including in regimes like the Third Basel Accord (Basel III) and the EU Solvency II Directive, which set international standards on capital adequacy, stress testing and liquidity requirements. At the same time, policy changes should be considered in banking and prudential regulations to remove barriers to capital flows in emerging markets. When reviewing models that can be replicated in other markets, it's important to acknowledge local circumstances where each country will have its own priority and dynamics so as not to further increase disparities among countries.

The State of Regulation and Fiduciary Duty

Laws, codes and standards are evolving to support and encourage the requisite integration of sustainability into the governance, duty and responsibilities of private-sector firms.

This includes corporate governance and disclosure requirements for companies listed on stock exchanges, as proposed by the UN's Sustainable Stock Exchange initiative. It also includes a comprehensive regulatory update to incorporate sustainability across financial markets.

How the Bank of England is tackling risks from climate change

As the core intermediary in the financial architecture, the banking system requires accurate risk management regarding capital requirements to ensure resiliency on sustainability-related financial risks. Enhanced risk management translates directly into portfolio impact management and effective sustainability practices can even lead to lower regulatory capital requirements.

In 2023, the Bank of England (BoE) reported on climate-related risks and the regulatory capital frameworks, testing the resilience of banks and insurers against severe but plausible climate scenarios, examining both physical risks (like extreme weather events) and transition risks (associated with the shift to a low-carbon economy). The review revealed that the existing time horizons over which risks are capitalized by banks and insurers are appropriate for climate risks, but further work is needed to assess whether there may be a regime gap in the macroprudential framework.

The BoE will undertake further analysis to explore whether changes to the regulatory capital frameworks may be required. Potentially, this approach could lead to a positive correlation between maximizing impact in banks' portfolio and banks' capital, enabling increased investments in sustainable development initiatives.

The European Union, for example, has made clarifications that fiduciary duties in asset management, (re-)insurance and investment sectors also account for sustainability risks. The EU has also laid down provisions requiring sustainability preferences of retail investors to be discussed at the point of sale.

In some countries, ESG and sustainability considerations have been explicitly incorporated into the fiduciary duties of corporate officers and directors and investment managers' duty of care to their clients.[20] Boards of directors in many countries are now expected to oversee sustainability and ensure that companies have transparent and verified processes to manage sustainability risks and opportunities.

Globally, regulators are putting pressure on pension funds to allocate large pools of capital toward greening the economy. However, this can conflict with the fiduciary duty to invest in the best interest of pensioners. Similarly, some countries are putting pressure on banks to allocate more capital towards sustainable development, without addressing the implications on capital requirements. This points to conflicting regulatory priorities for UN Member States as they try to steer more private capital to sustainable development.

Adopting transparency protocols and participating in initiatives like the **Science-Based Targets initiative (SBTi)**, in which more than 5,000 companies set and monitor emissions targets, enables companies and investors to more actively connect fiduciary duty with sustainability.

Countries can offer tax incentives, like the U.S. did with the 2022 Inflation Reduction Act, which encourages investment towards goals such as putting the brakes on climate change. Large-scale clean energy and clean vehicle projects in the first two years of the IRA were estimated to drive US$126 billion in private investments and create more than 109,000 good-paying direct and indirect jobs in rural counties often bypassed by previous economic programs, according to a report by the advocacy group E2.[21] Incentives and mandatory regulations give corporations a clear business case to incorporate sustainability in a way that will be immune from changes in executive leadership. Within the UN system, Resident Coordinators are well-positioned to effectively support this at country and regional levels.

Carbon pricing

Putting a price on carbon can also play an important role in integrating sustainability into the financial decision-making process for private-sector firms and reinforcing executive action on sustainability. Carbon pricing through emission trading systems, carbon taxes and other methodologies places the external costs of emissions squarely on the emitting firms and incentivizes climate-friendly investment decisions. According to a World Bank study, currently 23 per cent of global greenhouse gas emissions are covered by a direct carbon price, up from 7 per cent in 2013, and more countries may soon join in. Further expansion of the adoption of carbon markets and pricing schemes, including in less-developed economies, will add momentum to the integration of sustainability considerations into investment decision-making.

