

# Shifting Gears II

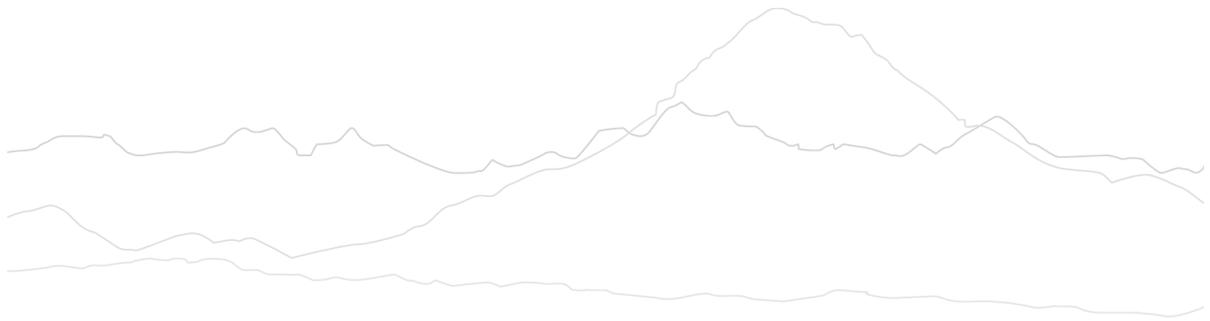
*Financial centres set the stage for sustainable finance's exponential growth in the next decade*

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## About the International Network of Financial Centres for Sustainability (FC4S Network)

The International Network of Financial Centres for Sustainability (FC4S Network) is a partnership between the world's financial centres, comprised of 33 member centres as of January 2021. An output of the UNEP Inquiry, the FC4S Network is supported in its work by both the UNDP Finance Sector Hub and the UNEP Finance Initiative. The objective of the Network is to enable financial centres to exchange experience, drive convergence, and take action on shared priorities to accelerate the expansion of green and sustainable finance. The FC4S Secretariat works with financial centre members to achieve this objective, through the provision of research on emerging issues, guidance on best practices, strategic advisory, and project development and support services, including through regional initiatives.

As of January 2021, the FC4S Network members include Abidjan, Abu Dhabi, Astana, Barcelona, Beijing, Cairo, Casablanca, Dublin, Frankfurt, Geneva, Guernsey, Hong Kong, Kuala Lumpur, Lagos, Liechtenstein, London, Lisbon, Luxembourg, Milan, Madrid, Mexico, Montréal, Nairobi, New York City, Paris, Rio de Janeiro, Seoul, Shanghai, Shenzhen, Stockholm, Tokyo, Toronto, and Zurich.

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# Foreword

In early 2020, the global financial system as we know it was upended. Like other elements of the economy and society, the sector had to deal with issues that were quite literally life-or-death challenges. And unfortunately, these challenges persist today. However, as we address the ongoing health issues as well as the impact on the poor and vulnerable of the closing of economies, we should also consider how best we can rebuild when the crisis fades, and adapt to a “new” normal economic activity. And with many of the world’s economies rebooting, we must ensure this period is utilised to rethink the structure of the economy, and to plan for how the economy can be further aligned with a resilient, low-carbon future.

In this context, greater mainstreaming of the sustainable finance agenda will be key. Sustainable finance was, until recently, regarded as a boutique topic. Financial establishments offered specially designed investment funds for clients with a conscience, but these were never offered to mainstream clients. Most financial managers felt that green finance was a temporary fad that would soon fade, in effect a modest ripple.

However, investments integrating environmental and social factors have notably outperformed the rest of the market during the pandemic. And the recent wave of innovation brought on by the sustainable finance agenda has touched not only the established financial players like banks and investors – it can be found right across the spectrum from measurement, standards and norm-setting on the one extreme, to digital financial technology (fintech) on the other, and embraced insurances, pension funds, stock exchanges, debt markets, rating agencies, central banks and other regulators. No part of the financial or capital markets has remained untouched.

Two factors appear central in explaining this movement: first, there is a rapidly growing concern at the dangers posed by rapid environmental change and the social

consequences of present trends. For instance, the reports of the Intergovernmental Panel for Climate Change (IPCC) have been laying out – in ever starker terms – the consequences of present trends. The cause of these trends, including the role of finance in generating the negative impacts, have become central to public debate, and can no longer be ignored.

In parallel, evidence increasingly shows that investment that respects sustainable development not only requires no sacrifice in terms of earnings; indeed, in many ways it outperforms traditional investment. Increasingly, also, financial services customers are demanding that investment respect basic sustainability criteria. What began as a modest ripple is now a powerful wave. And while, this reorientation of the financial system towards sustainability is only in its beginning, the trend is clear.

A reflection of this trend, this report demonstrates the significant progress made in the last three years by key international financial centres on embracing the sustainable finance agenda, all UN-convened Financial Centres for Sustainability (FC4S) members. Collectively representing over US\$1 trillion in listed green and sustainable debt instruments, it provides an unmatched global reference of where the worlds’ leading financial centres stand in terms of sustainability, and the role they can play in supporting the global economic recovery. Intended to stimulate dialogue on the role of financial centre sustainable finance activities, we welcome opportunities to engage with international organisations and coalitions to discuss its findings.



A blue ink signature of Jennifer Reynolds.

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# Executive Summary

In 2020 the world lost nearly two million people to the COVID-19 pandemic. The health of more than 90 million people globally was affected, lifestyles dramatically changed, and humanity was forced to rethink its natural (and so long ignored) fragility and its relationship with the environment. And with the economies of most, if not all countries in the world, brought to a standstill, millions of jobs, people's incomes, and savings were negatively affected, with governments scrambling to halt economic freefall. During this period, significant global progress that had been made in previous years in support of the UN Sustainable Development Goals (SDGs), took a massive hit.

Despite this, in 2020 the sustainable finance agenda surged. Increasing in importance throughout the last decade, and against many predictions, the global economic crisis brought on by the pandemic has only stressed the relevance of prioritizing sustainability within financial markets, to avoid or at least soften the impacts of future global threats. In fact, even though global markets were impacted by the crisis, sustainable finance has experienced an acceleration in several asset classes.

The magnitude and speed of this collapse was unprecedented. If we are to avoid undoing years of progress, the collaboration of multiple financial actors' is required. This will include banks, investors, corporates, insurers and others, through engagement as well as quick action, to increase their sustainability ambitions and drive the shift to a more resilient society.

In this context, the world's financial centres are positioned as essential cogs in the global sustainable finance mechanism. This report presents the findings from an in-depth assessment of actions in 24 of these hubs, all members of the UN-convened International Network of Financial Centres for Sustainability (FC4S) across Africa, the Americas, Asia and Europe. Together, they represent more than 2,000 environmental, social and governance (ESG) or green labelled investment funds, and

their listed green and sustainable debt instruments exceeded the US\$1 trillion threshold in 2020 hitting a record high of US\$1.195 billion.

A first of its kind globally, the FC4S assessment framework allows for an effective evaluation of each financial centre's alignment with the Paris Agreement and the UN SDGs, for the identification of areas which require further work, and for the development of strategic advice for each one of them to apply, considering current best practices.

For the first time in 2021, FC4S is providing personalized reports to the respondents, including strategic recommendations based on their results and benchmark performances. Now in its third year and having achieved a record response rate of 80% of FC4S members in 2020, this assessment provides an unmatched global reference of where the worlds' leading financial centres stand in terms of sustainability. It provides unique insights of their individual progress made in recent years on sustainable finance, including on institutional foundations, enabling environments as well as key market infrastructure features. As such, its analysis and outcomes allow for a collective better understanding of the role that these financial centres play in supporting the global economic recovery.

This year's assessment reveals eight key insights on how financial centres across all continents are mobilizing their capital, resources, connectivity, and expertise to align with the objectives of a sustainable financial system: in short, delivering capital to support the low-carbon transition and the achievement of the UN SDGs.

- **Thirst for data:** Data quality and availability is a persistent challenge faced by two thirds of financial centres. Issues regarding accessibility, reliability, incompleteness, non-comparability, as well as lack of necessary skills or analytical capabilities are currently hindering progress in mainstreaming sustainable finance globally.

Yet, leading financial centres and international institutions are coordinating, innovating and pulling their resources together with private actors to remedy the situation. Engaging with local stakeholders to appeal to them with a common framework or language at the financial centre level appears to be a redeeming first step.

- **Going beyond climate:** As in previous years of the assessment, climate change continues to be a major focus, and for many international, regional and national, as well as private and public institutions, it remains a point of entry into sustainable activities. Even other environmental issues are much less considered in the current sustainable finance market. Nonetheless, the UN SDGs are being gradually adopted as a global framework by mature public and private institutions and impact funds targeting social and biodiversity themes are emerging in many financial centres.
- **The regulatory environment remains a critical driver:** Four out of five financial centres consider that new policy initiatives can act as a “positive enabler” or even be a “major driver” of sustainable finance. Though, the exercise remains delicate between the two extremes of a lack of enforcement which encourages non-compliance, and an overregulation that deters innovation and risk taking. On average, respondents identified three instruments or incentives to encourage capital allocation to green and sustainable finance. Most financial centres still have room for ambitious policies and regulations to be developed, able to ease market conditions and truly drive investors to direct greater amounts of capital towards the low-carbon transition and the achievement of the SDGs.
- **Commitments from authorities are key for take-off:** Public authorities can play an important role in encouraging the implementation of the SDGs, addressing shared challenges and promoting the use and harmonization of existing market tools and methods. They can guarantee a level-playing

field between all financial institutions, ensure sufficient monitoring, and adopt long-term strategies at the country or financial centre level and thereby further raise ambitions, while ensuring that they are translated into meaningful and concrete actions. The combination of taking binding commitments and setting long-term strategies at the country or financial centre level is necessary to transform the financial system and accelerate alignment with the SDGs.

- **Despite the general move forward, sectors maturity levels are not yet aligned:** Debt capital markets persist as the most mature sector, notably due to green bonds being well-established and mainstream globally. In 2020, 38% of respondents identified dedicated exchange segments for green or sustainable debt instruments. Equities are following closely, with more than half respondents having specific green or sustainable equity indices. This is also a result of the broad development of ESG data, though diverging methodologies and frameworks between providers hamper comparability. Green and sustainable banking falls further behind and sustainable insurance solutions still have the furthest to go, with only 25% and 8% of respondents providing complete quantitative data in those sections, respectively.
- **Still a need for Increasing international collaboration:** A key lesson learnt from the pandemic is that for it be overcome, international collaboration and coordination are required. In other words, sustainability is not a zero-sum game, and that for the financial industry shift to advance, every country’s commitment and sustained progress are needed. The FC4S Network’s continuous expansion is a perfect example of this trend. Other international partnerships have also seen their membership increased, even more so in the 2020 turmoil. The FC4S assessment analysis results reflect this global trend, with nearly half centres identifying “building connectivity” in their top three priorities.



