GISD Global Investors for Sustainable Development

JULY 2020

RENEWED, RECHARGED AND REINFORCED

URGENT ACTIONS TO HARMONIZE AND SCALE SUSTAINABLE FINANCE

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Solvay	Ilham Kadri, CEO, *Chairman of the Executive Committee, member of the Board of Directors*	Belgium
UBS Group	Sergio P. Ermotti, *Group CEO*	Switzerland

**Due to a recent change in leadership, the representative will be appointed at a later date.*

First Foreword

By Oliver Bäte, CEO of Allianz, Co-Chair of the GISD
and Leila Fourie, CEO of the Johannesburg Stock Exchange, Co-Chair of the GISD

As a clear acknowledgement of the importance of the private sector in the Strategy for Financing the 2030 Agenda for Sustainable Development, the United Nations Secretary-General established the Global Investors for Sustainable Development (GISD) Alliance: a group of 30 private sector CEOs chosen for their ability to provide decisive leadership in mobilizing resources for sustainable development. We are honoured to co-chair this effort. Since the launch of GISD in October of 2019, we have been committed to accelerate and scale up finance and investment for the Sustainable Development Goals (SDGs). From the beginning, the Alliance embraced the Secretary General's call to align global economic policies and the financial systems with the 2030 Agenda, enhance sustainable financing strategies and seize the potential of financial innovations, new technologies and digitalization to provide equitable access to finance.

The dramatic implications of the COVID-19 pandemic for sustainable development led the GISD to enhance its focus and commitment, including: urging the broader business sector to step up its efforts to integrate the SDGs into core business models; scaling up sustainable investments to countries and areas hardest hit by the crisis; re-aligning investment of both private and public sectors with sustainable development objectives; advocating for a coordinated international approach to financial regulation and policies; encouraging rating agencies to better incorporate sustainable development considerations into their decision making; and advancing internalization of key externalities.

As the Secretary-General rightfully urged, "everything we do during and after this crisis must be with a strong focus on building more equal, inclusive and sustainable economies and societies that are more resilient in the face of pandemics, climate change, and the many other global challenges we face."

If we are to achieve our Global Goals and drive funding toward them, now is the time to act, to align and, in support of the term used by the European Commission, to "renew" our broad-based public and private sector collaborative efforts.

This report provides recommendations and strategic considerations that, if followed, will enable leaders from the public and private sectors to harmonize objectives, coordinate global standards and align efforts to facilitate, promote and scale up investment towards the Goals. Specific attention has been given to articulating how the global concepts and recommendations presented here apply to and can be translated at level of the European Union (EU). We appreciate the leadership of the European Commission in sustainable finance and acknowledge the extra-territorial impact that actions taken in the EU will have. The effect of the EU focus will be a potential force for good impact across the world.

Our strong desire is for the European Commission to consider the views of this Alliance as it takes the next steps to renew its own sustainable finance policies. This combination of a global and local approach is one we look forward to exploring with other regions as we continue our work.

Second Foreword

Jay Collins, Vice Chairman, Banking, Capital Markets and Advisory, Citi, Chair of the GISD Report Committee

The impetus for this report was originally driven out of a desire to provide a unique, unified, global private sector perspective to the European Commission as it considers the next stage of its policy work on sustainable finance. Then the COVID-19 crisis shook the world, spurring us to think bigger, bolder, and far beyond Europe's borders.

This report still very much addresses many of the core policy and regulatory challenges facing Europe as it works to lead the world in the sustainability space. It also articulates how building back better requires many of the underlying considerations and actions to be taken at a global level and in a harmonized manner. After all, the challenges of sustainability metrics, energy transition, disclosure paradigms, and financial product innovation are global in nature.

Embedded in this report is a commitment to long-termism and to funding the SDGs as a whole. Just as we worry about the dangers of methane bubbling up below the permafrost, we must also be concerned about the bubbling, disruptive forces of economic and social inequalities. Acted on promptly with the measures called for in this report, this pressure can be funnelled constructively towards the delivery of the SDGs. Left to expand further, this disruption represents a force capable of shaking the very foundations of our societies, governmental norms, economies and financial system.

In our strategy session with the Secretary-General of the United Nations, author Michelle Wucker described the COVID-19 pandemic as a 'Gray Rhino': a forceful, imminent threat that, after abundant scientific and political warnings, charged humanity. This report calls on all actors of the investment chain to live up to their historic responsibility to deliver a sustainable recovery. We must show resolve to address the social, economic, and climate challenges ahead of us, for they are the next Gray Rhinos – and they are about to charge.

This report reflects the collective best thinking of GISD members and the compromises that creating a collective narrative entail. It represents the views of the GISD itself. There has been close and productive collaboration between members throughout the process, and we have sought to be ambitious in scope, pace and scale at all times. Where views diverged, we have encouraged individual members to highlight these differences in their own responses to the Commission's consultation.

I would like to thank the Report Committee that helped draft this report and their firms, in particular Karen Fang (Bank of America), Daniel Hanna (Standard Chartered), Claudia Kruse (APG), Bertrand Millot (CDPQ), Amy O'Brien (Nuveen), Gavin Power (PIMCO), Anne Simpson (CalPERS), Shameela Soobramoney (Johannesburg Stock Exchange), Claus Sticker (Allianz), Steve Waygood (Aviva), and their respective teams. Our work was supported by a dedicated secretariat led by Navid Hanif (United Nations Department of Economic and Social Affairs) with additional support from the United Nations Capital Development Fund and the Principles for Responsible Investment. We also extend our great appreciation to Elie Chachoua from the Richard Attias & Associates Lab for his strategic guidance and editorial leadership.

This report is an important milestone for the Alliance and will serve as a foundation for future work. Importantly, it is the beginning of a partnership between GISD and the European Commission. It is also an invitation to policy making bodies in other regions to engage with GISD as we collectively work to build back better and mobilize capital towards a sustainable recovery for all.

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1. MANIFESTO AND RECOMMENDATION HIGHLIGHTS

This section summarizes the main themes and most important recommendations that have emerged from our collective work. This Manifesto includes the critical messages our members wish to convey to policymakers and stakeholders.

Be bold, act now

The global response to the COVID-19 pandemic has shown the world is capable of radical and forceful societal responses to humanity-threatening crises. As we move from response to recovery from the epidemic, we should be emboldened in our global ambition to achieve the Sustainable Development Goals (SDGs). Now is the time to act boldly.

This leadership responsibility falls on private and public actors alike. We must act in tandem. Governments' own behaviour should conform to the Paris Agreement and put the SDGs at the centre of their recovery effort. This role includes further developing best practices in the distribution and sustainable investment of public resources, as well as mobilizing private sustainable investment through fair and transparent risk sharing arrangements. We must make better, faster and scaled use of blended finance. Public sector asset managers and government-owned companies will also have a key role to play in driving their industries towards better sustainability behaviour. As governments support the private sector with extraordinary financial resources, there is also an unwritten expectation for improved, more purposeful corporate behaviour and governance.

The widespread call to action is by no means about environmental concerns alone. As the past months have demonstrated, the 'S' in environmental, social and governance (ESG) issues is critical. Today's expectations of C-suite leaders are related not just to how they respond to social needs but how well, how fast and how strongly they develop and implement strategies for the SDGs.

Fix flawed metrics, align standards and mandate conformed disclosures

Many of the sustainability signals – be they from regulators, rating agencies or ESG scorers, standard setters or accounting bodies – resemble a cacophony to investors. They may all be 'first chair' players, but the lack of global alignment, consistency and conformity paralyses the investing orchestra. The supply of capital is there, but inconsistent approaches to metrics and the failure to come together around common taxonomies create a wall between capital and the world's sustainability needs.

Above all, there is a need for alignment and consistency of information across the global sustainability ecosystem. Too often, sustainability data is of poor quality, inconsistently disclosed, frequently backward-looking if not stale, non-comparable in nature and often bereft of technology that could improve it. In addition to these input challenges, broad-based models and methodologies used to drive investment outcomes and manage risk are not harmonized. Without harmonized sustainability metrics and transparent methodologies, the current opportunity to fully align the unprecedented COVID-19 resources and the vast sums of institutional capital with the SDGs will be lost.

Disclosures are a means toward motivating action on sustainability and re-aligning investment flows toward our Goals. Securities regulators must mandate a core disclosure framework, defining broad guidelines and enabling alignment and comparability of robust metrics across sectors. Building globally

harmonized approaches across each layer of standards, legal and accounting frameworks will also ensure that SDG-related disclosures are built into existing governance structures.

Unleash partnerships, collaboration and innovation to fund the Goals

The scale of the challenge calls for reinvigorating public-private partnerships (PPPs) to a degree not experienced since World War II—and a degree that has perhaps never been seen in peacetime.

We must embrace the opportunity to re-enforce, re-purpose and re-invigorate multilateral cooperation mechanisms and organizations that can make a difference in the funding framework for the SDGs and the Paris Agreement.

A new collaborative mechanism is notably needed to help governments put financial flows on a sustainable trajectory and produce national capital-raising plans that are internationally coordinated and investible at scale. Going forward, we must also invest heavily and speedily in the technologies and processes for metrics that support sustainability and the SDGs. We must also invest in new technological solutions and apply them aggressively to sustainability challenges while guarding against their potential pitfalls; innovation will be key to empowering and democratising sustainable finance.

Align commitments, outcomes and behaviours

We cannot deliver the SDGs or Paris Agreement solely through new 'green' investments; we need to ensure that the whole financial system and the entire economy undergo a sweeping transition to a more sustainable future. A myriad of tools is available for companies to deliver this transition, including to a net-zero economy. We need to ensure that investors drive these companies to make credible and ambitious transition commitments.

More generally, there is a pressing need for a new incentive system in finance that uses fiscal measures to reward companies striving for sustainability outcomes and creating sustainable stakeholder value. We have a rare opportunity to set the world's most pro-capital formation and progressive investment standards, for impact investment, climate-resilient investment and SDG-positive investment.

A dominant theme throughout the report is the imperative of collective behavioural and policy alignment: we have to row in the same direction in a coordinated way. It is a simple but essential concept that cuts across all actors and activities, and is covered repeatedly herein, from aligning climate scenarios and risk methodologies for banks, to aligning policy lending and government-owned enterprises' energy transition, as well as aligning private investor flows and outcome-linked financing models.

Harness the power of global markets and financial innovation

Well-directed and harnessed, market forces can produce powerful and scaled results for society. Unfortunately, the gap between earmarked sustainability funding and the capital needed to achieve the SDG targets by 2030 has grown wider with the COVID-19 crisis. We must renew our focus on new products, apply creativity to market solutions and innovate around structures that will accelerate and scale funding. This is particularly true in developing countries, where risks create significant barriers to private sector investing. These countries face the most severe economic, financial and social impacts of the crisis and are the ones most in need of private capital.

Financial product innovation will be a bedrock of future SDG funding growth. Market participants have as of yet failed to tap into the full potential to innovate and scale sustainable finance. Active sovereign and sub-sovereign sustainability bond issuance will provide an important signal to the broader market, particularly if scaled and aligned with international standards and principles. Although this might require adjusting the architecture of the current market, new standards for sustainability issuance are not necessary.

Commit to the long-term

As corporations and investors around the world work to drive the sustainability agenda into market paradigms and to adopt behaviours that embrace multi-stakeholder capitalism, we will have to adjust market incentive structures, products and guidance to help them act with our longer-term interest in mind. We unequivocally believe that investors' fiduciary duties must encompass material sustainability considerations that look out over the horizon and are aligned across all jurisdictions. Our long-termism efforts must encompass the integration of sustainability principles into corporate governance and investor stewardship codes, thereby empowering investors to behave and vote as long-term owners.

Recommendation highlights

This report identifies a total of sixty-four recommendations, forty-two of which are of global relevance. The rest represent specific measures the European Commission (EC) could take to demonstrate global leadership on these issues.

Taken as a set, these recommendations provide a definite force multiplier and synergistic effect; they inter-relate and reinforce each other. The GISD believes their broad adoption would result in exponential benefits to the investment paradigm for sustainability and the SDGs. The recommendations below represent some of the most salient ones and should be considered in conjunction with the other measures listed in the report. While these recommendations are put forward globally, the different development stages and needs of all countries, especially developing countries, should be fully noted and respected.

1. Endorse the efforts of the Basel Committee's high-level Task Force on Climate-related Financial Risks (TCFR) to develop a framework for ESG risk supervision applicable to global financial institutions. The new Basel Task Force work should be aligned and coordinated with that of the ongoing work of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), with a view to ultimately conforming their efforts.