Beyond voluntary action, building on current voluntary sustainable finance principles requires policy innovation to clarify the connection between fiduciary duty and sustainability. This involves aligning financial regulations with sustainability outcomes and ensuring that investment incentives and regulations are effectively linked to these goals. Establishing mandatory accountability standards will help to ensure that setting strategic sustainability targets isn't merely a procedural exercise but a genuine commitment to better business practices.

Legal pathways to sustainability: Analyzing investor obligations and opportunities across 11 jurisdictions

In 2019, the Generation Foundation, the UN Environment Programme Finance Initiative and the Principles for Responsible Investment appointed the law firm Freshfields to analyze whether and how legal frameworks allow for investors to consider sustainability impact across 11 jurisdictions: Australia, Brazil, Canada, China, European Union, France, Japan, Netherlands, South Africa, United Kingdom and United States. As a result of the analysis, in 2021 "A Legal Framework for Impact" was published, providing answers about real-world sustainability impacts.

Some of the key findings included:

- Investors could be legally obligated to consider sustainability issues when they impact their investment objectives.
- In some circumstances, investors can pursue sustainability goals for reasons other than achieving financial return goals. Investors are legally required to pursue sustainability impacts if they have committed to them in the stated objectives of the financial product.
- Pursuing sustainability impact goals doesn't mean deprioritizing an investor's financial objectives. On the contrary, in some cases investors need to address sustainability impacts in order to protect or enhance financial returns.

Integration Calls to Action

Governments should undertake a stop-start analysis to ensure that the right mix of incentives and regulations are in place in the current complex marketplace to foster financial innovation.

Governments should link sustainability outcomes to financial regulation, including rules dealing with fiduciary responsibility, corporate reporting and issuance of securities.

Governments should integrate sustainability risk in stress testing for financial institutions and conduct a comprehensive regulatory review to ensure current capital requirements and policies are aligned with genuine risk and mandates related to sustainable investing.

Governments should support the expansion of carbon pricing schemes, such as emission trading systems and carbon taxes, to ensure that investment decisions take into account their full environmental costs.

Key Integration Recommendations

2

Expand partnerships beyond public and private to public-public and private-private.

Public-private partnerships (PPPs) that are properly designed for generating social value and executed efficiently are a known value-add.[23] Accelerating this model by brokering partnerships within sectors will unlock increased collaboration across the sustainable finance value chain.

The vaccine model

There may be no better example of the world-changing power of public-private-philanthropic cooperation than the development and deployment of life-saving vaccines.

The Covid-19 pandemic is Exhibit A. Pfizer-BioNTech, Moderna and Johnson & Johnson were among the private-sector companies that developed Covid-19 vaccines, but those efforts were boosted by taxpayer dollars, including billions of dollars spent by the U.S. under Operation Warp Speed on clinical trials, manufacturing and other efforts to bring the immunizations to market.

More importantly, the Covid-19 vaccines were built on decades of publicly funded research.

“Despite ownership of the patents on these lifesaving vaccines lying now mostly in the hands of private companies, U.S. taxpayers funded the fundamental innovations that made mRNA vaccines possible,” according to the National Institutes of Health, referring to one of the Covid vaccines.

Those efforts have been supplemented by philanthropic groups including the Bill & Melinda Gates Foundation, which says it has committed more than US$2 billion to combatting Covid-19, including funds for testing and treatment in sub-Saharan Africa and South Asia.

The Gates Foundation also worked with the Global Fund and the public-private vaccine alliance known as Gavi to develop price structures for Covid and other life-saving vaccines that are tailored for emerging markets, making immunizations more affordable and accessible.