- **The professional development and education offer grows in capacity:** Recognizing that a skill shortage would prevent public and private institutions alike to go beyond commitments and scale up impactful activities, FC4S developed a first-of-its-kind analysis in Europe to examine the sustainable finance skills and talent gap in 2020. The results were striking; although financial centres are reporting a growing number of sustainable finance programmes and trainings available to both students and workers, the capacity gap is still considerable and constitutes a remarkable challenge for the European (and potentially, many other global) markets. FC4S work in 2021 will address capacity-building activities while embracing high potential areas, at the intersection between fintech and sustainable finance.
- **The global sustainable agenda endures:** Despite COVID-19, 2020 saw a similar, if not even greater, trend for the development of sustainable finance as did previous assessments, both in terms of new commitments taken and sustainable financial product development dynamism. Economic recovery plans designed to offset the collateral damages of the COVID-19 pandemic are a once-in-a-lifetime opportunity for financial centres to further accelerate the sustainable finance agenda across all centre activities.

At this point, it is obvious that the financial industry is *not* turning a blind eye to the material sustainability risks which are being accentuated by the pandemic. This report's stocktake, as well as its calls to action and increased ambitions require attention across the whole financial and non-financial sector, since the sustainability transition has been shown to concern and require all market actors to take urgent action. Committed international financial centres have a key role as drivers of the upcoming accelerated shift, which has the potential to turn a dramatic year, as 2020 truly was into a pivotal one for unprecedented exponential growth in sustainable finance globally into 2021 and beyond.

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# 1. Introduction

The COVID-19 pandemic has highlighted the fragility of the global economy, as well as the interconnected nature of our markets and systems. In this sense, it has stressed the relevance of aligning the global financial system with the UN Sustainable Development Goals (SDGs) throughout the economic recovery process, in order that we re-build more resilient economies. And in highlighting key vulnerabilities of our societies and economic systems, the economic crisis has also shown that short-term economic growth is inefficient when considered against the huge societal direct and indirect impacts of extreme global events. The precariousness of complex global value chains has been exposed, with many countries struggling to access strategic supplies, and the weight of global informal economies being uncovered. The International Labour Organization (ILO) estimates that global labour income in the first three quarters of 2020 declined more than 10% inter annually (i.e. circa US\$ 3.5 trillion), with workers in developing and emerging economies being especially hard hit by both increasing inactivity and larger than previously estimated global working hours' losses.<sup>1</sup>

On the flip side, the pandemic has also strengthened the case for proper risk identification by demonstrating the impact ESG risks can have on the financial system. The Financial Stability Board (FSB) recently analysed the scale of climate change risks to financial stability, as well as the potential for the financial system to amplify them. It also highlighted the relevance of establishing voluntary frameworks for disclosure of climate-related risks and their contribution to global financial stability. In such a perspective, shifting the global financial system towards sustainability is urgent, but still very challenging for an impacted society. This urgency was recently highlighted by World Meteorological Organization (WMO) Secretary-General Petteri Taalas, who stated that the average temperature could temporarily exceed 1.5°C above pre-industrial (1850-1900) levels by 2024; the 1.5°C

threshold being the milestone almost all countries on earth pledged not to reach as part of the 2015 Paris Agreement on climate change. Thus, in a world focused on transition, raising climate and sustainability targets while integrating ESG factors through the use of reporting and accounting standards and frameworks, would align markets' incentives and mainstream sustainable projects to help achieve the much-desired capital reallocation.

And unlike the 2008 financial crisis, the economic crisis induced by the COVID-19 pandemic did not halt the development of the green and sustainable finance agenda. The powerful dynamic initiated these past years continued to accelerate. Green bonds issuance was sustained across 2020 (reaching the US\$1.002 trillion record in cumulative issuance since market inception in 2007, with 2020 market issuance at US\$222.8 billion<sup>2</sup>) and innovative investment products targeting sustainable issues have been proliferating globally, despite the generalized adverse context. ESG investment funds registered record inflows throughout 2020. Equities were not the exception: in 2020 the market saw an outperformance of ESG stocks, based not only in different sectors exposures, but also on better performing stocks selection within each sector.<sup>3</sup>

Furthermore, the consequences of the global economic downturn have prompted governments to design a variety of recovery packages. With the rise of the sustainability agenda, integrating tangible sustainable criteria to those packages could prove to be decisive to accelerate the low-carbon transition and the achievement of the SDGs. Recovery policies need to trigger not only investments, but also behavioural changes that will reduce the likelihood of future shocks. In other words, not only putting economies and livelihoods back to where they were before COVID-19, but simultaneously transition to more inclusive, more resilient and decarbonised societies with decreased impacts on nature.

<sup>1</sup> International Labour Organization (ILO), 2020. [https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS\\_755875/lang-en/index.htm](https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_755875/lang-en/index.htm)  
<sup>2</sup> Climate Bonds Initiative (As of December 13<sup>th</sup>, 2020) <https://www.climatebonds.net/>  
<sup>3</sup> Financial Times (2020) Better stock selection boosted ESG funds, research suggests. <https://www.ft.com/content/5351788a-7dbf-4d2e-95d1-764568dde41e>

On an optimistic perspective, 2020 advances towards sustainability prove that if progress could be made under such a stressful environment, it must be possible to continue it in more predictable times and achieve the desired transition towards a low-carbon, more equitable and resilient global economy. Moreover, it has shown that economic growth and responsibility are not irreconcilable paths, but co-dependent. There is not necessarily a trade-off between financial and non-financial return, as alignment can preserve the long-term value of assets by mitigating systemic risks.

In this extraordinary environment, the FC4S Assessment Programme offers a unique perspective, allowing for an understanding of the financial industry ecosystem structure including both the private and the public sectors. And while the purpose of this report is to further understand the central role financial centres are playing in the transition of the global financial system, in the midst of the pandemic assessment report

findings also highlight the fierce dynamism that sustainable finance will likely enjoy in the next decade.



# 2

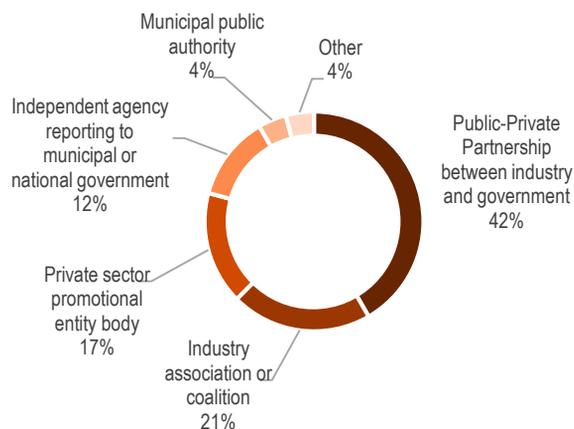


## The Role of Financial Centres



Sustainable Finance is increasingly gaining attention from global financial and political actors as well as the broad public. FC4S analysis<sup>4</sup> shows that sustainable finance initiatives quintupled in the last decade, including networks, alliances and coalitions (57%), knowledge-generating initiatives (15%), pledges (12%), principles (10%) and specific trust funds (6%). While only about a fifth were exclusively public sector partnerships (19%), half of them involved multiple private sector actors (52%), and the remaining initiatives exclusively covered the banking (16%), investment (11%) and insurance (2%) sectors. This shows the breadth of actors currently encompassed in the transition to low-carbon and more resilient economies and highlights the relevance of considering their particularities while developing relevant activities.

**Figure 1. FC4S Responding members' Institutional Models**



**Financial centres are natural nodes on which policy makers and international institutions can rely to pilot the transition, since they concentrate many different components of the financial system,** including financial activities and critical institutions. At the same time, the clustering effect of having both financial activities such as banking, capital markets, investing, insurance, and the rest of the entire ecosystem of professional services and institutions, makes financial centres and their

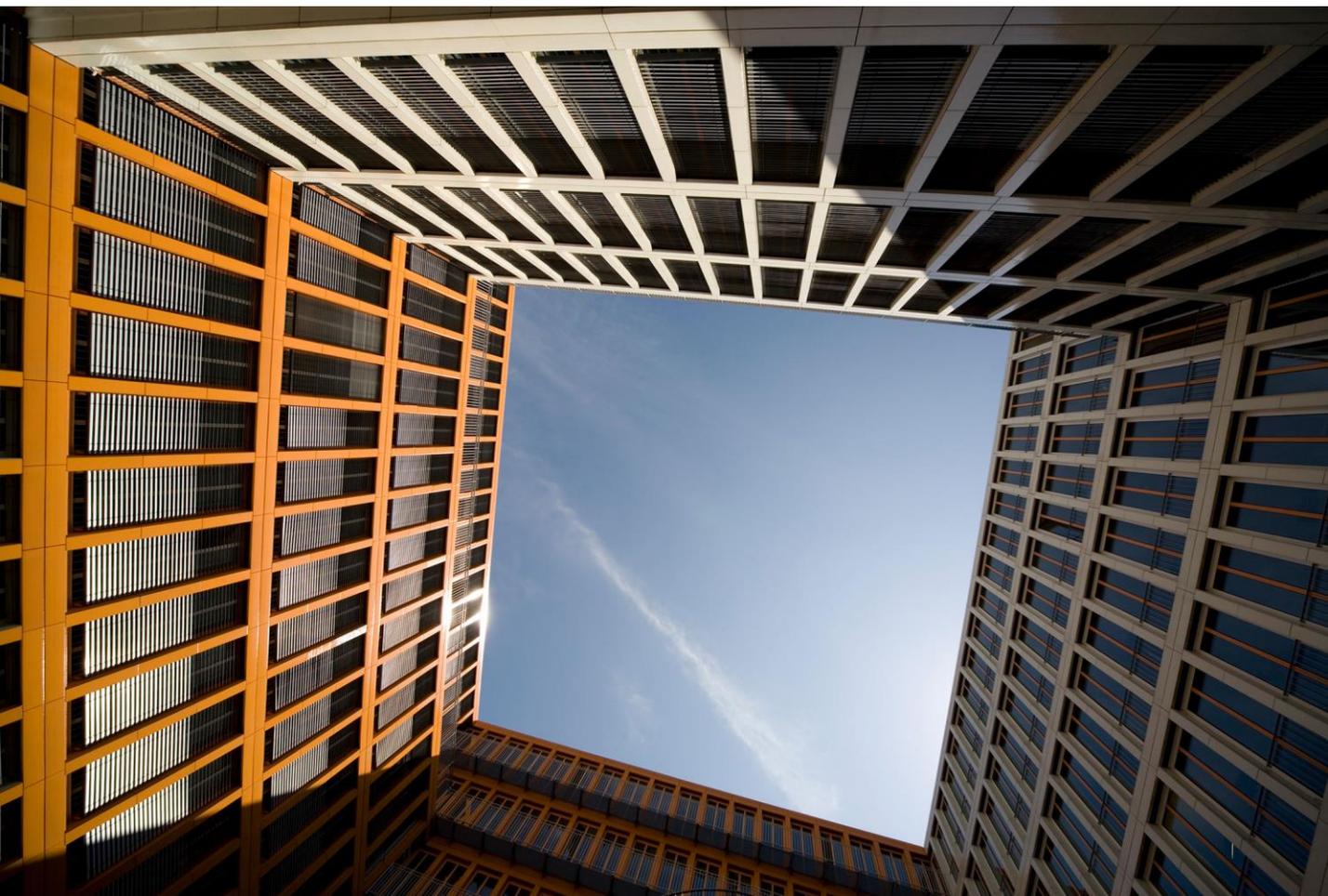
actions worth more than the sum of their parts. Such a strategic position and leverage establishes the major and most active financial centres in the world today as critical actors in the transition towards a sustainable financial system.