2. Develop science-based transition pathways to guide sector, subnational and regional transitions. Pathways should be based on taxonomies and be publicly available. Credit rating agencies (CRAs) should be encouraged to publish scenario analyses based on them.

3. Make sustainability reporting mandatory for financial and non-financial institutions, including TCFD disclosures. These disclosure requirements should be globally harmonized and extend beyond climate metrics to include material SDG-related information and forward-looking data. Reporting requirements should include sector-specific components while also containing sector-independent factors consistent for all firms. Small and medium-sized enterprises (SMEs) could be subject to a 'disclose-or-explain' standard.

4. Have regulators focus on metrics harmonization and methodological transparency. While mandatory action on the former is urgent and necessary, a non-regulatory approach for the latter might be sufficient in the short-term.

5. Have the G20 call on the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to integrate material sustainability disclosures into their respective accounting standards in an internationally consistent manner. Doing so would drive coherence in reporting and disclosure of material, long-term sustainability issues, as well as how reporting companies are contributing to the SDGs.

6. Make unequivocally clear that investors' fiduciary duties encompass material sustainability considerations. Asset owners should express their core sustainability preferences to asset managers and work with them to ensure these are reflected in investment decisions. It is also imperative to update and upgrade existing corporate governance and investor stewardship codes through an SDG lens.

7. Urgently increase the quality, ambition and standardisation of Voluntary National Reviews (VNRs) and Nationally Determined Contributions (NDCs). National capital-raising plans should be an integral part of the national development strategies for the SDGs. An international platform for the development of investable national capital-raising plans and transaction-oriented investor engagement should be established to accelerate this effort, drawing on the model of the United Nations Intergovernmental Panel on Climate Change and formally incorporating membership from the finance sector and global regulators.

8. Ensure public sector alignment with the SDGs. Public subsidies should align with the SDGs and the Paris Agreement. Governments should also encourage public sector investors and government-owned companies to align with the global goals and the Paris Agreement. Similar requirements should apply to domestic recipients of national public relief packages.

9. Create a blended finance fund for the SDGs, modelled after the International Finance Corporation's Managed Co-Lending Portfolio Program (MCPP), to scale blended finance and mobilize private investment by making previously 'unbankable' projects investable thanks to donor and concessional capital, and aggregating them to reach scale.

10. Diversify and dramatically increase bond issuance across the SDGs and across actors, including both use-of-proceeds and sustainability-linked instruments. Drive green bond standards and principles into the project finance market. Avoid duplicating global bond market principles by anchoring new developments within ICMA frameworks.

The sections of the report that follow are structured around topics identified as critical to delivering and financing the SDGs, namely: systemic sustainability risk (Chapter 2), data (Chapter 3), disclosure (Chapter 4), purposeful governance (Chapter 5), public sector (Chapter 6) and sustainable finance products (Chapter 7).

2. SYSTEMIC SUSTAINABILITY RISK

Systemic sustainability risk is fundamental to the finance industry. Financial firms require science-based approaches to measuring and managing it, particularly the risk related to climate change. Standardization of ESG risk metrics, definitions and sustainable transition trajectories for non-financial industries will enhance risk management and accelerate the growth of sustainable investment.

Systemic sustainability risks arising from climate change, ecosystem degradation and changing social expectations are fundamental threats to the financial sector. Across the financial service industry, asset managers, banks, insurance companies and pension providers are grasping the urgency of ESG physical, transition and liability risks. Integrating and managing material ESG risks is an integral part of a financial firm's fiduciary duties to beneficiaries.[i]

Regulators are rightly focused on climate change risks to financial stability. The best way for the world to manage the economic consequences of climate change is to ensure that climate risks remain within manageable boundaries. At the moment, the business-as-usual scenario leads us significantly past the 1.5°C warming threshold. Beyond it, climate change will become unmanageable, with disastrous economic and social impacts. Rising social inequality is another critical systemic risk, though harder to quantify.

The financial sector must not lose sight of the active role it will play in mitigating climate change and achieving the SDGs. This is especially true regarding emerging markets. Though they face the greatest risk from climate change, they also have the greatest opportunities to leapfrog outdated infrastructure in favour of low-carbon technologies and accelerated sustainable development. The financial sector's reaction cannot be to withdraw from these markets. More generally, asset managers are recognizing that not only do material ESG risks impact their portfolios; their portfolios also impact the environment and society. This 'double materiality' perspective, reflected in the EU Non-Financial Reporting Directive (NFRD), encourages financial firms both to minimize the negative externalities of their investment decisions and maximize the positive.[ii] With 27 investors representing more than US$5 trillion in assets under management as of July 2020, the Net-Zero Asset Owner Alliance is an example of such an approach. Its members commit to transitioning their investment portfolios to net-zero greenhouse gas (GHG) emissions by 2050, consistent with goal of the Paris Agreement to limit global warming to 'well below 2.0°C' (hereafter referred to as the Paris Agreement).[iii]

The financial sector still lacks the analytical tools, standards and predictable policy environment necessary to manage ESG risk and invest sustainably at scale. The following chapters address current data and disclosure limitations, but there are more foundational requirements. The financial industry and its key stakeholders, including regulators, notably need to define the boundaries of systemic ESG risk, agree what is material and measurable, and develop common, forward-looking scenarios. Combined with improved data, agreement on these basic points will support broadly applicable ESG risk management standards, pricing and regulations. Uniform and standardized ESG risk measures will in turn create new investment opportunities. For example, such ESG risk tools would support greater investment in long-term climate change resilience infrastructure.

Not all market participants are yet cognizant of the time scales on which ESG risks are material. The Network of Central Banks and Supervisors for Greening the Financial System (NGFS) and European

Insurance and Occupational Pensions Authority (EIOPA) have found a mismatch between the time horizons of a financial firm's internal rating-based credit assessment models under prudential regimes and the long-term perspective that sustainability risk demands.[iv] In a separate study, EIOPA found that market participants believe they have between 10 and 20 years to adapt their investment strategies.[v] Respondents saw limited incentive to consider climate change risks —particularly transition risk — in their portfolios. Future prudential regulation must balance the paradox that sustainability risks are both long-term and yet very much present in the system today.

Strategic considerations and opportunities

ESG risk management standards should be science-based wherever possible and supported by rigorous empirical evidence. Risk management in the financial services sector is a quantitative exercise rooted in statistical analysis. Initiatives that address the financial sector in those terms will more successfully stimulate sector-wide responses to ESG risks than those that do not. More research is needed to develop commonly agreed, science-based scenarios. Baseline methodologies for estimating the current and anticipated physical impacts of climate change and environmental degradation on financial portfolios are missing, and there is as yet no predominant approach to quantifying social-type risks. However, advances in data collection and analysis such as remote sensing, natural language processing and sentiment analysis are enabling new statistical approaches to ESG risk assessment (see Chapter 3).

Too narrow a focus on reducing material ESG risks in the financial system could have unintended consequences. A broader focus on the risks and opportunities related to the SDGs would help resolve this issue. Integrating material ESG risk considerations could make it more difficult for vulnerable countries to attract capital. More specifically, the economic impacts of climate change or biodiversity loss will affect their cost of capital. Taking a more integrated SDG approach would enable investors to better account for the double materiality of a particular sustainability strategy, whether this be the employment benefits of renewable investments or the environmental benefits of social programs. The use of de-risking mechanisms such as blended finance might also be necessary (see Chapter 6).

The financial sector and economy must undergo a systemic transition to a sustainable and low-carbon future. The financial sector cannot achieve the Paris Agreement with green investing alone. As part of predictable, certain and coherent policy frameworks, public authorities should define sustainable and low-carbon transition pathways for the most relevant sectors as well as create the incentives for aligned company action. In relation to these pathways, the role of financial market participants is two-fold: first, to challenge companies to make credible and ambitious transition plans; and second, to hold companies accountable through stewardship and engagement. For these functions, financial services firms need agreement about transitional activities between significant harm on the one hand and full sustainability on the other. Most companies fall in between these poles.

An activity-based 'Transition Taxonomy' would provide a common language with which to discuss sustainable economic behaviour in Europe and globally. It would provide a vision for how the real economy should transform. It would also identify different degrees of harm and misalignment with the transition objectives, which a green-only taxonomy does not necessarily do. Science-based metrics would enable stakeholders to measure progress towards climate and biodiversity targets and inform forward-looking analysis and policy. For those topics for which scientific targets are not available, a taxonomy should define minimum standards of accomplishment and aspiration, evidenced by suitable indicators of progress and action.

A new Transition Taxonomy should come with significant methodological guidance. Simplicity will facilitate acceptance but should be balanced with analytical rigor. To the extent that a Transition

Taxonomy employs science-based metrics, it should instruct companies how to consistently measure their performance against such metrics. Yet the framework should also be flexible enough to reflect future advances in the underlying science. Transitioning firms would also require guidance about how to aggregate activity-level risks to calculate risk at the company and regional levels.

Harmonized principles for ESG risk measurement will facilitate broader adoption. Rapid progress has positioned the European Union as the global leader driving the development and regulation of sustainable finance. The same progress could cause divergence between the European Union and other jurisdictions. Standardization will reduce compliance costs to multinational financial firms and companies, facilitating broad adoption and long-term, cross-border investment for sustainable development. The alternative is a counterproductive patchwork of definitions and regulation.

Any supervisory architecture for managing material ESG risk in the financial sector should be approached prudently and in coordination with diverse stakeholders. Desirable supervision will be committed to targets, based in scientific and financial evidence, internationally consistent regarding definitions and methods, and sufficiently adaptable to future advances. Precipitous regulation, particularly in the determination of rules rather than principles, increases the risk of regulatory fragmentation among markets. This would have negative effects on market liquidity. More work is necessary to establish international, ESG risk-based prudential principles and loss norms. Collaboration will be particularly important to codify classification systems, methodologies, scenarios and models. Prudential principles and loss norms will also require uniform and consistent data, as well as disclosures from financial and non-financial firms (see Chapters 3 and 4).

Prudential distinctions between sustainable and unsustainable investing by regulated firms must be based on empirical evidence of a link to financial risk. Other instruments can be used to achieve policy aims. The NGFS has recently pointed to the disunity of taxonomies, methodologies and models, which obscure any risk-based justification for 'green-supporting' or 'brown-penalizing' capital risk weight factors.[vi] Capital weight adjustments based on any taxonomy should reflect only observed correlations between risk exposure and financial performance. Further, such prudential tools should be applied only within the standard framework of prudential considerations. There is a lot of institutional and entrepreneurial energy focused on demonstrating ESG risk materiality, and these innovations should be fostered. Meanwhile, governments have a diversity of instruments at their disposal to stimulate sustainable investing and alignment to sustainability targets, including tax incentives, guarantees, insurance, and concessional financing. Risk management tools such as climate scenarios might inform public policy, but risk management is not itself a substitute for economy-wide sustainability policy.

With the above in mind, the GISD recommends the following:

- **Endorse the efforts of the Basel Committee's high-level Task Force on Climate-related Financial Risks to develop a framework for ESG risk supervision applicable to global financial institutions.** The new Basel Task Force work should be aligned and coordinated with that of the ongoing work of the NGFS, with a view to ultimately conforming their efforts. The framework should first tackle global standardization of climate risks and supervisory response before extending to wider material sustainability risks.

- **Create a Transition Taxonomy reflective of the SDGs as a whole and of the need to achieve a net-zero economy**. Where science-based metrics are available, as with climate or biodiversity, these should inform both the end-goals that the transition aims to achieve and the relevant activities and indicators thereunder. Where science-based targets are not possible (e.g. social issues), the directionality and end-goal of the transition should be defined in a way compatible

with the vision of a just, inclusive and sustainable transformation of the economy and be articulated through genuine multi-stakeholder dialogue. Finally, the Taxonomy should address the full range of financial instruments, as this will help maximize the deployment of private capital.

- **Develop science-based transition pathways to guide sector, subnational and regional transitions. Pathways should be based on taxonomies and be publicly available**. This will enable investors to assess the sustainability of corporate performance and targets in the context of public transition goals and in line with scientific consensus. The more detailed these transition pathways and sectoral strategies are with regard to timelines, metrics, technologies and tools, the easier it will be for the financial sector to identify the business opportunities and solutions to support them. Pathways should include industries that are currently unsustainable but that need to transform if society is to deliver the SDGs and a just transition. Pathways should be developed though an inclusive multi-stakeholder process.
- **Encourage credit rating agencies to publish scenario analyses based on the aforementioned transition pathways.** CRAs might not presently be able to meaningfully integrate long-term material ESG risks into their core credit ratings due to the significant forecasting uncertainties. However, scenario analyses with an extended time horizon could inform complementary products that would be valuable to long-term investors. Given their analytical expertise and experience, CRAs are uniquely able to produce a meaningful product of this type.