Gavi developed the model, which pools demand from low-income countries and secures long-term funding to accelerate access to vaccines. The Gates Foundation contributed funding and other strategies to drive down costs, while the Global Fund introduced innovative financing mechanisms, such as the Advance Market Commitment and the Matching Fund, that have been instrumental in mobilizing additional resources from the private sector.

This collaborative effort demonstrates how public-private partnerships can effectively address the challenges of improving the lives of people in low-income countries. Such cooperation shouldn’t be limited to vaccines.

Private-private partnerships

Partnerships within the private sector – among businesses, investors, financial institutions and non-governmental organizations – can greatly enhance the efficiency and speed by which sustainability can be expanded globally. Many multinational corporations are working to reduce emissions from their value chains (called Scope 3 emissions), but it's a formidable task given the quantity, diversity and different jurisdictions of their suppliers.

For example, the Johannesburg Stock Exchange created its Private Placement Platforms that is used by investors to facilitate broad-based funding across regions in the African continent.

Public-public partnerships

Secretary-General António Guterres has called multilateral cooperation the "beating heart" of the United Nations, responsible for saving millions of lives each year through humanitarian efforts. At the same time, he points out that wars and other challenges have put the multilateral system "under greater strain"[24] than at any time since the UN was founded. This makes public-public partnerships to address challenges to the growth of sustainable finance ever more important.

As countries and their policy makers work to develop sustainability investment frameworks and regulations that are aligned with their market structures and priorities, it is vital that they also work together to share information and support the interoperability of sustainability standards and sustainable investment plans.

Supplier leadership on climate transition

To counteract climate-related risks, a coalition of leading global companies formed the Supplier Leadership on Climate Transition collaborative, steered by Guidehouse. This initiative has successfully guided nearly 1,000 suppliers across 68 countries in measuring, monitoring and reducing emissions through expert-led workshops and mentoring. By uniting private-sector firms to tackle a shared challenge, the collaborative has established a model for enhancing understanding and driving sustainability actions across vast intersecting supply chains worldwide. This approach demonstrates the power of collective action in addressing complex environmental issues and fostering a more sustainable future.

Public-public partnership in Pakistan

Pakistan's Orangi Pilot Program improved sanitation for one million people in the Karachi region. The program aimed to empower low-income communities in Orangi to construct and oversee their own sanitation systems by fostering community organization and self-management. It provided training for local residents to maintain the infrastructure, ensuring long-term sustainability and scalability. Financial costs of the program were shared by multiple public participants, including affected communities, local Governments, NGOs and UN organizations. Ultimately, the Orangi Charitable Trust was able to provide access to finance for local households, with capital financed by bank loans. The UN and others were able to replicate the approach to providing low-cost basic services in other Pakistani communities.

Public-private partnerships

Public-private partnerships have existed for a long time, but recent innovations in this area are noteworthy for their impact and effectiveness. Blended finance partnerships, in particular, which involve concessional or public funds to mitigate risks or boost financial returns, can entice private-sector investors into new technologies and new markets where they might otherwise fear to venture.

There's also the potential for private-sector investment bankers and other finance professionals to collaborate with the in-house investment teams at development banks to increase the volume of transactions, resulting in more sustainable capital flowing to the sectors and markets that need it the most. One hurdle is the time it takes to put these deals together, a common complaint among private-sector players. Furthermore, as global efforts to raise private capital accelerate, both Government and private-sector actors should put in place safeguards against funds of illicit origin finding their way into sustainable finance projects.

How Egypt delivers food, water and energy

Water, food and energy are vulnerable sectors in the global economy and a constant priority for all United Nations Member States. For countries with emerging market economies, the complexity of dealing with these converging issues is compounded by the difficulties in attracting capital from foreign investors.

In the summer of 2022, Egypt launched a platform called the Nexus for Water, Food and Energy, working with a set of donors and multilateral development banks to accelerate investments for green projects in Egypt, securing US$14.7 billion from global investors.

Multilateral development banks helped the country in identifying the projects and de-risking them to attract foreign capital. Egypt also provided a roadmap for private investment. This example offers an interesting blueprint to other emerging economies working with multilateral development banks to attract private capital.