Due to their unique position in global financial markets, as well as their convening power, financial centres are well positioned to:

- 1** **Bring together** all the components of the local financial ecosystem under one banner and facilitate discussions to stimulate the build-up of an enabling policy environment.
- 2** Define **high level strategy** by identifying local barriers and setting shared priorities among all financial actors.
- 3** **Nurture and coordinate** all relevant actors in reaching the necessary maturity to scale-up sustainable finance across the industry.
- 4** Help **ensure the skills** related to sustainable finance topics are properly achieved by financial industry professionals, through capacity-building activities by relevant organizations.
- 5** **Leverage international connectivity** to identify and diffuse innovative solutions abroad as well as providing guidance to other financial centres to implement best practices.

<sup>4</sup> FC4S update to its 2020 "Nudging the Financial System" report

Currently, 33 global financial centres are members of the FC4S Network, representing 80% of global equity market and US\$76.4 trillion equity market capitalization. The analysed financial centres in 2020 differ in terms of institutional structure. Most financial centre institutions in FC4S centres are private entities or public-private partnerships (79%), between industry and government. (Figure 1). On the one hand, this can be seen as a potential strength, since both private actors and public authorities are involved, meaning the centres' sustainability activities imply a public and private sectors' agreement. On the other hand, it implies that their actions would still need to be extended to (smaller) private sector firms which are not part of the partnership. All in all, by connecting multiple stakeholders, organizing local forces and disseminating standards, the coordination power of financial centres is critical to unfold the agenda towards a sustainable global financial system.



## 2.1 Strengthening the Institutional Foundations

### 2.1.1 A Dedicated Initiative: Sustainable Finance's Centre of Gravity

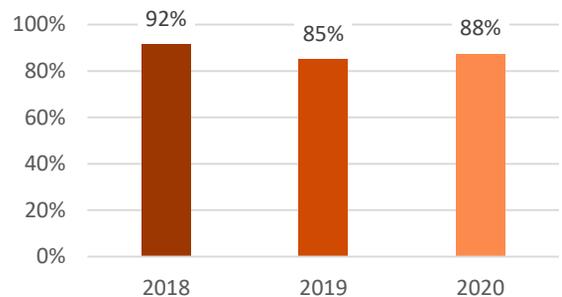
Sustainable finance represents more than the development of a new financial market segment, it requires significant investment and behavioral shifts. As such, the entire financial ecosystem needs to undertake some structural changes. To keep pace, a central institution able to organize actors and coordinate efforts is a must-have. Dedicated initiatives can play an important role in encouraging financial sector commitments (both at the industry and company levels), addressing shared challenges and promoting the use of standards and methods in order to achieve stated goals. In fact, collective commitments allow member institutions to exchange lessons learned and best practices, generating a positive loop that allows them to set more ambitious targets.

**Dedicated initiatives with a large number and variety of stakeholders involved are key to engage private institutions and to drive progress**

The establishment of a dedicated initiative related to green and sustainable within 12 months of joining the Network is a requirement of FC4S membership. Nevertheless, as shown in Figure 2, the share of FC4S members having established a dedicated initiative is stable despite a doubling number of respondents between 2018 and 2020. This signals an area for further advances for survey respondents.

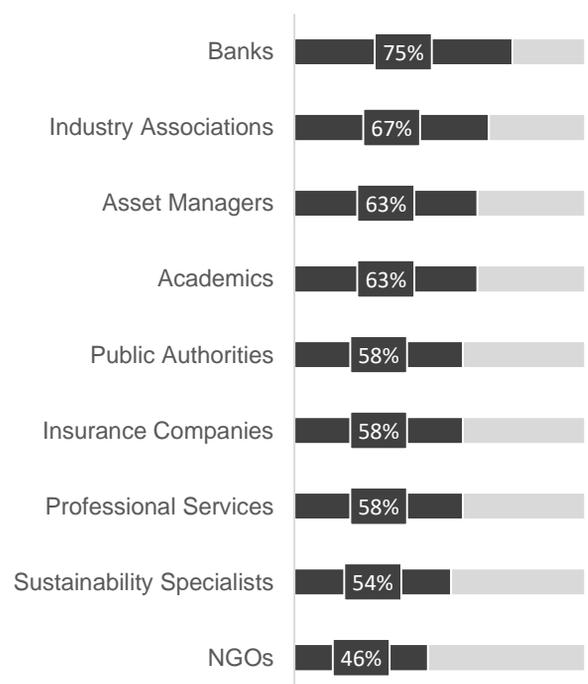
As in 2018 and 2019, dedicated initiatives are diverse in terms of stakeholders involved (Figure 3). Dedicated initiatives with a large number and variety of stakeholders involved represent a non-negligible cost for financial centres but as the embodiment of the clustering effect, they are key to engage private institutions and to drive progress in all sectors.

**Figure 2.** Respondents having established a Dedicated Initiative



Regarding the sustainable finance initiatives composition by stakeholder type, in 2020 banks, industry associations, and asset managers were their main components (present in 75%, 67% and 63% of analysed financial centres, respectively).

**Figure 3.** Stakeholders and/or members of dedicated sustainable finance initiatives



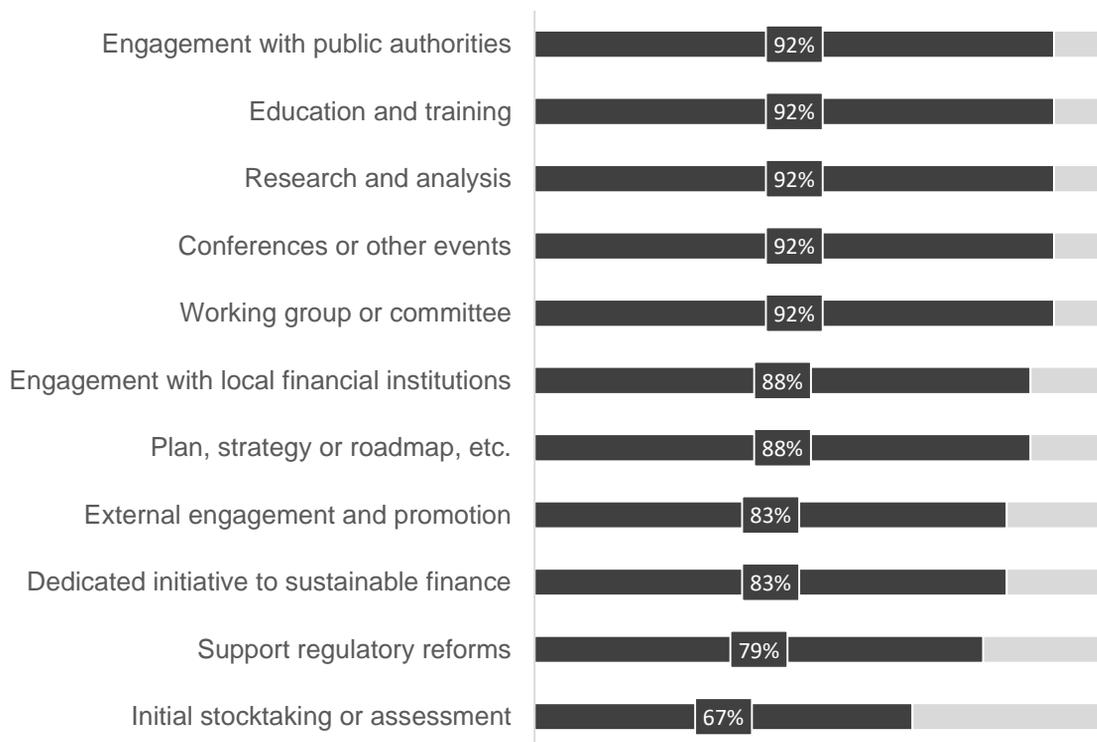
When analysing actors' evolution in the last three years, professional services have more than doubled their participation rates (and are now at almost 60% of financial centres dedicated initiatives), while industry associations and academics have doubled their participation and are now present in about two thirds of the analysed centres. On the contrary, public authorities and insurance companies have reduced their representation within dedicated sustainable finance initiatives in the last three years. Public authorities went from 77% in 2018 to 58% in 2020, while Insurance firms have reduced less, from 62% in 2018 to 58% in 2020 but sinking to 50% in 2019.

The larger scope of respondents does not explain the entire trend: initiatives that were already established in 2018 continued to expand and currently include nearly all types of stakeholders, which mechanically diminishes the relative number. Initiatives established recently also tend to have more diverse stakeholders involved early on. Although more research is needed, it appears

**that a well-established dedicated initiative which represents the large diversity of stakeholders might be critical to develop sustainable finance.**

The fact that banks are leading in sustainable finance dedicated initiatives can be related to the establishment in 2019 of the UNEP FI Principles for Responsible Banking (PRB), a framework for a sustainable banking system to help the industry demonstrate how it makes a positive contribution to society. They include a requirement to set targets to drive alignment with appropriate SDGs, the goals of the Paris Agreement, and other relevant international, national or regional frameworks and to embed sustainability at the strategic, portfolio and transactional levels, across all business areas. Currently, 200 banks have signed up to these principles. This also builds on the Sustainable Banking Network (SBN), a platform launched in September 2012 to facilitate global knowledge-sharing and capacity-building on sustainable banking .

**Figure 4.** Activities planned or undertaken by end H1-2020



Regarding **financial centres’ activities**, more than half respondents planned or implemented all activities relating to green and sustainable finance<sup>5</sup> in 2019-2020, showing the global dynamism of sustainable finance despite COVID-19 in 2020.