- **Harmonize ESG risk standards at the global level.** Reflecting the global nature of climate change and many other ESG risks, the integration of ESG risk should be consistent across borders to the extent possible. The TCFD, endorsed by the G20, has been the most visible effort to integrate climate risk into an international financial stability framework. Research by the NGFS is also advancing a shared understanding of climate risk that could eventually support comparability of climate risk exposure across financial firm balance sheets - and thus across economies as a whole.

- **Mobilize investment for new sustainability risk measurement and management technologies, working with the private sector to scale and standardize effective tools as they are proven.** This would empower financial services firms to test, compare, and develop the large and expanding variety of risk management tools currently at the pilot or prototype stage. Particular attention could be given to impact measurement frameworks, as these are important to track contributions to the SDGs. Given the EU's progress promoting greater ESG disclosure, entrepreneurial firms in this sub-sector could develop global leadership in the fields of identifying, measuring, and reporting sustainability risks.

- **Increase the use of fiscal tools to support sustainable finance, particularly investment flows to developing countries.** Fiscal risk mitigation and investment promotion tools include tax policies, guarantee schemes, insurance and concessional finance. Private sector investors are already familiar with such instruments, and there are already many programs utilizing such tools. However, existing programs are insufficient to achieve the SDGs or align economies towards net-zero targets. The expanded use of such tools is particularly important for regions and countries where increased ESG risk awareness is expected to cause an increase in capital costs. These tools can be paired with national capital-raising plans and integrated into sector transition pathways.

In pursuing the above, the European Union should:

- **Call on EIOPA to review the effect of Pillar 1 prudential regulation on insurers' cost of capital and impacts on systemic risk.** Prudential regulation has focused the investment of regulatory capital towards highly rated corporate bonds and away from infrastructure finance. The

investment-grade bond market is dominated by five sectors, three of which (oil and gas, chemicals and automotive industry) are among the most carbon intensive. Conversely, renewable energy projects such as offshore wind, solar and biomass energy from waste installations are funded through infrastructure finance. By biasing capital flows in this way, it is possible that the prudential regime is increasing systemic climate risk and contributing to long-term financial risk. It is counter-intuitive that capital from insurance companies is being deployed in this way, particularly given that these are among the companies at greatest commercial risk from runaway climate change.

3. IMPROVING ESG DATA AND SCORING TO ACCELERATE SUSTAINABLE FINANCE

Insufficient data and poor data usability are severely hampering the growth of sustainable finance. Greater transparency of ESG scoring firms' data and methodologies is needed to transform corporate sustainability analysis from a subjective exercise into an objective one. Mandatory corporate disclosure of sustainability data will help, as will the harmonization of ESG scoring methodologies.

Insufficient data and poor data usability severely hamper the further growth of sustainable finance. Data is fundamental to informed investment as the basis of valuation, investor stewardship and risk management. Without high-quality ESG data, sustainable finance cannot become mainstream, nor can investors accurately evaluate the sustainability impacts of their investments.

ESG data end-users face two main challenges. The first is the quality and consistency of data published by corporates. These are often missing information and are rarely comparable between companies or across time. Some corporates only publish data irregularly and with a delay following the period measured (see Chapter 4). The second issue is variation in the way ESG data is collected, processed and distributed by intermediate users such as ESG scoring firms and credit rating agencies. The latter, for example, cannot fairly incorporate ESG into their credit risk methodologies until rated companies provide consistent and timely data.

The opacity of ESG scorers' data sources and methodologies limits scores' value, as does the disparity of the results. A recent comparison of ESG scores shows a correlation of just 61% among the leading ESG score providers versus 99% correlation among the non-ESG credit ratings produced by Fitch Ratings, Moody's Investor Service and Standard & Poor's (S&P) Global.[vii] This variation in part reflects ESG scorers' different focus areas, metrics and component weights (e.g. the percentages allocated to 'E' versus 'S' metrics). Investors are therefore challenged to compare scores and are instead using inputs from multiple providers to form subjective views, which is costly and inefficient.

The financial sector requires 'forward-looking data'. A significant proportion of current ESG data is comprised of operational metrics, which could be described as 'backward-looking.' Backward-looking data can in some cases be used to establish correlative relationships with other risk and performance indicators. However, it does not tell investors what they need to know about corporate fulfilment of ESG goals. Forward-looking data should be verifiable, current, reported regularly and consistently, and relevant to firm, industry, and national commitments. With forward-looking data, investors can observe the momentum of the sustainability transition.

Increasing industry concentration raises concerns about future data quality and innovation. Of the 11 prominent independent ESG scoring firms in 2008, all but two are now owned by large index providers and CRAs.[viii] This has a twofold effect. On the one hand, experience with ESG scoring firms suggests that consolidation has so far broadly improved their professionalism. On the other hand, taken too far, consolidation would bring concerns about both the independence and dominance of a handful of players in a field that is critical for the mainstreaming of sustainable finance. To the extent that the industry observes over-concentration by any small group of firms or in one region, such an eventuality might deprive ESG score users from a diversity of perspectives and innovations.

Strategic considerations and opportunities

In the absence of global mandatory ESG disclosures, the provision of corporate ESG data in some jurisdictions will remain voluntary and insufficient. Fully voluntary generation of ESG data will not address issues of data availability, quality, consistency, and comparability. Without third-party verification, end-users will not have confidence that the data is reliable and accurate. Disclosure regulation or guidelines could also ensure greater consistency and timeliness of ESG data publication.

Greater transparency of data and methodologies is necessary to transform analysis of corporate ESG performance into an objective practice. Reaching deeper insights than industry ESG 'laggards' and 'leaders' requires detailed analysis of data sources, definitions and measurement techniques, and an understanding of underlying methodologies. Moreover, transparency is required at both the corporate level and intermediate user level (e.g. ESG scorer). The most progressive asset managers are circumventing current data limitations by creating proprietary ESG risk and performance models that integrate high-frequency raw data streams with big data analytics and artificial intelligence. These models generate forward-looking data unavailable to most investors. Basic standards of data collection and calculation transparency would enable a better evaluation of exposure to ESG risk and contribution to sustainability goals.

'Alternative' data sources and technology advances offer new ways to evaluate sustainability performance and make this information widely available. From the use of geospatial information for evaluating asset-level emissions to the use of artificial intelligence for large-scale sentiment analysis, new technology and forward-looking data sources are making it easier for investors to evaluate corporate sustainability performance without reliance on corporate disclosure. Making some such data accessible to investors, companies and citizens would inform investment—and consumer—decisions and strengthen investor engagement with companies about sustainability. However, many of the available data innovations are prototypes, and end-users are still discovering the breadth of applications that such approaches provide. Regulators must thus strike a balance between enforcing transparency and encouraging innovation.

Consolidation among the ESG scoring firms might impede the further development of sustainable finance. When the number and variety of firms providing sustainability research, ESG scoring and integrated credit ratings is large, mergers and acquisitions (M&A) activity can lead to economies of scale and improved research. Once consolidation impacts competition, however, these sub-industries will suffer from oligopolistic behaviour. Stakeholders of these sub-industries, including financial sector regulators, need high-quality data, fair pricing and robust creativity from new entrants. To the extent that such characteristics are not maintained, this will be an obstacle to the further integration of ESG information into financial decisions and would slow the future growth of the sustainable finance industry.

With the above in mind, the GISD recommends the following:

- **Mandate sustainability reporting requirements, including TCFD disclosures, for financial and non-financial institutions**. These requirements should apply to companies of certain minimum sizes, both listed and unlisted, and take sector and business activities into consideration. Mandatory reporting should be pragmatic, based on company size and initially focused on material ESG factors, such as those proposed by TCFD. Reporting requirements should include sector-specific components while also containing sector-independent factors consistent for all firms. SMEs could be subject to a 'disclose-or-explain' standard. A transitional period during which companies are excluded from legal liabilities arising from the collection and disclosure of new data categories would be necessary until methods are routinized.

- **In a second stage, introduce SDG key performance indicators (KPIs) to reflect companies' contributions to the SDGs.** Only when the financial sector can quantify the impact of investments on the SDGs will significant volumes of capital flow systematically towards the Goals. There is growing market demand for such indicators. Although the SDGs were not written specifically for corporates, any effort to translate them into corporate-level metrics can build on multiple existing initiatives, such as the World Benchmarking Alliance[ix] or the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR)[x].

- **Promote 'alternative' data sources and new technologies related to sustainability data.** This includes but should not be limited to unstructured, academic and non-governmental organization (NGO) data, as well as spatial finance data. These data streams can enable innovations beyond standard, corporate-reported data sets and should be encouraged within existing data privacy limitations. Requiring companies to report on consistent data elements and metrics and provide access in machine readable formats would enable them to fully leverage the potential of technologies such as machine learning or artificial intelligence.

- **Regulators should focus on metric harmonization and methodological transparency.** While mandatory action on the former is urgent and necessary, what matters for methodologies is that users understand them in detail. Instead of regulation, therefore, it might be sufficient in the short-term to encourage multi-stakeholder initiatives promoting transparency of ESG scoring methodologies in a way that preserves the scoring firms' intellectual property. Experience illustrates that, given methodological transparency, market forces will facilitate comparability of ESG scores and promote greater competition on analytical merits.

In pursuing the above, the European Union should:

- **Require standardized ESG disclosures from companies participating in the European Union Green Deal Investment Plan.** Such a requirement would establish a clear and logical incentive for non-financial companies to report in conformity with guidelines. It would apply beyond the 6000 companies subject to NFRD and enhance investors' and lenders' ability to drive sustainability. The detail of required disclosures could vary based on company size so as not to burden SMEs. Standards could be set as part of the establishment of an open source ESG data platform.

- **Create the European Single Access Point as an open source platform controlled by a public-private partnership.** The European Commission would be the ideal host for a platform managed in cooperation by public sector, private sector and academic leaders and which would showcase Europe's leadership in this area. Reported data must be stored in a secure but accessible data repository, in a consistent format, and be easily callable through a free, public web portal. As proposed by the European Data Warehouse, straightforward climate performance indicators, such as those embedded in TCFD, should be included, as should other sustainable and SDG-relevant data reported according to the Non-Financial Reporting Directive (NFRD), the Taxonomy Regulation as well as investee data needed for compliance with the Sustainable Finance Disclosure Regulation (SFDR).

- **Define the inputs to the data platform through a multi-stakeholder process.** An open source platform could aggregate both mandatory corporate disclosure data and independent 'alternative data,' leveraging technology advances. To achieve this would require combining the technical know-how of new players with the insights, scale and expertise from industry incumbents as well as regulators in a public-private approach. Industry associations, investor alliances and civil society organisations should be consulted on the processes and rules for data collection.

- **Extend the ESG data platform beyond Europe in an inclusive manner once the European rollout is complete.** A collaboration between the EU Data Warehouse and its equivalents in the U.S. and Asia would be particularly important to cover the maximum number of large multinational companies that would need to report. To be most useful for analysts, the available data should be consistent internationally and include data on SMEs and private firms as well.

4. TOWARDS MANDATORY, RELEVANT AND GLOBALLY CONFORMED DISCLOSURE

Financial markets are currently awash with inconsistent and poorly disclosed ESG data. Global harmonization of disclosure requirements is essential to promote sustainable investment and maintain market liquidity. A relevant, coherent, harmonized, and mandatory disclosure framework would have benefits throughout the investment ecosystem and accelerate sustainable investment flows. It would also benefit companies seeking guidance on efficient and effective disclosures valued by investors.

Lack of corporate reporting and disclosure on issues of vital importance to the SDGs is a barrier to their financing and hence their achievement. The topic of sustainability disclosure goes straight to the heart of funding efforts to transition to a net-zero economy and to advance sustainable development. Policymakers, regulators, companies, investors, and NGOs broadly agree on this point. Recent empirical research suggests that mandatory disclosure not only reduces the gender pay gap, but also does so in a way that does not affect company profitability, for example.[xi] Disclosure is not an end it itself but a means to sustainability action. Without harmonized disclosure norms, the global economy and financial markets cannot effectively and efficiently move global capital at scale towards sustainability objectives.

Despite broad agreement on the need for harmonized disclosures, there continues to be a cacophony of global approaches across the various layers of sustainability benchmarks, best practice initiatives and securities frameworks. The absence of harmonized guidance for sustainability related disclosures prevents comparisons of performance between firms and of single firms over time. This makes it hard for investors to put a company's sustainability performance in perspective or to evaluate the company's progress on sustainability objectives. Importantly, it prevents investors from assessing how sustainability performance links with financial performance, both in terms of risks and opportunities. Without such ability, investors cannot make informed decisions, creating a significant barrier to sustainable investment.