Integration Calls to Action

Governments should work with public and private partners to ensure the interoperability of sustainability standards and sustainable investment plans that facilitate investment across jurisdictions.

Governments and companies should partner to address mutual challenges in financing sustainable development. Public-private partnerships are a known value-add.

Companies should partner with peers to increase collaboration across the sustainable finance value chain and help accelerate the growth of sustainable finance.

CONCLUSION

At the request of the Secretary-General, the Global Compact researched ways the UN can help increase the flow of private capital investment towards achieving the Sustainable Development Goals, ultimately to deliver sustainable economic development for countries and people everywhere.

Private investment is critical, given that progress towards sustainable development has been hampered by global events, including the Covid-19 pandemic, geopolitical turmoil, inflation and high borrowing costs. Multilateral development banks lack the resources to make up the deficit, now estimated at US$4 trillion annually in lower-income countries alone.

The study by the UN Global Compact, in partnership with the Department of Economic and Social Affairs, found that there is ample private capital available, but that barriers to investment exist, especially in the countries where the needs are greatest. The report identified three major trouble spots and innovations to address them:

Transparency

There's an absence of shared definitions and global standards for financial markets, discouraging investment in unfamiliar regions and technologies. The report calls upon regulators to mandate minimum sustainability disclosure requirements and to consider offering incentives for companies that contribute to data transparency efforts. It also recommends judicious use of AI and open-source platforms to help fill the gaps in data.

Risk and Returns

There's too often a mismatch between risk and returns in sustainable finance, especially in countries without a well-established infrastructure for financial markets. The report recommends ways to more accurately assess those risks and also tactics to mitigate them – such as spreading out risk across investor portfolios, having philanthropic funds take first-loss positions and including sustainable investments with syndication of structured finance products.

Integration

Sustainability isn't universally accepted in the business world, and in some instances there has been a backlash against the related concept of incorporating ESG principles into financial practices. The study calls upon national Governments to link sustainability outcomes to financial regulation, including in securities laws and in statutes outlining fiduciary responsibility.

To turn these recommendations into reality, the report calls upon private enterprise, Governments, multilateral development banks and others to be a part of the sustainable finance revolution.

Sustainable finance can be a powerful tool in improving the lives of billions. Significant and urgent changes are needed so it can reach its fullest potential.

Company names and examples are included solely for learning purposes and do not constitute an endorsement of the individual companies by the UN and/or the UN Global Compact.

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THE TEN PRINCIPLES OF THE UNITED NATIONS GLOBAL COMPACT

HUMAN RIGHTS

1 Businesses should support and respect the protection of internationally proclaimed human rights; and

2 make sure that they are not complicit in human rights abuses.

LABOUR

3 Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

4 the elimination of all forms of forced and compulsory labour;

5 the effective abolition of child labour; and

6 the elimination of discrimination in respect of employment and occupation.

ENVIRONMENT

7 Businesses should support a precautionary approach to environmental challenges;

8 undertake initiatives to promote greater environmental responsibility; and

9 encourage the development and diffusion of environmentally friendly technologies.

ANTI-CORRUPTION

10 Businesses should work against corruption in all its forms, including extortion and bribery.

The Ten Principles of the United Nations Global Compact are derived from: the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

ABOUT THE UNITED NATIONS GLOBAL COMPACT

As a special initiative of the United Nations Secretary-General, the **UN Global Compact** is a call to companies worldwide to align their operations and strategies with Ten Principles in the areas of human rights, labour, environment and anti-corruption. Our ambition is to accelerate and scale the global collective impact of business by upholding the Ten Principles and delivering the Sustainable Development Goals through accountable companies and ecosystems that enable change. With more than 20,000 companies based in over 160 countries, and more than 60 Global Compact Country Networks, it is the largest corporate sustainability initiative in the world.

For more information, follow **@globalcompact** on social media and visit our website at **unglobalcompact.org**.

United Nations Global Compact

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