Even though this is encouraging, more information regarding their outcomes is necessary to prove their effectiveness. Although collective actions and commitments are a necessary first step towards achieving more sustainable financial systems, their implementation is usually full of challenges. The heterogeneous nature of the financial centres membership can contribute to this difficulty. In fact, FC4S analysis shows that for existing initiatives implementation still remains challenging: while 43% of them exclusively help “plan, anticipate and assess conditions and trends, formulate strategies and establish goals”, only 19% exclusively target “decision support, and implementation collaboration”. Moreover, only 29% of the analysed initiatives require “target setting”. This reveals a need for financial centres to focus on implementation capacity in the current sustainable finance landscape, including technical assistance and improving existing tools management.<sup>4</sup>

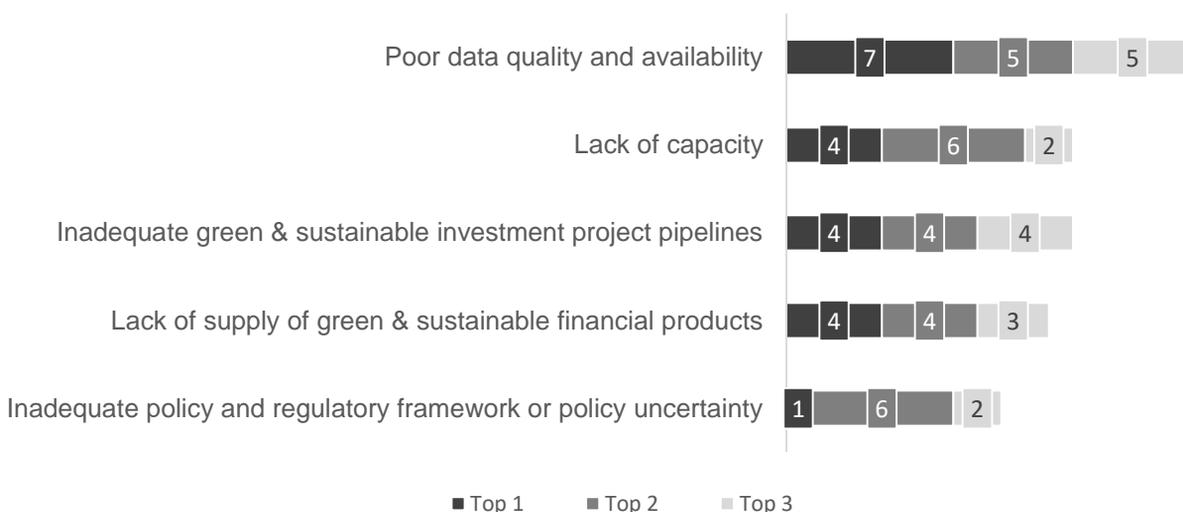
### 2.1.2 Identifying Challenges and setting Priorities

The ability to identify the main challenges that a financial centre faces to scale up sustainable finance is key to engage with the right actors and implement the necessary policies. Depending on local strengths and weaknesses, financial ecosystems may face different barriers yet global trends remain identifiable.

**Responding financial centres reported data quality and availability as their main challenge**

**When analysing challenges as a group (i.e. considering the top one, two and three identified challenges), in 2020, responding financial centres reported data quality and availability as their main challenge** (Figure 5). Interestingly, this barrier was reported by only a minority of centres back in 2018. Increasing requirements from policies and regulations can be an explanation, and more generally as public and private financial institutions are gaining maturity on sustainable finance, they are in growing need of high-quality data due to market pressure, policy assessment and ambition to develop new products and services.

**Figure 5.** Number of respondents underlying the barrier as a top three challenge for scaling up sustainable finance



<sup>5</sup> including Engagement with public authorities; Education and training; Research and analysis; Conferences or other event; Establishment of working group or committee; Engagement with local financial institutions; Issuance of plan, strategy, roadmap, or other documents; External engagement and promotion (e.g. roadshows); Action to support implementation of policies or regulatory reforms (e.g. TCFD, taxonomy); and Initial stock-taking or assessment.

Likewise, this issue has been reported by several regional and international organizations as a key obstacle to successfully deploying sustainable capital. In response to both regulatory and market demand for transparency, quality data is now one of the most pressing sustainable finance market needs. Key data challenges that still have to be overcome include:

- Accessibility (missing data, non-publicly available data, spread data and data collection costs)
- Reliability (ESG data is often not audited or lacks assurance)
- Incompleteness (there is still poor coverage across holdings, sectors and regions, as well as immaterial and dichotomic data, rather than robust quantitative performance indicators)
- Non-comparability (granular portfolio information is largely not comparable between institutions and economic sectors. ESG scores, ratings and rankings from data firms also lack comparability, since they carry different assumptions about what is material)
- Lack of in-house capacity to process and analyse data (Insufficient sustainability-related analytical capabilities)

The Institute of International Finance<sup>6</sup> recently highlighted the increased stakeholder demand for more consistent, granular, and comprehensive disclosure of information relevant to ESG factors across various industries, including the financial industry. Other international bodies highlighting data challenges go from the G20<sup>7</sup> and the Network for Greening the Financial System (NGFS)<sup>8</sup> to the FSB<sup>9</sup>, which recently detailed the methodological complexities of climate risk measuring, including multiple estimation uncertainties. For instance, the estimation of future paths of global emissions, the impacts of physical risks, the reductions in the value of financial assets (for physical risks), as well as exposures to carbon-intensive production, the assumed path of transition to a low-carbon economy and the scope of losses they consider (for transition risks) among others.

**Also, inadequate investment pipelines and the lack of green and sustainable products are persistent barriers for scaling-up sustainable finance, which were already**

indicated by respondents in 2018 and 2019. The fact both these barriers were cited as the main priority by several financial centres shows that **the COVID-19 pandemic has had a minimal impact on investors' appetite for green and sustainable products.**

The development of taxonomies could at least partly remedy this issue by clarifying local requirements for a project to be classified as "green" or "sustainable", benefitting investors, who understand which financial products and activities align to the criteria it defines, and to what degree; corporates, which align their businesses with sustainability goals, and also supervisors, who get informed about sustainable finance activities that have been developed. The new EU sustainable finance taxonomy, released in July 2020, is a tool intended to assist investors, companies, issuers and project promoters navigate the transition to a low-carbon, resilient and resource-efficient economy. It sets performance thresholds which will help parties to access green financing as well as identifying activities which are already environmentally friendly. This will assist in determining the environmental impact on a consistent basis in the EU and beyond for the future. Though the taxonomy is designed specifically for EU countries, its actual impact will stretch beyond the boundaries of European markets to any financial companies selling products and services into the EU, and companies receiving capital investment and financing from European investors.

While taxonomies developments are certainly meritorious and signal a stronger market movement, the emergence of multiple taxonomies and standards risks incompatibility, non-comparability and can generate investor confusion. Consequently, coordination efforts are now being developed by international bodies and organizations, such as the International Platform for Sustainable Finance (IPSF). Emphasis should therefore not be on promoting uniform definitions, thresholds or screening criteria, but on establishing due process considerations and acceptable methodologies to define sustainable activities in each jurisdiction.

<sup>6</sup> IIF (2020) <https://www.iif.com/Research/Global-Focus/Weekly-Insight/?apq-861/2>

<sup>7</sup> UNEP Improving the availability and usefulness of Publicly Available Environmental Data for financial analysis.

<http://unepinquiry.org/wp-content/uploads/2017/07/Improving-the-Availability-and-Usefulness-of-Publicly-Available-Environmental-Data-for-Financial-Analysis.pdf>

G20 Sustainable Finance Study Group Synthesis Report

[http://www.g20.utoronto.ca/2018/g20\\_sustainable\\_finance\\_synthesis\\_report.pdf](http://www.g20.utoronto.ca/2018/g20_sustainable_finance_synthesis_report.pdf)

<sup>8</sup> NGFS (June 2020) Guide to climate scenario analysis for central banks and supervisors.

[https://www.ngfs.net/sites/default/files/medias/documents/ngfs\\_guide\\_scenario\\_analysis\\_final.pdf](https://www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_scenario_analysis_final.pdf)

<sup>9</sup> FSB (November 2020) The implications of climate change for financial stability.

<https://www.fsb.org/2020/11/the-implications-of-climate-change-for-financial-stability/#:~:text=A%20disorderly%20transition%20to%20a,financial%20system%20responds%20to%20shocks>



## European Union Taxonomy

On 18 June 2020, the EU Parliament adopted the Taxonomy Regulations which then came into force in July. The Taxonomy Regulation provides a general framework for the development of an EU-wide classification system for environmentally sustainable economic activities. It does not itself define sustainable financial products but sets out the criteria to be considered for a product or activity to be considered environmentally sustainable. The detail of what constitutes an environmentally sustainable activity or product will be built up gradually over time through complex delegated legislation, helping investors and companies determine whether certain activities qualify as “sustainable” (i.e. whether certain projects / activities pursue the EU’s environmental goals and contribute to the transition towards a low-carbon economy).

The Taxonomy Regulation sets out six different types of environmental objectives with economic activities that qualify as sustainable activities: (i) climate change mitigation; (ii) climate change adaptation; (iii) sustainable use and protection of water and marine resources; (iv) transition to a circular economy; (v) pollution prevention and control; and (vi) protection and restoration. The taxonomy for climate change mitigation and climate change adaptation should have been established by the end of 2020 (delay of a few weeks is expected) in order to ensure its full application by the end of 2021. For the four other

objectives, the taxonomy should be established by the end of 2021 for application by the end of 2022. Furthermore, any other economic activities which directly enable any of the above six objectives shall also qualify as environmentally sustainable activities, provided that any such activity (i) does not lead to a “lock-in” of carbon-intensive or other types of assets that undermine long-term environmental goals; and (ii) has a substantial positive environmental impact on the basis of life cycle considerations.

In addition to contributing to one of the six objectives described above, for an activity to qualify as an environmentally sustainable activity under the Taxonomy Regulation, the activity must also comply with the following criteria:

- **No Significant Harm** – i.e. the activity must not significantly harm any of the environmental objectives above;
- **Compliance with Technical Screening Criteria** – i.e. the activity must comply with technical screening criteria for each of the six objectives that will be specified by the European Commission (EC) and
- **Minimum Social and Governance Safeguards** – i.e. the activity must be carried out in compliance with a number of minimum social and governance safeguards as referred to in the Taxonomy Regulation.



Complementary actions outside the financial sector might be necessary to incentivise real economy actors in order to multiply transition projects. For instance, the NGFS recommends that international organizations, central banks and supervisors should consider supporting (by organizing or mobilizing research grants) demonstration Environmental Risk Assessment (ERA) projects in key sectors such as banking, insurance and asset management, and for key regions exposed to substantial environment-related risks. They could also support case studies to understand with more granularity the potential impact of physical and transition risks in highly vulnerable regions<sup>10</sup>. A relevant example of active public sector engagement is China's 2017 establishment of regional green finance pilot programs in five provinces (Zhejiang, Guangdong, Jiangxi, Xinjiang and Guizhou) to enhance the role of green finance in domestic institutions, promote green credit, insurance and bonds, explore the establishment of the markets for environmental rights, strengthen government policies support, and develop green finance risk control mechanisms. The most fruitful case to date is Huzhou in Zhejiang province, which has played a pioneering role in green finance development including constructing a statistical system for green finance, an IT-based green financing platform, and an evaluation standard and rating system for green finance applicable for green companies, projects, banks and services. As of June 2018, Huzhou's green credit volume reached 22% of total financial credit issued by institutions in the city—that is about 9% higher than the national average due to the green credit policy incentives promoted in the city as a green finance pilot. As a result, the Bank of Huzhou has applied to be the third Equator Principles Financial Institution in China<sup>11</sup>.