The increasing number of principles, frameworks, benchmarks and standards adds data but does not increase knowledge. Rather, it reduces the comparability and reliability of the information. It also does little to improve the ultimate qualitative and quantitative understanding by investors of sustainability behaviour, risk or impact. Despite the enormous growth in investor commitments to include ESG factors and SDG objectives into their investment and financial paradigms, there is crippling asymmetry in data disclosure. Asset owners and financial institutions are often forced to make decisions with backward-looking, dated information that is generally incomplete, sometimes immaterial, rarely fully comparable and often difficult to verify. The voluntary nature of disclosure also results in troubling false positives across data sets.

Outcome and impact measurements remain a challenge. Companies often report on process rather than outputs and outcomes. Impact data is lacking and, in the absence of standards, can be expensive to produce. While there are multiple data sources providing some variant on ESG data, there are far fewer sources of impact data enabling the measurement of the positive or negative impact that investments are having in relation to their stated ambition, be that on the economy or target populations or groups.

Strategic considerations and opportunities

Until ESG and impact data are qualitatively improved, consistent, and integrated into financial reporting, scoring outputs will remain unreliable. A case in point is the plethora of inconsistent

sustainability scores for many major firms (see Chapter 3). One explanation given for the lack of correlation between ESG scores of the same entity is the differentiated and inconsistent inputs into scoring firms' models and methodologies. There is also broad agreement among CRAs and ESG scoring firms that the underlying lack of adequate, consistent and comparable disclosures from firms is a dominant impediment to improved financial credit, equity and risk modelling, as well as rating or scoring of sustainability factors.

Harmonized global disclosure standards are therefore urgently needed across industries and sectors. Consistency of global reporting standards is essential to underpin global regulatory frameworks. Policymakers and regulators must play a stronger role and fulfil their mandate to ensure investors are provided with the information relevant to understanding the drivers of risk and return. To ensure comparability of robust metrics across sectors, securities regulators need to mandate a core disclosure framework aligned with their financial reporting requirements. There is a continuing role for market-led initiatives to assist standard setters. Yet unless this is anchored to financial reporting, these will continue to be viewed as unreliable or, at best, idiosyncratic. Action by standard setters is needed to address the growing demand for high-quality, timely, assured and comparable standards on sustainability.

There is a need for improved integration of material SDG considerations into accounting frameworks, including both International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (U.S. GAAP). Financial reporting principles direct companies to disclose material risks, without limitation to financial disclosures. Providing the information is material, the existing accounting standards architecture can accommodate new non-financial reporting. It is on this basis that International Accounting Standards Board (IASB) has developed a framework to integrate TCFD reporting into IFRS, creating a path toward reporting on SDG 13 (Climate action) across IFRS conforming markets—144 jurisdictions worldwide in 2018.[xii] Similarly, the U.S. Securities and Exchange Commission (SEC) Investor Advisory Committee's recommendations on human capital management set out disclosures relevant to SDG 5 (Gender equality) and SDG 8 (Decent work). These initiatives are first steps towards to defining the materiality of SDG-relevant metrics.[xiii]

The work of harmonizing global sustainability disclosure poses a challenge to the two primary international bodies responsible for corporate reporting requirements. Namely, these are the SEC — which oversees the Financial Accounting Standards Board (FASB)— and the IASB, each of which has a mandate to ensure that corporate reporting meets the needs of investors and allows for reasonable evaluation of the risk and return of investments. Current sustainability reporting clearly falls short of meeting those needs.

With the above in mind, the GISD recommends the following:

- **Adopt mandatory and globally harmonized disclosure requirements, extending beyond climate metrics to the SDGs and forward-looking data.** Mandatory disclosure principles need to be broad enough to encompass both listed and unlisted firms, phased-in as appropriate, and provide meaningful insights into privately-owned firms as well as SMEs without overburdening them with regulatory or disclosure costs. The flexibility of requirements should not come at the expense of consistent reporting, however. Some key information such as diversity statistics or climate data will thus need to be disclosed by all companies. Climate disclosures could include GHG emissions (e.g. broken down by emission type; by scope 1, 2 and 3, and in aggregate) as well as GHG intensity.

- **Standardize disclosures revealing portfolio-level alignment to climate scenarios.** Investors should consistently and comparably disclose portfolio alignment to climate scenarios, with

reference to temperature pathways (e.g. 1.5°C, 2°C, 3°C, 4°C). This is critically important for understanding the financial sector's contributions to achieving the Paris Agreement. For this effort to be meaningful and effective, however, there needs to be a robust, widely accepted methodology building on frameworks such as those developed by the TCFD or the Paris Agreement Capital Transition Assessment (PACTA).[xiv]

- **Have the G20 call on IASB and FASB to integrate material sustainability disclosures into their respective accounting standards in an internationally consistent manner.** This would accelerate disclosure and reporting of material, long-term sustainability issues and provide comparability of reporting across jurisdictions. It would also provide insights into how reporting companies contribute to the SDGs. Such collaboration should build on existing sustainability reporting efforts. The standards should be globally comprehensive, science-based and empirical, and address all market participants—both corporates and financial institutions. This effort would not require the creation of a new institution. In fact, scale and speed will come from integrating sustainability accounting into existing standards rather than the creation of new ones.

In pursuing the above, the European Union should:

- **Leverage its leadership and influence with global governments and accounting bodies to ensure a consistent, coherent, relevant and integrated global reporting regime.** Such a regime will ensure the systemic risks and opportunities of the SDGs are presented in the disclosures and audited reports of the more than 40,000 public companies in global markets. This would lend scale, impact and considerable influence to the related efforts undertaken by CRAs and ESG scoring firms, moving the market further towards longer-term sustainability objectives.

- **Address and implement regulatory requirements for disclosure in a globally consistent manner**. The recent decision by the European Commission to ask the European Financial Reporting Advisory Group (EFRAG) to provide recommendations for non-financial reporting standards to support the NFRD is a welcome step addressing the urgent need for harmonization of disclosure standards. Greater alignment is needed for disclosure requirements under the NFRD, upcoming Taxonomy Regulation and the envisaged SFDR. This is particularly important as disclosure requirements under the Taxonomy Regulation and the SFDR can only be fulfilled if the NFRD provides a base of data. Building a set of European non-financial reporting standards will not solve the problem of harmonization, however. Without consistent information across all markets, European investors will not be provided with the decision-useful information that they need beyond the EU. The EU should thus make it clear that the EU standard will coalesce with international standards as and when such a development occurs.

- **To succeed in its global ambition, any EU-wide methodology should draw on existing global multi-stakeholder efforts.** This notably includes work by the United Nations-convened Net-Zero Asset Owner Alliance, which has been working on a global approach in coordination with TCFD.

5. TOWARDS PURPOSEFUL GOVERNANCE

The COVID-19 crisis underscores the imperative to embed long-term thinking and sustainability into corporate and investment practices. Strengthened corporate governance mechanisms will be key in that regard, as will more meaningful and transparent interactions with stakeholders.

The COVID-19 crisis puts the onus on companies and investors to articulate how they will contribute to the future of our societies. The crisis has focused minds on the immediate task of managing market turmoil, liquidity, and funding challenges. For many, it has also brought greater scrutiny of the maintenance of core operations and business survival. Yet as companies and investors transition from crisis response to recovery and the development of a post-pandemic 'new normal,' there is a window in which to disrupt the status quo. Now is the time to change the governance paradigm and embed long-term thinking and sustainability commitments into core corporate practices and investment behaviour.

Corporate and investment behaviour has been dominated by short-term thinking and a narrow definition of 'purpose.' This approach is out of date. All along the investment chain, from individual investors to asset managers, stakeholders are calling for higher standards of corporate behaviour. Positive social contributions by corporations are no longer the request of fringe investors and customers; they are something all stakeholders will expect. And expectations of corporate boards have increased regarding not just whether they respond to ESG concerns, but how well, how fast, and how forcefully. Raised expectations are already reflected in ESG scores, with ESG analysts evaluating corporate leadership in response to COVID-19.[xv] Some governments have also linked relief packages to corporate ESG commitments and board-level ESG oversight.

Long-termism is core to the governance challenge and the GISD agenda. In their joint statement adopted at the launch of the GISD Alliance in October 2019, CEO members committed to a long-term approach to business and investment decisions.[xvi] This included the integration of a long-term performance outlook into investment decision-making, recognizing the importance of sustainable, long-term value creation, and how the latter requires stewardship of financial, human and natural capital. In addition, in their June 2020 Statement of Action, GISD members agreed to urge the broader business sector to better integrate the SDGs into core business models, including by aligning internal strategies, policies and guidelines with the SDGs, introducing long-term performance metrics and accelerating company disclosure and reporting on social and environmental issues.[xvii]

Strategic considerations and opportunities

To achieve change in the real economy, focus must evolve from setting goals to demonstrating impact. A sustainable recovery requires the finance community to support change in the real economy. This will be measured by demonstrable corporate progress towards the SDGs. However, many corporate ESG goals currently fall short in terms of ambition and impact. After COVID-19, companies and investors will increasingly be judged not by their sustainability statements, but on the materiality of their targets, how they are achieved and the impact these demonstrate. More work is also needed to empower institutional investors to track the ESG impact of their investments – something that will be critical over the coming decade if we are to maximize the financial sector's role in delivering the SDGs (see Chapter 4).

Improving the 'G' of ESG will be critical for progress on the 'S.' There is increasing evidence that improved corporate governance is a leading indicator for overall ESG performance – suggesting (without

demonstrating) a causal relationship. Expectations of the role companies play in society are also changing fast. With this comes greater scrutiny of whether and how a company delivers its sustainability targets or implements ESG policies. As a result, board and management commitment, performance metrics, and monitoring and verification methodologies will be more important than ever.

Purposeful governance requires accelerated pace and long-term vision. With millions unemployed, billions increasingly vulnerable, economies in recession and social challenges more entrenched than ever, companies will be expected to increase the pace of their sustainability efforts and to do so within the context of a well-articulated, long-term statement of purpose. Corporate purpose will be expressed in terms of what a company aims to deliver to society, moving beyond shareholder interests to include a genuine stakeholder perspective. Companies without a comprehensive positioning across ESG topics will appear tone-deaf.

Directional gestures must give way to commitments. Declaring the importance of corporate purpose statements can no longer be sufficient for stakeholders. Purpose needs to be demonstrated in practice, and stakeholders will expect – and may enforce – a cost for companies failing to fulfil their commitments. This is particularly true of environmental issues linked to science-based targets such as climate change, about which there is growing conviction that a lack of progress will increase investors' measurable exposure to physical risks. On any ESG topics for which reliable data is available, demonstration of purpose will be evaluated quantitatively.

Stewardship and active dialogue between investors and companies will be critical, even for passive investors. Long-term investors can play a more active role in stewarding companies towards durable, purposeful decisions and discouraging short-term behaviour contrary to stakeholder interests. Companies should also report regularly on their progress towards sustainability targets and time disclosures to coincide with the issuance of their financial reports. Facilitating cross-border voting on issues where a company's impact is global would also incentivize companies to take a more holistic approach to management of supply chains and externalities.

Interactions between stakeholders along the investment chain need to evolve. The nature of contracts between large asset owners and their asset managers, for example, strongly influences incentives, habits and time horizons throughout the investment industry. Recent improvements in global custody transparency have improved asset owners' ability to understand asset manager activities, providing enhanced accountability and principal-agent alignment.

With the above in mind, the GISD recommends the following:

- **Make unequivocally clear that investors' fiduciary duties encompass material sustainability considerations.** Without explicit clarification of the relationship between material sustainability issues and fiduciary duties, investors lack certainty about the extent of their responsibilities regarding ESG, undermining systematic ESG integration. While important progress has been made on this front in many jurisdictions, we note with grave concern the recent positioning of some important players. Given the need to mobilize institutional investment for the SDGs, all jurisdictions must urgently empower investors to act.

- **Boards should adopt sustainability strategies with clear management-set targets, monitored and reviewed by the board to ensure materiality, ambition and impact.** Sustainability and long-termism need to be overseen at the board level and integrated into senior executives' duties. Boards should ensure their members are appropriately informed and skilled to scrutinize sustainability issues, which could include instituting a 'fit and proper' test for new board members and directors as well as

sustainability training for existing ones. Including appropriately skilled and informed stakeholders on the board is another strategy to promote long-termism among executives and managers. In the case of companies with exposure to material ESG risks, an expectation could be set to include members with relevant scientific sustainability expertise.

- **Long-term investors must actively engage companies on their sustainability objectives.** Investors should request companies to set ESG-related performance goals such as GHG emission reduction targets, net-zero objectives, or performance standards referencing the most material and relevant Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB) or similar ESG accounting metrics. Joining global initiatives such as the Net-Zero Asset Owner Alliance or the Climate Action 100+ are powerful ways to amplify the scale and impact of engagement efforts. Regulators could also simplify cross-border voting, making it fully auditable with vote confirmation and reconciliation, which will further strengthen investors' stewardship.

- **Update and upgrade existing corporate governance and investor stewardship codes through an SDG lens.** International and national corporate governance or investor stewardship codes have yet to integrate the full governance implications of the SDGs. Governments and international bodies should revisit these codes and ensure that sustainability is integrated throughout. Particularly important in this regard are the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance and stewardship standards, which should be updated to reflect the SDGs and the Paris Agreement (see Box 1). Jurisdictions that do not have corporate governance or stewardship codes should consider publishing their own, building on international principles such as those of the OECD.

- **Asset owners should express their core sustainability preferences to asset managers and work with them to ensure their preferences are reflected in investment decisions.** Such opportunities should be designed to ensure that asset managers' activities are closely aligned to the long-term interests of asset owners. This could be achieved by adopting the International Corporate Governance Network's (ICGN) Model Mandate initiative as an appropriate framework, or by introducing guidance aligned with it. Standardized documentation can help. Asset owners should also encourage asset managers to disclose the nature and impact of their engagement on sustainability and SDG-related issues in detail on a regular basis and monitor related voting behaviour.

- **Companies must drive sustainability through their supply chains.** Technology developments such as blockchain are increasing supply chain transparency and traceability. Supply chain due diligence and reporting requirements should be based on internationally established principles and guidelines and encouraged by investors. This might include encouraging greater adoption of the United Nations Global Compact Guidelines on Supply Chain Sustainability, the Guiding Principles on Business and Human Rights (UNGPs) and the OECD guidelines for multinational enterprises, which are binding standards for social and environmental due diligence in OECD countries. Although the OECD guidelines and UNGPs apply to all companies, including SMEs, requirements should be proportionate to the size of the reporting company. Multinationals should be subject to stricter requirements.

In pursuing the above, the European Union should:

- **Reflect the above fiduciary considerations into EU law.** While term 'fiduciary duty' is not expressed in EU law, the key components of fiduciary duty – the duties of loyalty and prudence – are expressed in the Markets in Financial Instruments Directive 2004 (recast) (MiFID II), Undertakings for the Collective Investment in Transferable Securities Directive (UCITS) and the Alternative Investment Fund Managers Directive 2011 (AIFMD). Indeed, the EC recently completed a consultation on how to

integrate sustainability into the aforementioned regulations. In implementing the resulting updates, the Commission should ensure that sustainability is reflected in the articles and provisions detailing market participants' duties to act in the best interest of their beneficiaries.

- **Empower institutional investors to take a more active and influential role in the management of their assets.** Introduce requirements mandating long-term investors to demonstrate the necessary expertise to focus corporate attention on long-term risks and opportunities. Requirements might be similar to provisions in the United Kingdom Stewardship Code and could be integrated into the EU Shareholder Rights Directive.

- **Elevate the Shareholder Rights Directive to the status of an EU regulation**. This would ensure consistency of application and supervision across the Union. In particular, a fully harmonized definition of a 'shareholder' at the European level would improve the conditions for shareholder engagement. The Shareholder Rights Directive II and its implementing measures should be amended to clarify and further harmonise the interaction between investors, intermediaries, and issuers or issuer agents with respect to the exercise of voting rights and corporate action processing. Consideration should be given to creating and enhancing a monitoring mandate for the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) where relevant. Should regulatory action be difficult or slow to achieve, the EC should pursue these changes through delegated acts.

- **Elevate the EU Non-Financial Reporting Directive to the status of an EU Regulation supervised by ESMA.** This will foster better comparability and usability of data through harmonised reporting requirements.[xviii] Should it be difficult or slow to achieve regulatory action, the EC should pursue these changes through delegated acts.

Box 1. Embedding sustainability in corporate governance and investors stewardship codes

Global corporate governance practices have evolved significantly over the years. Recent governance codes set out best practice about how a company's 'guiding mind' should be optimally structured. Stewardship codes are also emerging, elaborating best practices for investor behaviour as owners. These codes are increasingly integrating sustainability issues such as gender, ethnicity, and climate change.

Sustainability issues must be integrated into existing corporate governance and stewardship codes as topics worthy of substantive debate and resolution. New sustainability governance codes and principles are most likely not necessary. Rather, consideration should be given to upgrading existing ones by including some of the following best practices

Corporate Governance Codes	Investor Stewardship Codes
Create a boardroom culture that considers sustainability in general and the SDGs in particular	Integrate the SDGs into the asset manager's investment philosophy
Nominate an independent board member to have responsibility for the championing of the SDGs	Ensure in-house investment expertise on sustainability issues in general and the SDGs in particular

Provide board training and succession planning	Consider how sustainability is integrated into the investor's governance policies, including on board training and succession planning
Integrate long-term sustainability issues into corporate strategy	Disclosure of the results of SDG engagements to end-investors (beneficiary)
Include sustainability issues within the terms of reference of the audit, risk management and remuneration committees	Include sustainability in the terms of reference of investment committees, compliance and internal audit
Include a 'Say on Sustainability' vote at company Annual General Meetings to encourage investor-corporate dialogue on material, long-term sustainability issues	Integrate SDG issues into voting and engagement policies, in particular on director (re-)election, executive pay, and corporate disclosure
Create an independent SDG advisory committee	Provide mechanisms for the inclusion of end-investor (beneficiary) views on the SDGs and associated engagement
Include SDG impact assessment within financial or other reporting with attention to material sustainability issues	Make substantive attempts to measure the impact of material, long-term sustainability issues on corporate performance as well as how the corporate entity contributes to the achievement of the SDGs
Incentivise executives with reference to long-term sustainability metrics	Include sustainability issues within the asset manager's remuneration framework

6. PUBLIC SECTOR LEADING BY EXAMPLE TO CATALYSE PRIVATE FINANCE

The way out of the current crisis is clear: we must Build Back Better. Doing so in time will require governments to live up to societal expectations and to establish financing and regulatory frameworks that promote sustainable finance and SDG progress. Public investors and government-owned enterprises will also need to do their part.

The current state of the world demands transformational change. The convergence of climate change, COVID-19 and the attendant economic and social crises pose a stark choice: return to the status quo or Build Back Better for long-term sustainability. As of May 2020, G20 governments had committed over 10 per cent of their aggregate GDP to pandemic relief and have continued to offer additional economic support.[xix] The magnitude of relief spending has deepened the interdependence between governments and societies. Public authorities therefore have a historic opportunity to guide financial resources towards a sustainable future, including for the climate. The recent EU agreement over the COVID-19 recovery package is an important example in that regard.

Success requires governments to put the SDGs and the Paris Agreement at the heart of their COVID-19 response and recovery plans. Sensible fiscal recovery packages can decouple economic growth from GHG emissions and reduce existing welfare inequalities within states.[xx] Governments will also need to use all the tools at their disposal to encourage domestic and international progress towards the SDGs. This includes modelling best practices, setting the tone of public debate, defining standards and educating the public on the challenges we face. It also includes distributing and investing public resources to catalyse private sector participation.

The scale of the challenge calls for reinvigorating public-private partnerships to a degree not experienced since World War II—a degree perhaps never before seen in peacetime. The SDGs already required between US$5 trillion and $7 trillion of annual investment before the pandemic hit. Success is predicated on effective collaboration between public and private actors at the global scale. We urgently need intensified multilateral coordination and institutional support for a coherent, international sustainable finance framework focused on delivering the SDGs and the Paris Agreement.

Governments choosing to Build Back Better will find support from the international scientific, academic, business and finance communities, as well as from their citizens. Even through the pandemic, recent polling reveals continued high levels of public concern about climate change. According to a recent Ipsos survey across 14 large countries, an average of 65 per cent of respondents are calling for a green recovery – a number that goes up to 80 per cent in emerging markets like China, India, and Mexico.[xxi] Meanwhile, business organizations, multinational corporations and a host of CEOs are calling for current stimulus and recovery packages to advance the transition to a sustainable, low-carbon future.[xxii]

To leverage available support, governments must act now. Developing a predictable regulatory framework is essential for the deployment of private capital. The threat of sudden regulatory change, lack of policy predictability and uncertain legal frameworks make regulatory risk difficult to calculate and difficult to price. The more predictable and coherent the direction of relevant regulatory policy, the easier it will be for private actors to engage in financing the transition.

Strategic considerations and opportunities

To be successful, the transition towards a sustainable, net-zero world will need to be inclusive, equitable and just. Achieving the SDGs and a net-zero future requires reallocation of public and private resources across countries, economic sectors and social segments. Without attention to the most vulnerable groups, however, the transition will result in increased social and economic stress. It is thus essential for policymakers to establish a conceptual framework for fairness and to use public financial resources in the most efficient and catalytic way possible to implement that just transition framework.

Global and national policy coherence will be critical. Government actions often do not conform to their own stated aspirations. This is most evident in the aberrant continuation of fossil fuel subsidies, which the IMF estimates totalled US$5.2 trillion (6.5 per cent of global GDP) in 2017.[xxiii] Emissions should be costly, not rewarded. Importantly, when it comes to the recovery effort, the green share of the stimulus effort is insufficient. Current estimates put it somewhere between 0.2 per cent and 4 per cent, depending on how stringently one defines green activities.[xxiv, xxv] This is not only less than the 16 per cent that was deployed during the global financial crisis, it also falls far short of the investments required to address climate change. By way of comparison, the Intergovernmental Panel on Climate Change estimates that fulfilling the Paris Agreement will require annual investments of $2.4 trillion per year between 2016 and 2035 in the energy sector alone.[xxvi] Global trade and investment policies can also be used to align significant flows of capital to the SDGs.

Deploying commercial capital at scale will require investment returns to appropriately compensate for risk. Historically, there have been many barriers between private capital and sustainable investments. As discussed throughout this report, improved data and reporting, as well as improved understanding of the risks and opportunities, are eroding those barriers. Despite this, the SDGs and climate goals might in some cases require investments for which the risk overwhelms expected returns. COVID-19 will also increase the real and perceived risk of cross-border investments into emerging markets, depriving them of much-needed capital. Capital inflows into emerging markets have returned after historic portfolio outflows of almost $100 billion in March 2020, but whether investment confidence fully recovers is yet to be seen.[xxvii] Governments can take steps to reduce emerging market investment risk and catalyse private capital flows through effective risk mitigation and risk sharing. Stable and predictable policy frameworks are necessary but not sufficient; in many instances blended finance will also be needed.

The public sector has a wide variety of tools available to mobilize private finance. Deployed thoughtfully, commercial capital is responsive to guarantees, tax policies and targeted insurance subsidies (e.g. political risk insurance). Blended finance structures, in particular, have enormous unrealized potential to guide private investment to either domestic or international objectives at both the project and fund levels. National, regional, and multilateral development institutions as well as donors have yet to design and fund blended structures at scale, however. Furthermore, there is no authoritative 'hub' to facilitate sustainable blended finance transactions at scale, as there are in other areas of finance. Successful finance allows capital to be recycled and redeployed, increasing total capital mobilization for the SDGs.

Success is as much about joint effort as it is about joint responsibility. Public sector investors and government-owned companies will have to play their part. Global public sector investors have the capital to lead the finance industry towards ESG investing best practices. Before COVID-19, the world's largest public pension, superannuation, government and sovereign wealth funds held US$61.5 trillion of assets under management, roughly one-third of the global equity and fixed income markets.[xxviii, xxix] Similarly, government-owned companies, which account for the lion's share of energy investments in emerging markets, could do much more to contribute to the Paris Agreement. As of 2018, these firms accounted

for 59 per cent of fossil fuel generation investments in emerging markets, compared to just 28 per cent of renewable energy and energy efficiency investments.[xxx]

National capital-raising plans are a powerful way for governments to articulate the role they expect the private sector to play in jointly achieving the SDGs. Properly designed, national capital-raising plans oblige governments to articulate a vision while providing private investors with a clear sense of the project pipeline as well as the key sustainable financing vehicles, products, and incentives available to support the national effort. Many countries currently produce VNRs to illustrate progress toward the SDGs. However, VNRs should be enhanced to guide investment. Investors wish to see forward-looking national data, standardized international metrics, consistent and regular reporting, and the setting of clear, near- and long-term targets. Transposing national capital-rising plans to the local level is also important, given that an estimated 65 per cent of SDG targets require municipal and regional government involvement.[xxxi] These plans will only become meaningful if government policies represent durable commitments and are aligned with the SDGs and the Paris Agreement.