**“Promotion and awareness” has been less and less considered as a challenge or a priority as a whole**, (i.e. when considering top three identified challenges and priorities together) since 2018. This probably indicates that global awareness on sustainability issues has dramatically increased in the last years, at least within the financial industry. Nevertheless, in 2020, when analysing only top one challenges, 17% of FC4S members still mentioned “promotion and awareness” as a leading obstacle, showing they might have further space

to mainstream sustainability issues within the finance industry. Also, another 17% of respondents in 2020 highlighted “supporting the development of new products/services” as an obstacle to overcome. FC4S 2019 analysis<sup>12</sup> already showed that “lack of green financial products” was a key concern for financial centres. Notwithstanding, there have been some market advancements on this regard, including pandemic bonds (specially in China, providing short-term emergency funding for liquidity to banks, and issuing small shares for personal protective equipment and other healthcare-related spending), green sukuk (across markets in the Middle East, Africa and South-East Asia) which garnered some of the best performance of all global fixed income asset classes over the past five years<sup>13</sup>, as well as sustainability-linked loans and bonds, whose interest rate varies based on the achievement of predetermined sustainability performance objectives. In 2019, the sustainability-linked loans market was US\$122 billion globally, while the sustainability-linked bonds market was much smaller, at less than US\$2 billion<sup>14</sup>.



<sup>10</sup> NGFS (September 2020) Overview of Environmental Risk Analysis by Financial Institutions

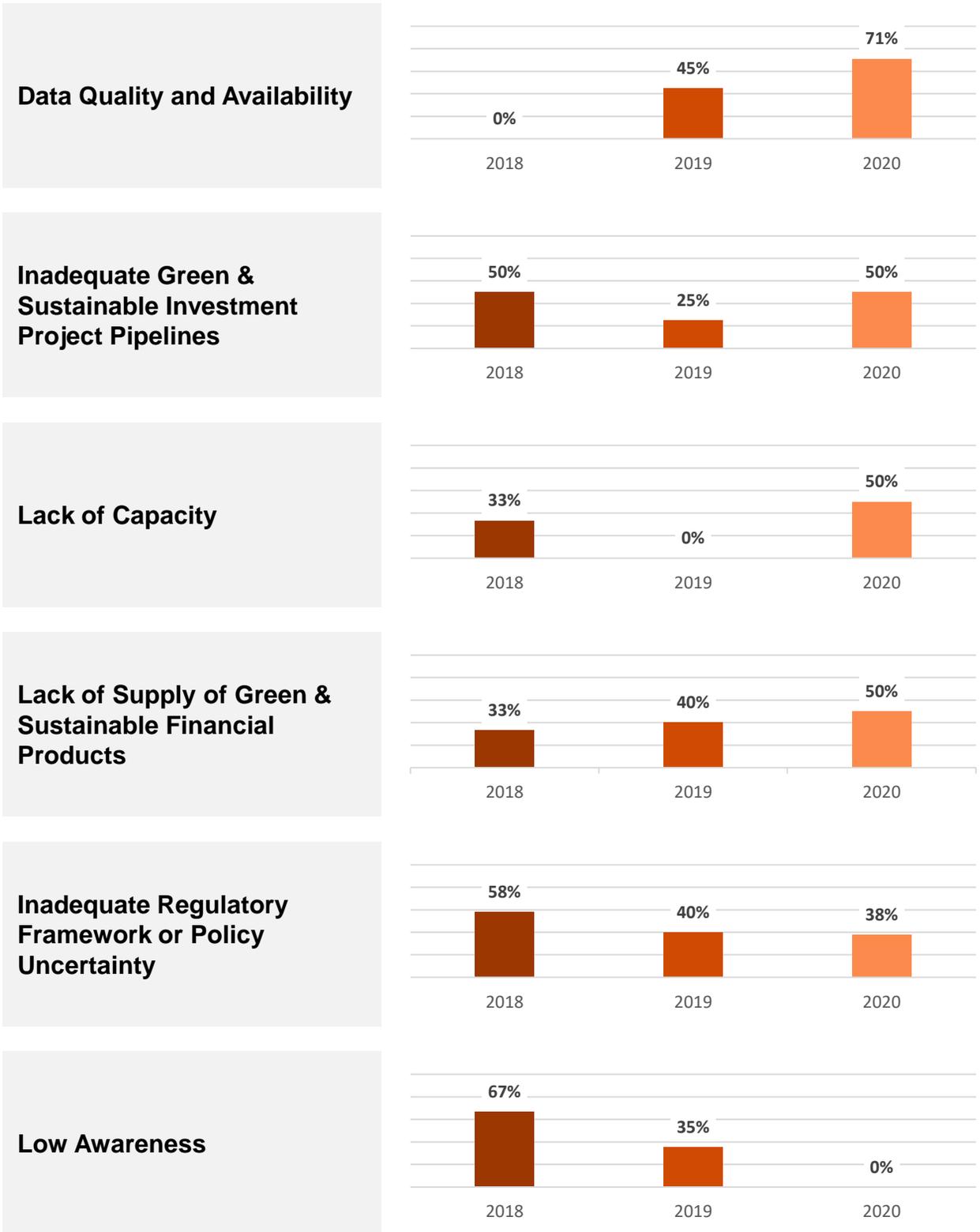
<sup>11</sup> Paulson Institute (2019) China's Green Finance Pilot Zones: Ready for Takeoff. <https://www.paulsoninstitute.org/green-finance/green-scene/chinas-green-finance-pilot-zones-ready-for-takeoff/>

<sup>12</sup> FC4S (2019) “Shifting gears: How the world’s leading financial centres are entering a new phase of strategic action on green and sustainable finance”

<sup>13</sup> S&P (2020) *The Development of the Global Sukuk Market from an Indexing Perspective*

<sup>14</sup> IPSF, International Platform on Sustainable Finance Annual Report (October, 2020)

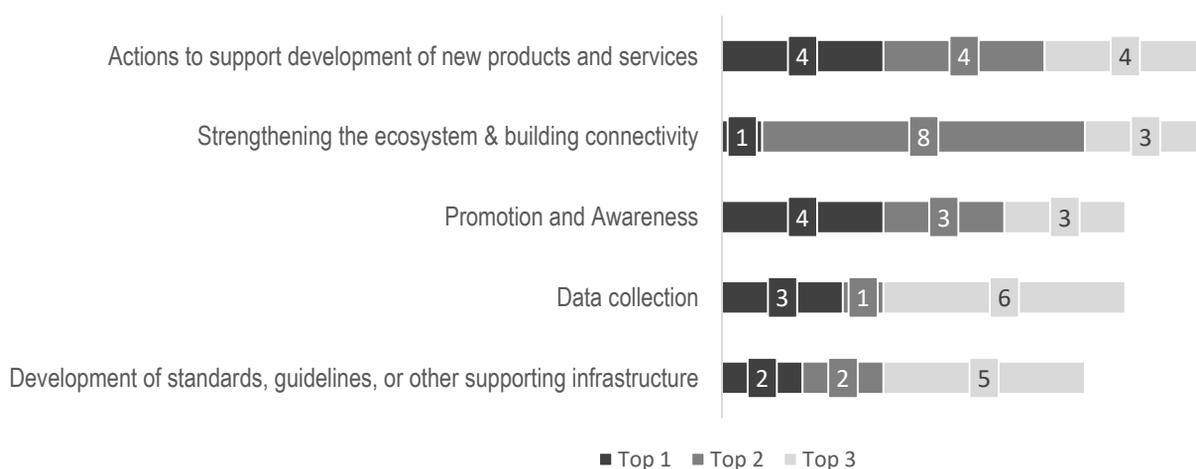
**Figure 6.** Evolution of key barriers between 2018 and 2020. In % of respondents indicating one of the following barrier as a top-three challenge for the future development of sustainable finance



**In this sense, respondents' top priorities reflect the main challenges they are facing.** The main priority is supporting the development of new products and services, followed by the need to strengthen the ecosystem and building connectivity. The second most recognized priority covers both the policy and regulatory aspects of each financial centres' location, signalling the relevance of FC4S assessment's second pillar (i.e. enabling environment) as well as the increasing need for international coordination and collaboration. Nearly half of the centres have

identified "building connectivity" in their top three priorities, the continuous expansion of the FC4S Network is the perfect example of this trend. The close collaboration between EU countries on issues such as its Taxonomy, the growing adoption of international commitments and pledges at the industry level, as well as the increasing number of global partnerships exclusively focused on enhancing sustainable finance are examples of global advances in collaborative innovation, best practices' sharing and international coordination.

**Figure 7. Top three priorities**



### 2.1.3 Driving Commitments from Large Market Players

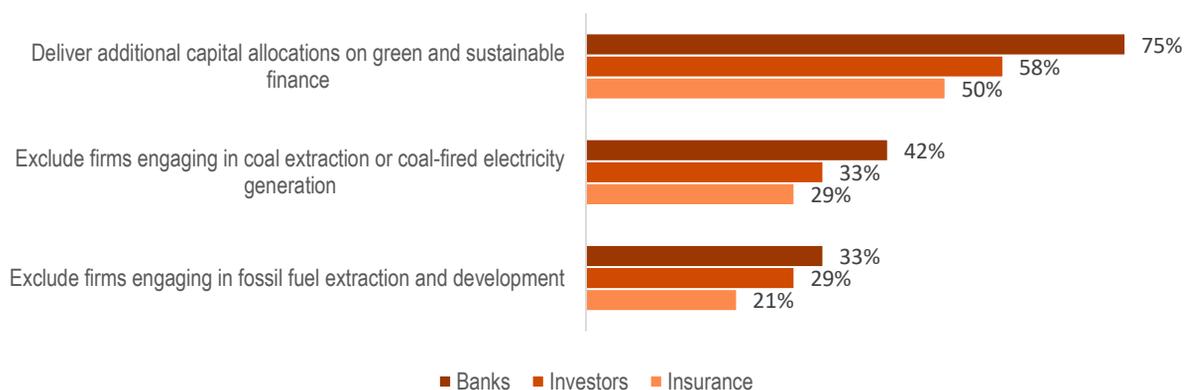
Key market players such as banks, insurers, asset owners and asset managers are leading the way, developing strong sustainable practices and are taking commitments towards the low-carbon transition and the achievement of the SDGs. Based on the results from the 2020 analysis, **banks are leading industry players in establishing commitments on the sustainable finance field.**

Collective commitments allow their participants to exchange knowledge on actions that have real-world impact, including measuring methodologies, and incentivize them to set more ambitious targets. Nevertheless, there is a trade-off between developing inclusive commitments or

sharper and more effective ones. Thus, the inclusion of standardized reporting requirements and clear compliance rules and systems is necessary to ensure accountability.

The FC4S Assessment Programme includes three different types of commitments, along diverse types of stakeholders. Results from the 2020 analysis suggest that although all types of commitments are on the rise, there is still space for further action both in developing new ones and in perfecting existing commitments' design. FC4S members targeting advancements on mainstreaming sustainability within their financial markets have a leading role in engaging in these processes.