In the present global economic crisis, the pricing of externalities represents a powerful way to accelerate the transition while also boosting government revenues. Significant progress is needed to put a price on key externalities such as carbon emissions. As of 2020, however, just a fifth (22 per cent) of global emissions were covered by a carbon price - and less than 5 per cent of these emissions were priced at a level judged to be compatible with the Paris Agreement. Not only is this limiting the ability of investors and companies to price in externalities, it also drains governments of fiscal capacity to protect the most vulnerable in their societies and accelerate the sustainability transition. It is particularly urgent for governments to price carbon at a level commensurate with the imperative of achieving a net-zero carbon economy by 2050. This might require a price in the range of at least US$50–100/t$CO_2$ by 2030 to cost-effectively reduce emissions.[xxxii]

Deploying sustainable finance for the SDGs demands coordination and harmonization. While there are a wide range of initiatives and platforms at the regional and global levels to increase global action on different aspects of sustainable finance, these platforms are often poorly coordinated and siloed in their work. Little has been done to ensure that their work fits into a coherent framework. There are of course exceptions; the NGFS notably demonstrates impressive global leadership in the field of financial supervision and climate risk, for example. A similar approach is needed to coordinate and promote best practices in the field of sustainable finance.

Research efforts are also required. Evidence-based research is key to the effective mainstreaming of sustainability into the financial system. Changing market practices and culture also requires the generation of new ideas and, in some cases, the revisiting of long-held market conventions. Research networks on sustainable finance have been established, but they need to be supported and coordinated. Given the rapidly evolving nature of the topic and of the market, collaboration between the academic, NGO and financial sectors are necessary. Genuinely collaborative, multi-stakeholder research programs remain the exception, although the International Network for Sustainable Financial Policy Insights, Research, and Exchange (INSPIRE) is an example for global, inclusive and rigorous investigation. Similar research projects in key areas of sustainable finance theory, practice and culture are needed.

With the above considerations in mind, the GISD recommends the following:

- **Urgently increase the quality, ambition and standardisation of VNRs and NDCs.** Both are critical, strategic tools to benchmark progress on the SDGs and the Paris Agreement, within and across countries. They should be consistently of high quality, comparable in their approach and metrics, and meet high, multilaterally agreed upon disclosure standards. VNRs and NDCs must be strengthened if

we are to use them as a way to track progress on SDG spending. The VNR process should integrate concepts that are decision-useful for investors. Governments should also improve the quality and consistency of private and public data sources feeding the VNRs. Reviews should be published on a more frequent basis.

- **Make national capital-raising plans an integral part of the national development strategies for the SDGs.** Within the context of Integrated National Financing Framework (INFF), national capital raising plans should build on and be consistent with the improved VNRs and NDCs. [xxxiii] These plans should articulate what investments are needed, the role the private capital is expected to play in the financing, how the government intends to mobilize it, and the role sustainable finance will play as part of that effort. Designed as a way to channel capital at the local level, these would provide a much-needed capital boost to cities, which have a key role to play in delivering the SDGs. The INFFs should draw upon the work underway by the World Economic Forum on SDG Roadmaps.

- **Establish an international platform for the development of investable national capital-raising plans and transaction-oriented investor engagement.** The platform would help governments produce national capital-raising plans that are internationally coordinated and investible. Staffed with finance professionals, this independent international body would track the alignment of capital markets with the SDGs and bring the key multilateral bodies together with central banks, finance ministries and systemically important financial institutions together to finance the transition to a net-zero carbon economy. COP26 has a unique opportunity to call for such a platform.

- **National governments should require domestic recipients of ongoing national public relief packages to align future operations with the SDGs and the Paris Agreement.** The requirement should be imposed in a proportionate manner, reflective of the particular sector's economic situation as well as its contribution (positive or negative) to the SDGs and the Paris Agreement. Examples of such requirements include TCFD disclosure requirements (e.g. in Canada) and increased emission reduction targets (e.g. in France). Other options could include requiring accelerated transition plans appropriate for the sector (e.g. faster electrification plans for the auto industry).

- **Mandate SDG and Paris Agreement alignment for public procurement and infrastructure spending, where appropriate, including both direct and supply chain components.** Compared to their unsustainable counterparts, sustainable infrastructure projects create more jobs and generate stronger economic multipliers – both in the short term and in the long run. The pursuit of these public investments should be done in a way that is compatible with anti-corruption principles and associated SDG targets, including SDG 16.5 (Reduce corruption and bribery). Signatories to the Equator Principles should create a higher baseline for project financing of sustainable infrastructure and ensure ESG risks are managed while also improving data availability and harmonisation, including climate change impacts. Applicants for public procurement contracts should disclose the extent to which their plans and operations support achievement of the SDGs and conform to the net-zero trajectory.

- **Harmonize guidelines for public-private partnerships (PPPs) to promote fiscal and operational transparency.** Given the need to mobilize private capital, the establishment of an internationally accepted accounting and reporting standard for PPPs would reduce current barriers to their use. Guidelines on how to implement PPPs often differ from – and in some case contradict – each other. A harmonized standard would provide clarity on the fiscal implications of PPPs and help to establish the legal, regulatory and monitoring frameworks to ensure transparency, appropriate pricing and quality of service. This should be developed in a multi-stakeholder and inclusive manner.

- **Create a global blended finance fund for the SDGs.** Such a fund could be modelled after the International Finance Corporation (IFC) Managed Co-Lending Portfolio Program (MCPP). The new fund's purpose would be to scale blended finance and mobilize private investment by making previously 'unbankable' projects investable and aggregating them to reach scale. The fund should facilitate donor organization and multilateral development bank participation in blended finance structures. It should be established in a way that builds on existing blended finance principles, ensures accountability and transparency over the projects financed, and guarantees a fair allocation of risk between public and private actors.

- **Establish a Sustainable Finance Hub at the G20 level to facilitate international exchange of best practices for structuring bankable deals in the sustainability space.** Based on the model of the G20 Infrastructure Hub, a sustainable finance transaction-focused hub could accelerate the supply of high-impact SDG investments.

- **Align public subsidies with the SDGs or the Paris Agreement and invest the fiscal savings towards a sustainable recovery and a just transition.** Programs creating perverse incentives, such as fossil fuel subsidies, are not only inefficient, but also impede progress towards the SDGs. Governments should remove these in earnest, investing the funds towards facilitating a just transition and ensuring a sustainable recovery from COVID-19 instead.

- **Establish a strong carbon price compatible with a net-zero trajectory, both to correct the price signal and to increase government revenues.** Removing perverse incentives is necessary but not sufficient. Externalities also need to be priced at a level reflecting the scale and urgency of sustainability challenges. Doing so will not only help carbon-intensive industries transition, it will also diversify and increase the sources of government revenues – something deeply needed in the context of tight public budgets.

- **Governments should encourage public asset owners to join the Net-Zero Asset Owner Alliance and to disclose their alignment to the SDGs.** Public asset managers exercise extraordinary influence over the entire financial ecosystem, including securities issuers and other investors. Aligning publicly controlled funds with evolving ESG standards, benchmarks and objectives would be a significant signal of market evolution in the right direction. Similarly, aligning government-owned companies with sustainability objectives and the Paris agreement would play an important role in increasing capital deployment towards the SDGs. As a way to support their government's' vision, public asset owners in countries that have committed to net-zero should join the Net-Zero Asset Owner Alliance.

- **Fill the sustainable finance skills gap through training, education and certification.** Enhancing sustainability knowledge in the finance sector could be accomplished by incorporating sustainable finance components into financial sector education and certifications. In emerging markets, it would also involve enhancing technical assistance for sustainable investment, blended finance and capital market development, as well as data reporting and transparency criteria.

In pursuing the above, the European Union should:

- **Ensure that Member States' national recovery and resilience plans are aligned with the SDGs and the Paris Agreement.** As part of the Next Generation EU recovery effort, member states have been asked to prepare national recovery and resilience plans setting out the reform and investment agenda for the period 2021-2023. Given the need to restart the economy in a just and sustainable manner, it is imperative that public spending prioritizes investments that maximize both economic and sustainable returns. These include sustainable energy infrastructure, energy efficiency spending for

renovations and retrofits, investment in education and training to address immediate unemployment from COVID-19 and structural shifts from decarbonisation, natural capital investment for ecosystem resilience and regeneration, and supportive R&D spending.[xxxiv]

- **Ask the Platform on Sustainable Finance to support and advise the EC on how to track and align EU financing with the SDGs**. The research question for the EU Sustainable Finance High-Level Expert Group (HLEG) focused on how the EC could best integrate sustainability within the capital markets union (CMU). Yet it also critical for the EU to better understand how EU finance supports or hinders achievement of the SDGs. Such an undertaking would fit well under the newly established Sustainable Finance Platform as part of its mandates to "monitor and report on capital flows towards sustainable investments" and "advise the Commission on sustainable finance policy more broadly".[xxxv]

- **Apply the EU Taxonomy (and future taxonomies) and other reporting frameworks as necessary to provide frequent, clear and transparent reporting on the contribution of public spending and assets towards the SDGs and the Paris Agreement.** The EU should also require public asset managers to use the EU Taxonomy, to request ESG data and transparency from invested firms, and to reference ESG performance benchmarks in their periodic reporting. Wider adoption of the EU Taxonomy by public sector entities will bring greater understanding of how it supports financial flows to sustainable activities, its shortcomings, and how to resolve the these.

- **Incorporate sustainable finance components into financial sector continuing education obligations and tertiary finance education.** Such curricula should include components relevant to the challenges and opportunities of financing the SDGs outside of the EU.

- **Leverage research vehicles such as Horizon 2020 and its next iteration to advance research in sustainable finance.** By funding this research effort, the EU would ensure its market reforms are informed by the latest thinking on sustainable finance. It would also gain a competitive edge in shaping the discourse and thinking around sustainable finance, generating new paradigms and securing a global leadership position at both market and thought leadership level.

7. SUSTAINABLE FINANCE PRODUCTS AND CAPITAL MARKET INFRASTRUCTURE

Sustainable finance products have an important role to play in channelling capital towards the SDGs and a sustainable future. Governments can help the market achieve scale through public sector bond issuance and facilitating private sector capital-raising and securitisation.

Sustainable finance products have a critical role to play in the mobilization of capital towards the SDGs. Long a niche market, sustainable finance products have now become both developed and diversified enough to rapidly channel capital towards sustainability objectives. Sustainable financial solutions are available in the bond, equity and loan markets, with focuses ranging from green and social to more general sustainability. They can be found both in the form of products (e.g. green, social, as well as SDG bonds and loans) and in the form of financial vehicles (e.g. green and sustainability funds).

The COVID-19 crisis has shown that investors and issuers can adjust quickly to address previously neglected SDGs when an urgent need is demonstrated. While investor demand and product issuance has historically been concentrated on environmental capital, it took just a few weeks for the market to structure the financial products that supported governments' response to the crisis. This speed and flexibility will be critical for the financing of national capital-raising plans and projects that best fit national SDG needs. It should be noted, however, that some emerging markets still lack the proper market infrastructure for foreign investors to buy and settle bonds, while other markets suffer from a limited supply of local currency debt.

Numerous principles and standards exist to assist market actors in developing strategies and deploying capital. Groups including the International Capital Market Association (ICMA), United Nations Global Compact, United Nations Development Programme (UNDP), United Nations Principles for Responsible Investment (PRI), and the IFC have developed relevant, global operating principles and standards to guide financial market actors. ICMA's Bond Principles, for example, are widely adopted (600 members as of March 2020) and have global reach (62 countries as of March 2020) throughout the bond market.

Strategic considerations and opportunities

While there is strong institutional and retail demand for sustainable finance products, impact assessment, accountability, and transparency are uneven. Recent years have seen tremendous growth in the ESG investment market, with global assets managed with an ESG mandate currently estimated at more than US$30 trillion.[xxxvi] The pandemic has also revealed strong investor (both institutional and retail) demand and issuer interest in social, sustainability and COVID-19-related products. However, use-of-proceeds instruments and sustainability or impact reporting are insufficient and limited. In the case of bonds, greater global use of the ICMA principles and guidelines and focus on SDG indicators should be pursued. Any new frameworks for specific sustainability bond product issuance (e.g. blue bonds) should notably build upon the established ICMA Principles for Green, Social, and Sustainability-Linked Bonds.[xxxvii] A similar argument applies to new loan products, which should build on the relevant principles jointly established by the loan market associations of Europe, Asia Pacific and North America.[xxxviii]

Product growth is not a function of investor appetite alone. By design, use-of-proceeds products are tied to an underlying base of assets, the size of which constrains overall market size. For such products, increasing the qualifying asset base is necessary for growth. By contrast, outcome-linked products (e.g.

SDG-linked loans) are dependent on the ability to improve sustainability performance. They can thus be deployed much more rapidly and at a scale commensurate with global sustainability challenges.

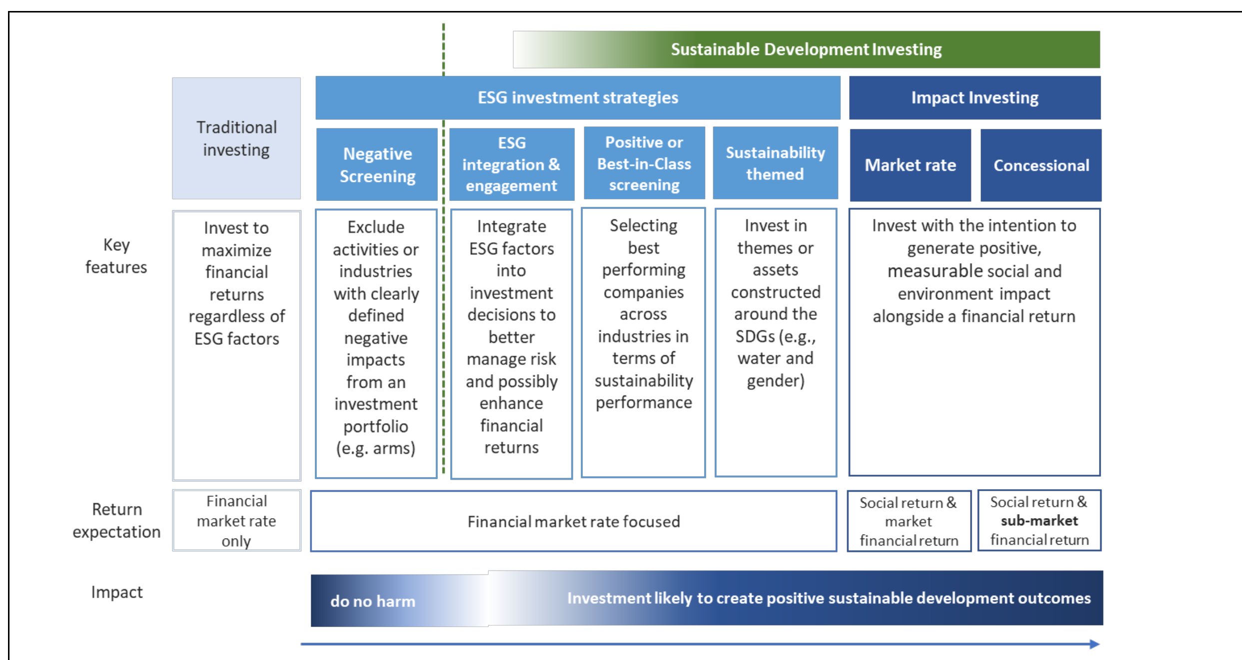
Sustainable finance offers an opportunity to involve citizens in the effort to Build Back Better. According to a recent survey, 85 per cent of US individual investors express interested in sustainable investing strategies.[xxxix] Similar results are found in other regions. In Europe, 30 per cent of total assets targeting sustainable and responsible investment strategies in 2018 came from retail investors.[xl] Global household wealth is more than US$280 trillion.[xli] The use of labels would enable retail investors to confidently identify sustainable finance products. Meanwhile, digital technologies offer them opportunities to participate at scale and drive capital to projects in innovative ways. Some governments in emerging markets have leveraged digital technologies like mobile money to help retail investors invest in sovereign bonds, for example.[xlii] Democratizing access to sustainable finance will also require efforts to improve sustainable finance literacy and to facilitate access to corporate sustainability performance information (see Chapter 4 for more details).

High net worth investors are also an important source of capital for sustainability objectives. More than 80 per cent of wealthy individuals express an interest in sustainable investing, and 45 per cent already hold sustainable investments. In the next 20 years, approximately $2.1 trillion held by fewer than 500 billionaires will be transferred to millennial-aged inheritors.[xliii] Such investors are less constrained than institutions with regards to time horizon and allocation flexibility, and are most interested in SDGs for which a value can be assigned to impact. These include SDG1 (No Poverty), SDG2 (Zero Hunger) and SDG3 (Health and Wellbeing). But there are obstacles to fully involving private wealth in support of the SDGs, including a lack of information. Similar to other investors, high net worth investors want centralized, clearer data about SDG funding gaps, standardized investment terms and disclosures for SDG-related projects, appropriate risk-return profiles and the mainstreaming of SDG impact investing.[xliv]

A globally agreed definition for Sustainable Development Investing will help mobilize, scale and track capital flows towards the SDGs. The GISD Alliance has developed the Sustainable Development Investing (SDI) definition (see Box 2). The working definition, which is currently being piloted and could be subjected to adjustments in the future, goes beyond broad principles to include concrete steps to support its operationalization in an investment portfolio. These steps build on the many initiatives currently underway to reinforce impact investment practices (e.g. IFC's Operating Principles for Impact Management or UNDP's SDG Impact Practice Assurance Standards) and existing sustainability standards (e.g. ICMA Green Bond Principles, sustainable activity taxonomies and the Global Compact Principles).

Box 2. The GISD's definition of Sustainable Development Investing

Sustainable Development Investing (SDI) refers to deploying capital in ways that make a positive contribution to sustainable development, using the Sustainable Development Goals (SDGs) as a basis for measurement. The contribution can be made through products, services, and/or operations or through projects financed across asset classes and in multiple sectors or themes. The positive contribution of an investment should not be outweighed by the negative impacts of the same investment over the life of this investment. Investors can strengthen their positive contribution through active ownership, such as engagement for more sustainability in companies, sectors, and projects they invest in, as well as through greater investment in developing countries. While SDI may be achieved through impact investing and some ESG investing strategies, it is broader than both terms (see spectrum diagram below).



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sustainable assets and free up balance sheet capacity for financial institutions, enabling them to recycle capital more effectively and thereby increase sustainable investment. There is significant appetite in the market for this approach. The difficulty, however, is to determine what classifies as a 'sustainable' lending portfolio. Standardization of data and defining what activities qualify as sustainable will help investors to make informed decisions. The emergence of synthetic securitization will also be facilitated by providing investors with standardized information on a loan-by-loan level, including internal risk parameters, so investors can better assess the alignment of the securitized portfolio with sustainability considerations. Technology will be the bridge to full transparency of the collateral pool.

Market liquidity and integrity are of paramount importance. Participants and regulators should avoid fragmenting the market as this may harm liquidity**.** Numerous stock exchanges have created dedicated segments for sustainable instruments to increase the visibility of qualifying products and to enforce minimum product standards. Such efforts can be important to initially help build markets, but should be pursued as transitional efforts towards the mainstreaming of sustainability within core market infrastructure. Transparency and disclosure also play a critical role in driving investors to commit capital to sustainable finance products. Establishing a minimum standard for independent sustainability verifiers will enhance market credibility and should be done in a way that does not discourage new entrants nor increase costs to issuers.

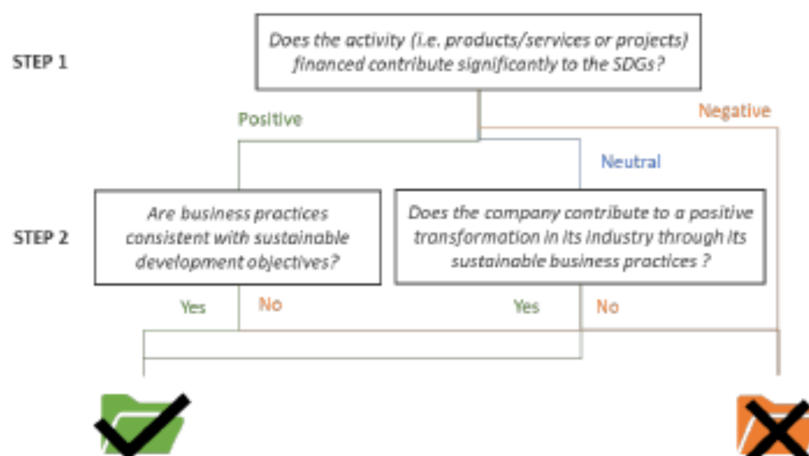
With the above in mind, the GISD recommends the following:

- **Diversify and dramatically increase bond issuance across the SDGs and across actors, including both use-of-proceeds and sustainability-linked instruments.** Active sovereign and sub-sovereign sustainability bond issuance will provide an important signal to the market, particularly if it is aligned with international standards. Sovereigns reporting under environmental bond standards with reference to the EU Green Bond Standard will signal support for the shared goals of transparency, harmonization and greater sustainable investing. Through the issuance of national capital-raising plans focused on SDG delivery, it will also enable to mobilize a wide set of

sustainable finance products. Private issuers should diversify their issuance across multiple SDGs. This is important to ensure that sustainable finance does not become limited to 'green' priorities.

- **Drive green, social and sustainability bond standards and principles into the project finance market.** Limiting global warming to 1.5C requires annual energy investments of $2.4 trillion of investment per annum over the next decade.[xlv] Ensuring these deliver a just transition to net-zero will also require investing and re-investing in urban and social infrastructures. Originating these investments so they can leverage the full range of available sustainable finance products will provide an important boost to the market while also providing investors with greater visibility into the deployment of capital towards the SDGs.

- **Encourage investors and companies to apply the Sustainable Development Investing (SDI) definition to investment portfolios, business operations and products to better align financial flows with the SDGs.** To be eligible as SDI, business activities and projects should change the status quo and not be outweighed by negative impact. Companies must commit be transparent about their business practices and provide adequate sustainability disclosure and reporting. Investors and companies can leverage the decision tree below to help assess whether activities and or projects qualify as SDI.



- **Deploy capital at a scale commensurate with the increased SDG financing gap.** Governments are uniquely positioned in this moment to drive the deployment of capital to the SDGs by committing to a sustainable recovery. Having witnessed the economic devastation inflicted by the present global crisis, the private sector should also be keen to make investments in sustainable outcomes that will help prevent future global crises (see Chapter 6 for recommendations on how the public sector can catalyse private investment).

- **Integrate sustainability into mainstream capital market infrastructure.** Exchange segments that only cater to specific trading in sustainable finance securities should be used as an early step towards integration into mainstream capital market infrastructure. Notwithstanding the advantages of separate sustainability exchange segments, new market infrastructure should promote capital flows at scale, minimise the risk of market fragmentation or illiquidity, and ensure sustainability is not relegated to 'niche markets.'

- **Provide technical assistance to developing countries about how to build well-functioning local capital markets, inclusive of sustainable finance products**. Local capital markets facilitate growth in developing countries in part by creating local currency financing options for domestic

businesses and infrastructure. They are also necessary to support sustainable investing at scale. The necessary technical assistance includes support for pricing, dealing, settlement, benchmark inclusion and development of sustainable finance products. Support for developing a sufficient pipeline of sustainable finance projects will also help to ensure a sufficient asset base for use-of-proceeds instruments.

- **Avoid duplicating global bond market principles by anchoring new developments within ICMA frameworks.** The marginal benefit of any new standard or principle is weakened if it does not build on existing and widely accepted standards, such as those promulgated by ICMA. Given that a significant barrier to scaling sustainable investments is the lack of consistent global comparable standards, governments should avoid creating still more differentiated sets of jurisdictionally specific principles for investors to manage. However, there is room for new global standards and principles (e.g. the planned UNDP SDG Bond practice standards, and Global Compact's CFO Principles), provided these are aligned with and build on the existing standards and principles.

- **Promote market integrity by certifying and accrediting independent verifiers in a harmonized manner.** Market confidence needs independent verification of issuer adherence to sustainable finance principles and taxonomies. Verifiers should be accredited and regulated, and their practices monitored. 'Light touch' regulation of verifiers, in which only a basic level of registration and supervision is required to ensure proper corporate governance, proper disclosure and adequate resources in relation to scope of evaluation, would likely achieve the necessary aims and allow for scale. Setting the standards in a harmonized manner will enable certified verifiers to exercise in multiple jurisdictions, spurring market growth. Finally, it will be important to ensure that the cost of verification does not fall on the issuer, as this would discourage issuance.