**Figure 8.** Respondents where at least 1 market player (bank, investor or insurer) took the following commitments



Regarding formal commitments to deliver additional allocation on green and/or sustainable finance, half of the analysed financial centres declared that their top 10 industry actors (including banks, institutional investors –including both asset owners and asset managers- and insurers) are aiming to establish them. In fact, two thirds of financial centres (i.e. 18) highlighted that their top 10 banks have committed to do so, while institutional investors are catching up, with 14 financial centres declaring their top asset owners and asset managers are committing to it.

respondents indicated having at least one insurer committed to no longer underwrite insurance for them.

Commitments taken on fossil fuels are still limited to international actors but are progressively emerging, notably regarding the exclusion of unconventional fossil fuels such as oil sands or shale gas. Aggregate analysis shows that less than a third of respondents (i.e. 8) mentioned having at least one bank signing this type of commitments in 2020.

**Although all types of commitments are on the rise, there is still space for further action both in developing new ones and in perfecting existing commitments' design**

Commitments to ban financing to or exclude firms engaging in coal activities are multiplying and most importantly the tone of these commitments is evolving. From “limiting exposure to coal” recent commitments include full exit strategies and strict exclusion policies. More and more financial centres outside the European Union are reporting commitments to progressively exclude coal activities. Precisely, 2020 results show that 42% of surveyed financial centres indicated that at least one bank had made commitments to ban its financing. Moreover, a third of financial centres (33%) indicated having at least one investor committed to excluding them and 29% of

The FC4S sustainable finance initiatives analysis also covered the 30 identified Global Systemically Important Banks<sup>4</sup> by the FSB in 2020. The analysis found that they are currently involved in 47% of the 150 considered sustainable finance initiatives. Their participation, on average, raises to 14 initiatives for each bank, ranging from 2 to 46. Moreover, GSIBs' adherence to these initiatives has grown exponentially, and even at a higher (approximately double) rate than the number of initiatives themselves. Although this shows that sustainability is on the agenda of key global banks, the true economic impact of increasingly committed GSIBs still needs to be noted. According to the “Banking on Climate Change. Fossil Fuel Finance Report 2020”<sup>15</sup>, in the last 5 years GSIBs fossil fuel finance (when considered as a group) has increased, surpassing the US\$ 600 trillion. This highlights the relevance of establishing ambitious commitments with monitoring mechanisms and clear compliance criteria, in order to truly decarbonize economies.

<sup>15</sup> Rainforest Action Network, Banktrack, Indigenous Environmental Network, Oilchange, Reclaim Finance and Sierra Club (2020). Banking on Climate Change. Fossil Fuel Finance Report.



## 2.2 Building an Enabling Environment

### 2.2.1 Regulators and Supervisors' Role on ESG Risks Integration

**Policies and regulations have been major drivers in recent years and will likely continue to be.** Currently, the European Union and its Member States lead the world on the sustainable finance transition policy. The European Commission has issued an array of regulations that impact every type of financial organization that must satisfy both regulatory and investor demands to change the way they invest and report, and the products they offer. These regulations bring both complexity and clarity to financial markets — and possible competitive advantage. Several financial centres indicated that the implementation of the European Union Action Plan for Sustainable Finance has been a significant driver overall, allowing them to engage with private actors. Countries' experiences show that difficulties can arise from policy and regulatory uncertainty (for instance, higher financing costs or increased risk premiums which impede the creation of a sustainable pipeline of bankable projects).

**Policies and regulations have been major drivers in recent years and will likely continue to be.**

Respondents also indicated that impulses from regulatory bodies, the development of soft regulations or taxonomies, and the implementation of regional policies are all major drivers to scale-up sustainable finance in their centre.

International bodies are increasingly highlighting the relevance of mainstreaming ESG or sustainable finance in the financial systems. For example, the International Organization of Securities Commissions (IOSCO) recognized that issuers' disclosure of material ESG-related matters facilitates market participants' decision-

making processes, and is also crucial for the credibility of investments that claim to pursue sustainability objectives<sup>16</sup>. Also, the International Organisation of Pensions Supervisors (IOPS) has developed supervisory guidelines on the integration of ESG factors in the investment and risk management of pension funds, requiring pension supervisory authorities to clarify to asset managers that the integration of ESG factors into investment is in line with their fiduciary duties and should be reported, and to encourage them to develop scenario testing of their investment strategy<sup>17</sup>. Finally, the Coalition of Finance Ministers for Climate Action (which kick started its work in February 2019) brings together fiscal and economic policymakers from over 50 countries in leading the global climate response and in securing a just transition towards low-carbon resilient development. It constitutes a purely public authorities network, which provides Ministers of Finance with a space to align with international commitments (i.e. the Paris Agreement) through better measurement and finance mobilization, coordination with several countries and learning from global best practices, with the final goal of integrating sustainability within macroeconomic policy, fiscal planning, budgeting, public investment management, and procurement practices<sup>18</sup>.

**The 2020 Assessment results show that on average, financial centres identified eight types of policies and regulations relating to sustainable finance** currently in place, and a median of seven (with a maximum of sixteen policies in two financial centres). Collectively, the regulations in place in the 24 analysed financial centres reached over 200 policies. The regulatory environment of financial centres tends to swell progressively as public and private actors are gaining maturity. Growth in sustainability-related financial products or commitments taken by public authorities often triggers the development of regulatory frameworks to improve disclosure and develop a common level playing field.

<sup>16</sup> IOSCO (April 2020). Sustainable Finance and the Role of Securities Regulators and IOSCO - Final Report  
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf>

<sup>17</sup> IOPS Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds (October, 2019).  
<http://www.iopsweb.org/iops-supervisory-guidelines-esg-factors.htm>

<sup>18</sup> The Coalition of Finance Ministers for Climate Action- An Overview (2019)  
<https://www.financeministersforclimate.org/#:~:text=About%20the%20Coalition%20of%20Finance,the%20economic%20and%20financial%20policies>

## Europe's Green Deal

At the end of 2019, the EC announced a 'Green Deal' for Europe in response to EU and global climate and environment-related challenges. The Commission defined the Green Deal as 'a new growth strategy' aimed at cutting greenhouse gas (GHG) emissions (50% to 55% by 2030, and zero net emissions by 2050), improving the health and well-being of citizens and protecting the environment and wildlife. This means that, by 2050, EU carbon emissions shall be balanced by at least equal levels of carbon removal from the atmosphere. The Green Deal builds on the complex framework of energy and climate policies that the EU has developed over the last three decades by accelerating existing goals and measures on climate action and environmental protection, making new funds available, proposing new legislation and representing a bold ambition to prioritize climate goals in EU policy-making. Its broad scope includes a combination of funding measures, regulatory reform and policy proposals covering the energy, transportation, agriculture, construction and financial sectors, among others. The Green Deal includes numerous strategies and plans, such as the Sustainable Europe Investment Plan, a new EU industrial strategy, a circular economy action plan, the new EU Biodiversity Strategy to 2030 and a 'farm to fork' sustainable agriculture strategy. The introduction of a carbon border tax is envisaged in order to prevent carbon leakage,

namely the transfer of heavily polluting industrial production outside the EU, where it would not be subject to the same level of environmental restrictions.

The Green Deal also revives the idea of turning the European Investment Bank into 'Europe's climate bank' through the preferential financing of green projects. In order to meet the higher costs of the energy transition for regions that are more reliant on coal, the Green Deal includes a Just Transition Mechanism and Fund.

Importantly, the Green Deal led to the drafting of a climate law that codifies the carbon neutrality goal by 2050. The law, which has not yet been approved by Member States and the European Parliament, would empower the Commission to assess the progress made by Member States towards the goal and to review the trajectory towards carbon neutrality every five years starting in 2023. It states that the Commission shall do this by 'delegated acts', namely without going through full negotiations with Member States and the European Parliament. Furthermore, the draft law proposes to explore options for a new GHG reduction target of 50-55% for 2030. Achieving ambitious emission reductions over the next ten years is essential to prevent catastrophic climate change. Hence, intra-EU negotiations on the new 2030 target will be an important test for the EU's climate agenda.

**Regarding their coverage, 55% of all types of policies and regulations identified target most, if not all, asset classes and financial services.** At the same time, a similar share include specific requirements that financial actors need to apply. Though these requirements may depend on various thresholds; non-complying actors are exposed to coercive measures.

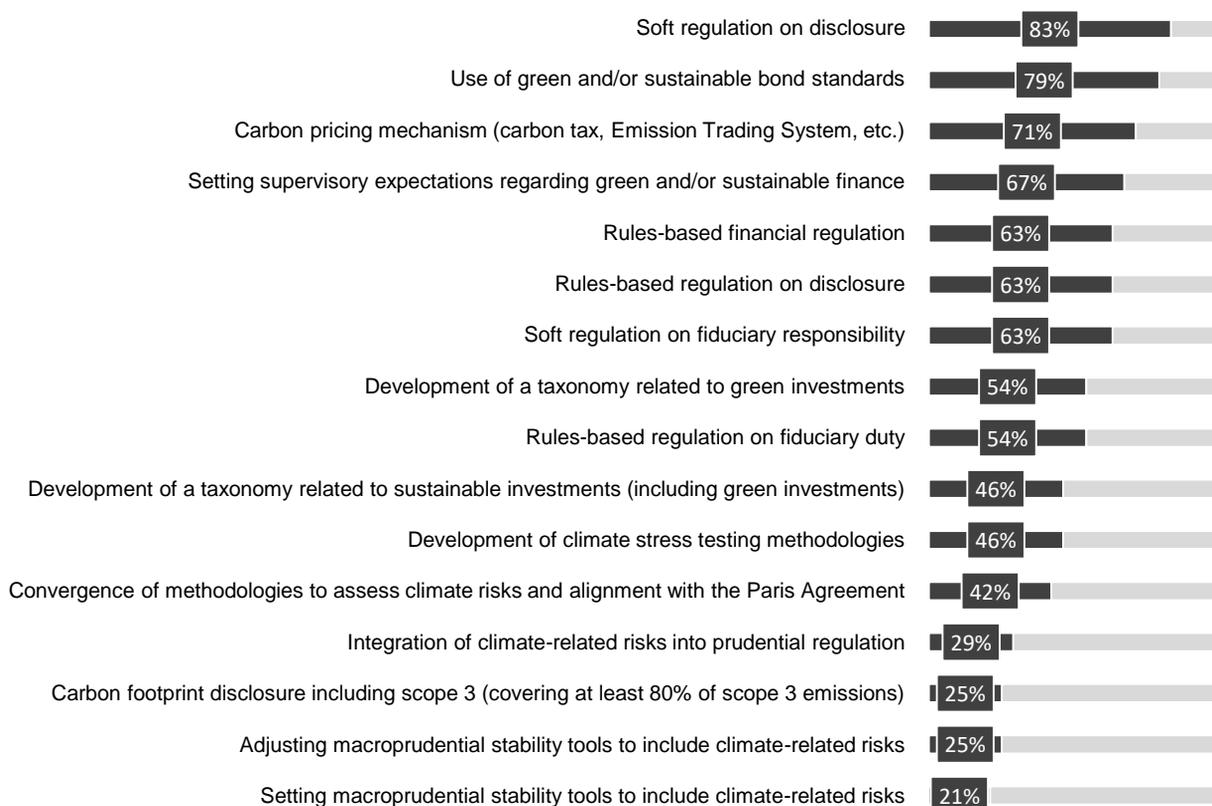
macroeconomic, monetary and financial sectors' developments), and the breadth of issues which were considered to potentially be regulated (i.e. investments, disclosures, tools' and methodologies' application, prudential regulation, among others), an in-depth analysis of policies and regulations effectiveness remains out of the scope of this Assessment Programme.