- **Create long-term oriented benchmarks and indices to increase the supply of funding to the SDGs.** This could include benchmarks or indices based on GISD's definition of SDI. Regulators would help to set up the criteria for the benchmarks, while the development of the benchmarks themselves would be left to the market players. More generally, asset managers should be encouraged to be more 'active' in their assessment of how companies perform on sustainability criteria, while passive funds could be designed to allow some investors, such as pension funds, to opt-out of or tilt away from unsustainable assets. A tilting strategy based on maximizing measurements of performance would reduce the risk of unintentionally under- or overweighting a certain industry through exclusions (e.g. on climate action, a portfolio might be over-weight financials and underweight natural resources). Tilting a core S&P index can be a better solution than creating niche, new products. An index based on the World Benchmarking Alliance's work could also add value.

- **Democratize access to sustainable finance by leveraging fintech innovations and promoting sustainable finance literacy**. Fintech solutions could, for example, enable retail investors to have easy access to their investment portfolios by security, a measure of how these are performing financially and how the associated companies contribute to delivering the SDGs. The creation of sustainable investing labels – perhaps based on the SDI definition – would further enable them to align their investments with positive contributions to sustainability and the SDGs.

In pursuit of the above, the European Union should:

- **Facilitate cross-border capital flows for sustainable finance.** As much as possible, the EU should embed sustainable finance in the existing capital market infrastructure. It is imperative to ensure coherence and convergence between the CMU agenda and that of the EU Renewed Sustainable

Finance Strategy. As the EU continues to integrate and enhance European capital markets, it should also focus on reducing impediments to cross border income and capital flows for sustainable finance, building on the recommendations of the High-Level Forum for the CMU.

- **Ensure consistency between the EU Green Bond Standard and other internationally recognized standards or principles.** The EU should seek to conform its standards to existing, widely adopted programs with global reach such that it does not create another differentiated set of principles for investors and issuers to manage.

- **Facilitate global adoption of new standards by avoiding dependence on EU-specific regulations.** If the EU intends to encourage international adoption of its Green Bond Standard, the Standard should avoid deterrents for non-EU players. This should not be pursued in a way that lowers ambition of the proposed measures. As one of the most advanced sustainable markets globally, the EU should encourage international adoption in a way that raises the bar globally.

- **Go beyond the European green agenda to include the SDGs as a whole.** As the COVID-19 crisis and present social unrest make clear, sustainability considerations extend beyond climate concerns to broad-based sustainability concerns. It is therefore important that EU develops bond standards complementary to the Green Bond Standard with the intention of increasing investment to the SDGs. In time, the EU should also look at ways to address social, sustainability, and SDG bonds in due course.

- **Leverage existing work for the CMU to facilitate sustainable securitization.** The recent report of the High-Level Forum on CMU contains specific proposals to modify the existing securitisation framework. Several of these proposals will also facilitate green securitizations, which are an important tool for capital markets to increase funding for the SDGs.

8. FROM RECOMMENDATIONS TO ACTION

Sustainable finance is critical to achieving the SDGs. This was already the case before the global COVID-19 crisis, and it is even more so now. The formation of the GISD Alliance in October 2019 is just one example of many attesting to the financial sector's strengthening commitment to the SDGs. The trillions currently being deployed in the pandemic recovery effort are a unique opportunity to unleash this potential at scale.

The GISD members are grateful for the invitation to respond to the European Commission's Renewed Sustainable Finance Strategy consultation. The process of developing a response demonstrated the depth of alignment among the global Alliance and our shared desire for action. It also gave the Alliance an opportunity to share some of its current thinking on priorities for sustainable finance: industries and countries should articulate science-based transition pathways; reporting of material sustainability information should be mandatory; the metrics and data that feed ESG risk management and sustainable investing should be harmonized; public-private collaboration will be necessary to achieve the SDGs; and others as stated throughout this submission.

Most importantly, the preparation of report has enabled the GISD to identify concrete opportunities on which to take action and accelerate capital flows towards the SDGs. Alliance members look forward to continued dialogue with the European Commission with the hope that the Commission and GISD can work together to realize some of this submission's recommendations.

Alliance members also intend to share this document beyond the Commission with policy makers and peer institutions globally in an effort to build coalitions for the sustainable finance agenda. Many of the considerations identified in this report are global in nature, and the Alliance members look forward to engaging with other global actors as it continues its work.

The Alliance welcomes interest from public sector, business, academic and civil society organizations wishing to develop any of its proposals for achieving the SDGs and creating a sustainable tomorrow.

ACKNOWLEDGEMENTS

"Renewed, Recharged and Reinforced: Urgent actions to harmonize and scale sustainable finance" is the product of a focused consultation, drafting and editing process undertaken by the GISD Alliance Strategy Group, spearheaded by the Report Committee and supported by the GISD's UN Core Group teams.

The GISD Alliance thanks the Report Committee members and UN teams for their commitment to this project, which gathers in one place a wealth of global priorities and inspirational ideas. The Alliance also thanks the colleagues in each of its participating organizations who provided critical input and support.

Report Committee

Chair: **Jay Collins**, Citi

Members: **Claus Sticker,** Allianz; **Claudia Kruse,** APG; **Steve Waygood**, Aviva; **Karen Fang,** Bank of America; **Anne Simpson**, CalPERS; **Bertrand Millot**, CDPQ; **Shameela Soobramoney**, Johannesburg Stock Exchange; **Amy O'Brien,** Nuveen; **Gavin Power,** PIMCO; **Daniel Hanna**, Standard Chartered

Team: **Franziska Ehm, Nina Fichtl,** Allianz; **Johan Barnard,** APG; **Patrick Arber, Alexandra Belias, Thomas Tayler,** Aviva; **Allison Fleming, Katharina Kort,** Bank of America; **Philippe Batani,** CDPQ; **Ilan Jacobs, Paull Randt,** Citi; **Anne Clayton,** Johannesburg Stock Exchange; **Tulsi Byrne, Jamie Minkove, Hannah Schiff,** Nuveen; **Emma Doner**, **Ketish Pothalingam,** PIMCO; **Simon Connell, Ashley Dorrington,** Standard Chartered

UN GISD Secretariat and Core Group Participants involved in the drafting of the report

** organization's team lead*

Navid Hanif*, Director, Financing for Sustainable Development Office, UN Department of Economic and Social Affairs (UN DESA)

Will Martindale*, Principles for Responsible Investing; **Esther Pan Sloane*, Abhisheik Dhawan, Laura Sennett**, **Casper Sonesson, Fernando Zarauz-Astorki,** UN Capital Development Fund (UNCDF); **Krishnan Sharma*, Sarah DeCuir, Ildem Esin, Tim Hilger, Arend Janssen, Karen Newman, Alberto Padova, Andrea Torres, Mathieu Verougstraete,** UN DESA and GISD Secretariat; **Eric Usher, Careen Abb*,** UN Environment Programme—Finance Initiative (UNEP FI)

Special Thanks

Special thanks are due to **Elie Chachoua** (Richard Attias & Associates Lab) for editorial leadership and strategic guidance on how to empower the group to drive global impact as well as to **Paull Randt** (Citi) and **Esther Pan Sloane** (UNCDF), whose content and editorial contributions made this report possible.

This report has benefitted from the GISD Alliance's engagement with global thought leaders and subject matter experts. For their strategic insights, the Alliance would like to thank **Mark Carney** (Special Envoy of the UN Secretary-General on Climate Action and Finance) and **Lawrence Summers** (Harvard University). We would also like to thank **FTSE Russell,** the **Institute of International Finance, Moody's Investor Services, MSCI, S&P Global,** the **Swedish International Development Cooperation Agency, Truvalue Labs,** the **UN Conference on Trade and Development,** the **UN Development Programme,** the **UN Global Compact** and the **World Bank Group** for sharing their time and expertise with us.

ACRONYMS AND ABBREVIATIONS

AIFMD	Alternative Investment Fund Managers Directive (EU)
CMU	Capital market union (EU)
COP26	26th Conference of the Parties to the United Nations Framework Convention on Climate Change
COVID-19	Coronavirus Disease 2019
CRA	Credit Rating Agency
EC	European Commission
EFRAG	European Financial Reporting Advisory Group
EIOPA	European Insurance and Occupational Pensions Authority
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
EU	European Union
EUR	Euros
FASB	Financial Accounting Standards Board
GHG	Greenhouse Gas
GISD	Global Investors for Sustainable Development Alliance
GRI	Global Reporting Initiative
HLEG	High-Level Expert Group
IASB	International Accounting Standards Board
ICGN	International Corporate Governance Network
ICMA	International Capital Market Association
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
INFF	Integrated National Financing Framework
INSPIRE	International Network for Sustainable Financial Policy Insights, Research, and Exchange
ISAR	International Standards of Accounting and Reporting
KPI	Key Performance Indicator
MCPP	Managed Co-Lending Portfolio Program
MiFID II	Markets in Financial Instruments Directive (2014/65/EU)
NDCs	Nationally Determined Contributions
NFRD	Non-Financial Reporting Directive (EU)
NGFS	Network of Central Banks and Supervisors for Greening the Financial System
OECD	Organisation for Economic Co-operation and Development
PACTA	Paris Agreement Capital Transition Assessment
PPP	Public–Private Partnership
PRI	Principles for Responsible Investment
RA&A Lab	Richard Attias & Associates Lab
R&D	Research and development
SASB	Sustainability Accounting Standards Board
SDGs	Sustainable Development Goals
SDI	Sustainable Development Investing
SEC	U.S. Securities and Exchange Commission
SFDR	Regulation on sustainability-related disclosures in the financial services sector (EU)
SMEs	Small and Medium-sized Enterprises
TCFD	Task Force on Climate-related Financial Disclosures
TCFR	Basel Committee Taskforce on Climate-related Financial Risks

UCITS	Undertakings for the Collective Investment in Transferable Securities Directive (EU)
UNCDF	United Nations Capital Development Fund
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNEP FI	United Nations Environment Programme Finance Initiative
UNGP	United Nations Guiding Principles on Business and Human Rights
UN	United Nations
UN DESA	United Nations Department of Economic and Social Affairs
U.S. GAAP	United States Generally Accepted Accounting Principles
VNR	Voluntary National Review
WBA	World Benchmarking Alliance

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GISD STRATEGY GROUP MEMBERS

Allianz	Claus Stickler	Germany
APG	Claudia Kruse	Netherlands
Aviva	Steve Waygood	United Kingdom
Banco Santander	George Bridges	Spain
Bancolombia	Franco Alexander Piza Rondón	Colombia
Bank of America	Karen Fang	USA
Caisse de dépôt et placement du Québec	Bertrand Millot	Canada
California Public Employees' Retirement System	Anne Simpson	USA
CIMB	Luanne Sieh	Malaysia
Citi	Jay Collins	USA
Consejo Mexicano de Negocios	Regina Gandara Mendoza	Mexico
Les Eaux Minérales d'Oulmès	Aicha Kouraich	Morocco
Emirates Environmental Group	Ali Al Jassim	UAE
Enel	Alessandro Canta	Italy
First State Super	Damian Graham	Australia
Government Pension Investment Fund	Mai Masui	Japan
Industrial and Commercial Bank of China	Zhang Weiwu	China
Infosys	Srikantan Moorthy	India
Investec Group	Tanya dos Santos	South Africa
Johannesburg Stock Exchange	Shameela Soobramoney	South Africa
Nuveen	Amy O'Brien	USA
Pal Pensions	Saheed Kolade	Nigeria
PIMCO	Gavin Power	USA
Safaricom	Karen Basiye	Kenya
Sintesa Group	Yono Reksoprodjo	Indonesia
Standard Chartered	Daniel Hanna	United Kingdom
SulAmérica	Tomás Carmona	Brazil
Swedish International Development Cooperation Agency (Sida)	Carin Jämtin	Sweden
Swedish Investors for Sustainable Development	Ingrid Albinsson	Sweden
Solvay	Fellipe Alves	Belgium
UBS Group	Christian Leitz	Switzerland

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About

The magnitude of financing required to implement the 2030 Agenda for Sustainable Development is significant, yet to date, levels of investment have been insufficient. While public resources will be essential, the mobilization of the private sector is critical to the implementation of the Sustainable Development Goals.

To help address this shortfall, the Secretary-General is convening the Global Investors for Sustainable Development (GISD) Alliance as part of his Strategy for Financing the 2030 Agenda for Sustainable Development. The group is aimed at leveraging the insights of private sector leaders to remove impediments and implement solutions for mobilizing resources for sustainable development.

The Alliance has a two-year timeline, from October 2019 to October 2021. It will focus on facilitating solutions relating to:

+ Increasing the available supply of long-term investment for sustainable development.
+ Realizing SDG investment opportunities in developing countries.
+ Enhancing the impact of private investment on sustainable development.

Contact Us

https://www.un.org/development/desa/financing/what-we-do/other/global-investors-for-sustainable-development-alliance/GISD-home