**Policies and regulations tend to progressively cover more financial sectors and have increasing requirements**

Acknowledging that each country has different regulatory approaches to these topics (depending, among others on its general

Following the current trend, **regulatory environments related to sustainable finance are likely to thicken in most financial centres in the coming years.** Policies and regulations again tend to progressively cover more financial sectors and have increasing specific requirements. As a result of the COVID-19 crisis, the gap to achieving both the SDGs and the Paris Agreement is increasing again, thus, more public sector involvement is expected.

**Figure 9.** Types of policies and regulations identified by financial centres



A recent paper by the OECD and UNDP<sup>19</sup> shows that pre-crisis US\$2.5 trillion were missing annually to achieve the SDGs by 2030. With the crisis, this gap widened by an estimated US\$1 trillion in COVID-19 emergency and response spending in developing countries compared to OECD countries. Moreover, there has been an estimated a US\$700 billion loss of external private financing to developing countries in the pandemic year. Consequently, the year 2020 has seen a generalized increase in social policies and regulations worldwide. Specifically, the IMF Policy Tracker covering 197 economies provides an update of the global different policy actions taken to overcome the pandemic dramatic context.<sup>20</sup> In total, we expect more comprehensive and compelling regulatory environments in the coming years, which if aligned with global sustainability and environmental goals, will have a positive global impact on sustainable finance market growth.

Financial centres shared several concerns on sustainable finance policies and regulation. On the one hand, overregulation appeared as a concern for some financial centres, although the landscape is very diverse between countries. On the other hand, lack of enforcement, lack of political will and commitments, and the lack of common standards or taxonomies were recognized as potential features entailing negative impacts on the local environment, restraining the development of sustainable finance.

<sup>19</sup> OECD, UNDP (2020) Framework for SDG Aligned Finance - <http://www.oecd.org/development/financing-sustainable-development/Framework-for-SDG-Aligned-Finance-OECD-UNDP.pdf>

<sup>20</sup> International Monetary Fund (IMF) Policy Tracker - <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#L>



## 2.2.2 Leveraging Public Finance Mechanisms to Kickstart Sustainable Products

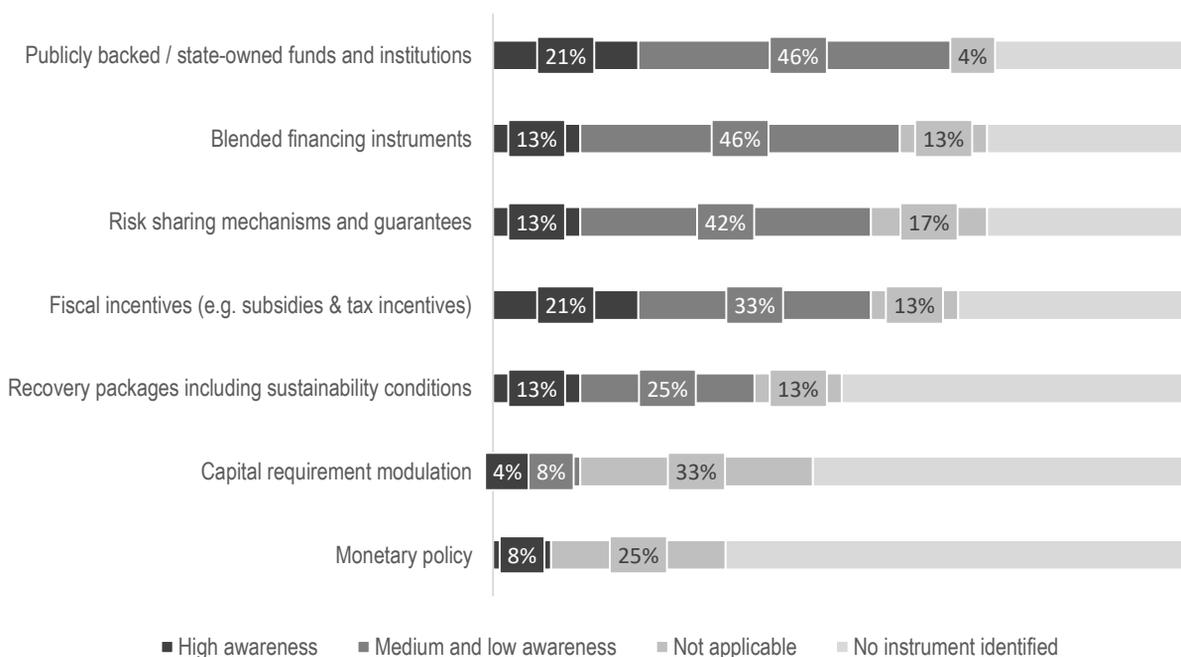
Public financial instruments can have a powerful knock-on effect to develop sustainable finance on markets that are generally neglected by private actors. Financial centres can act as strategists using their central positioning to identify critical market segments where both private and public resources require coordination. In 2020, **87% of financial centres were home to at least one financial instrument or incentive** implemented by public institutions vs. 70% in 2019 (Figure 10). This widespread adoption of innovative instruments and incentives can be a significant contributing factor of dynamism of sustainable finance, both currently and in the future.

**Financial centres can act as strategists using their central positioning to identify critical market segments where both private and public resources require coordination**

Nearly half responding financial centres (43%) have seen the emergence of a recovery package that includes sustainability conditions. This direct consequence of the COVID-19 pandemic initiates a series of superb opportunities across financial centres to put sustainability at the core of public-led economic development for the years to come. Combined with the investment needs to set the global economy on a strict decarbonization pathway, ambitious recovery plans could provide a swell of green and sustainable investment pipeline if well-designed policies and incentives are able to bolster private actors' participation, while at the same time addressing one of the surveyed financial centres selected top challenges in 2020 (i.e. lack of sustainable products/services).

31% of all the public finance instruments reported have a high awareness among financial institutions, meaning that public bodies are actively communicating about them and that they have been largely used by private actors. Increasing awareness and usage of existing public finance instruments and incentives will likely continue to have a significant impact on the potential market growth in the coming years.

**Figure 10.** Financial centres which identified instruments or incentives provided by public finance mechanism or bodies to encourage capital allocation towards green and sustainable finance



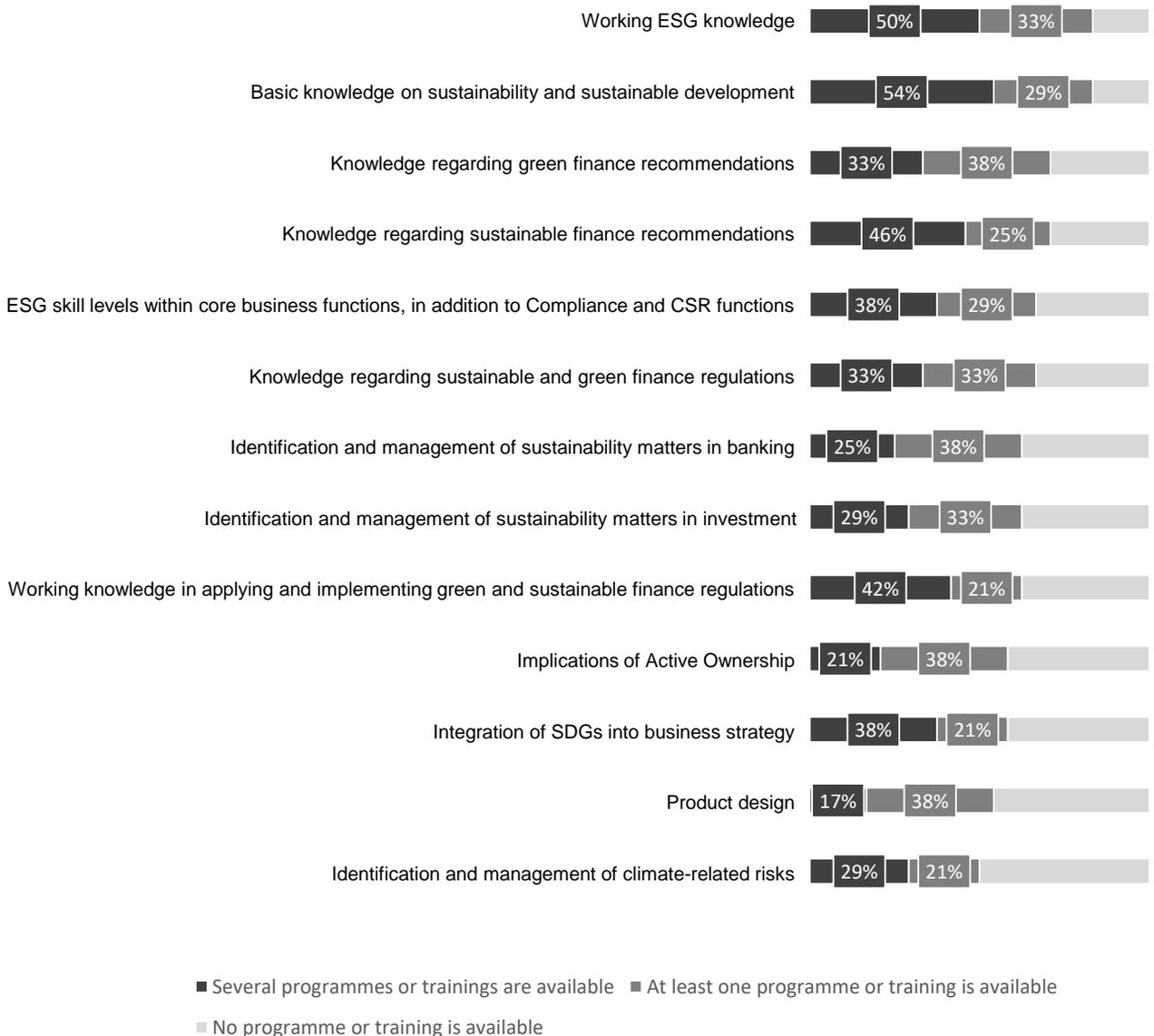
### 2.2.3 Building Capacity to Support the Exponential Growth Ahead

Capacity-building has been a rampant challenge for many financial centres. **The skill shortages and lack of expertise in the general workforce continues to restrain broad integration of sustainability criteria within financial institutions.** The 2020 results of the Assessment Programme show that currently, two thirds (67%) of financial centres have developed 10 key skills or more covered by at least one programme or

training. Nevertheless, this does not mean that currently the financial industry workforce is ready to successfully drive the transition to mainstreaming sustainability.

In 2020, the FC4S Europe node undertook a first-of-its-kind analysis from organizations spanning banking, insurance, asset management, fund services and professional services' sectors domiciled in Europe to examine the scale of the sustainable finance skills and talent gap.

**Figure 11.** Skills covered by the programmes and training available in each financial centre



The analysis was based on a survey, as well as on interviews with a number of respondents. Key outcomes from this analysis were:

1. Almost three quarters of respondents were affected to some degree by “Sustainable Finance skills shortages”, including C-suite, board level and other management levels.
2. Organizations are finding it difficult to hire sustainable finance staff, and human resources teams’ lack of sustainable finance skills hinders workforce selection and future requirements’ projections.
3. Although a uniform level of baseline knowledge and skills amongst all employees across the financial sector is required, commercial and financial functions dominate intermediate demand for sustainable finance skills and talent. Concerning training, technical and strategic expertise are its most desired outcomes within the surveyed institutions.
4. ESG is moving up the corporate agenda with about two thirds (65%) of respondents indicating they have either a high-level executive who reports directly to the Chief Executive Officer (CEO) and board or a dedicated sustainable finance team with dedicated KPIs and/or a budget.
5. The key driver identified is the pursuit of improved long-term returns followed by decreased investment risk and/or underwriting risk, brand image and reputation and regulatory and disclosure demands.
6. More than three quarters of respondents expect experienced sustainable finance hires will be required. They also expect that Sustainable Finance is integrated into business and economic curricula by third-level educational providers, and 91% are willing to upskill their employees with respect to these topics within their organizations.

Clearly traditional finance-related skills do not adequately enable an appropriate understanding and analysis of ESG factors and impacts or address the strategic and organizational impact of this regulatory and socio-economic change. Similarly, more skills are needed in emerging technologies such as artificial intelligence and

advanced analytics which are capable of significantly aiding the integration of ESG factors into decision-making. **The financial sector should ensure to play a leadership role in the development of sustainable finance skills** across financial disciplines and non-financial ones, in order to address this gap and allow for sustainability’s integration in the financial system.

**It is crucial that sustainable finance skill-building – which requires sector-wide collaboration – evolves to meet the shift towards the sustainable economy**

**A significant skills gap exists** in this (and potentially, in many other global) markets. Overcoming it requires effort from governments, industry, educational systems and individuals. Thus, financial centres are well positioned to address this issue by encouraging the development of education programmes and professional training on sustainable finance or by ensuring that existing curricula and professional development offers cover the required skill sets.

The relevance of this analysis is almost invaluable, since markets will not move at scale without the sustainable finance skills necessary to meet the current and future needs of the global sustainable economy. Thus, it is crucial that sustainable finance skill-building – which requires sector-wide collaboration – evolves to meet the shift towards the sustainable economy.





## 2.3 Overseeing the Growth of Capital Flows

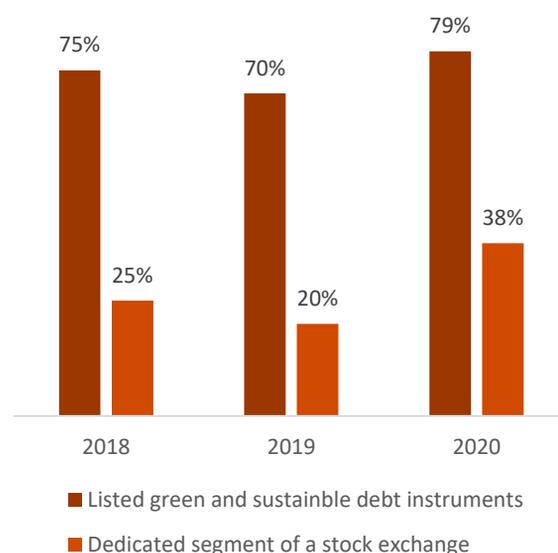
### 2.3.1 Debt Instruments

With interest rates at a record low level, swift intervention from central banks avoided a dramatic crash of debt markets in the beginning of the COVID-19 pandemic. At this time, research already suggested that **green bonds demonstrated greater resilience than vanilla equivalents** despite a 90% plunge in issuances in March 2020.<sup>21</sup> A more comprehensive report from the Climate Bonds Initiative showed that green bond issuance regained momentum in the second quarter of 2020 and that Euro- and US Dollar- denominated green bonds achieved on average higher levels of oversubscription and spread compression than vanilla equivalents.<sup>22</sup> This trend continued for the remainder of 2020 and **the US\$1 trillion milestone of cumulative green bonds issuance was hit, 2020 issuances representing more than 22% of the total** (issuances aligned with CBI definitions).<sup>23</sup>

**When put in perspective with the total volume of debt instruments, the resilience and growth of green bonds issuance remains impressive but still represents a fraction of capital flows**

At the same time, **listed green and sustainable debt instruments** (including green bonds, social bonds, SDG bonds, etc.) **reported by FC4S members exceeded the US\$1 trillion threshold hitting a record high US\$1,195 billion**. Nearly 80% of FC4S respondents have witnessed the growth of debt instruments related to green and/or sustainable finance (Figure 12). The number of respondents reporting the existence of a dedicated exchange segment for green and sustainable debt instruments tripled between 2018 and 2020, from three to nine centres. Nevertheless, most respondents still do not have one.

**Figure 12.** Respondents indicating the presence of listed green and sustainable debt instruments and the presence of a dedicated exchange segment for green and sustainable debt instruments



Sustainable debt instruments (including green bonds) continue to show extensive growth across FC4S respondents stock exchanges: during the past three years, the volume of debt instruments listed on respondents' stock exchanges nearly tripled<sup>24</sup>. And this global trend is likely to increase in the short to medium term as analysts are forecasting up to US\$500 billion of green bonds in 2021<sup>25</sup> while the Climate Bonds Initiative estimates 2021 green bonds issuance to hit US\$350 billion<sup>23</sup>.

When put in perspective with the total volume of debt instruments, the resilience and growth of green bonds issuance remains impressive but still represents a fraction of capital flows. As Figure 13 shows, the share of listed debt instruments that is green and sustainable can vary enormously depending on each financial centre.

<sup>21</sup> UNEP Inquiry and FC4S (2020), Implications of the COVID-19 Pandemic for Global Sustainable Finance [https://www.fc4s.org/viewpdf.php?pdf\\_file=wp-content/uploads/2020/11/FC4S20Implications\\_of\\_the\\_COVID-19\\_Pandemic\\_for\\_Global\\_Sustainable\\_Finance.pdf](https://www.fc4s.org/viewpdf.php?pdf_file=wp-content/uploads/2020/11/FC4S20Implications_of_the_COVID-19_Pandemic_for_Global_Sustainable_Finance.pdf)

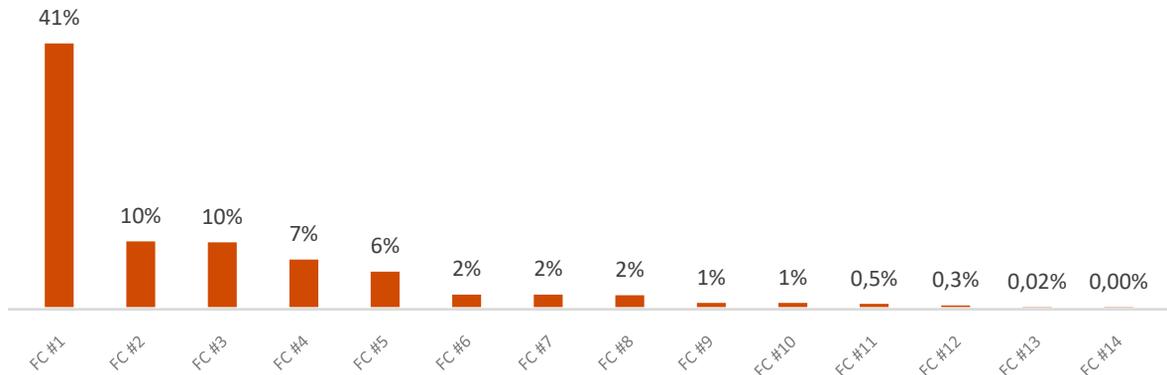
<sup>22</sup> Climate Bonds Initiative (2020), Latest Green Bond Pricing Report for Q1-Q2 2020 <https://www.climatebonds.net/2020/09/latest-green-bond-pricing-report-q1-q2-2020-performance-analysis-46-green-bonds-value>

<sup>23</sup> Climate Bonds Initiative, <https://www.climatebonds.net/>

<sup>24</sup> The calculation is based on the data provided by the Climate Bonds Initiative at end of Q3 2018 and on the data reported by respondents as part of the 2020 FC4S Assessment Programme. To calculate the improvement since 2018, we only used the centres surveyed in 2018, so those centres have reached US\$ 1065bn in 2020. Nevertheless, 2020 FC4S respondents together reached US\$ 1195bn.

<sup>25</sup> Financial Times (2020), Analysts expect as much as US\$500 billion of green bonds in bumper 2021 <https://www.ft.com/content/021329aa-b0bd-4183-8559-0f3260b73d62>

**Figure 13.** Ratio between the volume of green and sustainable debt instruments and the total volume of debt instruments (bonds) listed. 14 out of 24 respondents provided data



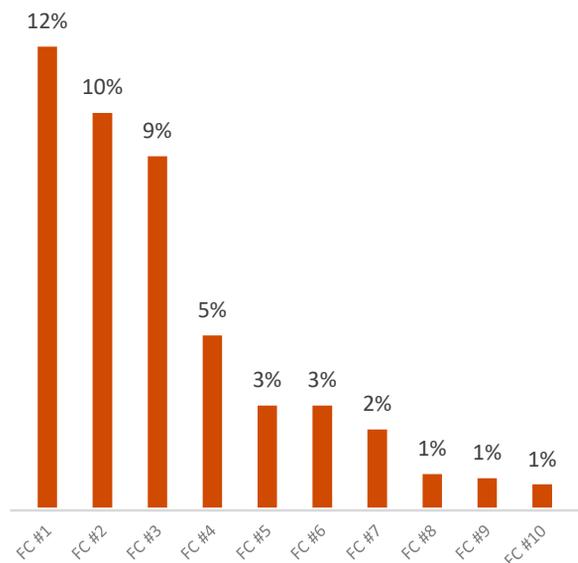
FC4S members that have implemented a dedicated exchange segment or even an entire stock exchange dedicated to green and sustainable debt instruments tend to show higher rates and comparatively to other centres, have a better access to quantitative data.

Figure 14 depicts the current dynamism of green and sustainable debt instruments as well as the ability of financial centres to supply green and sustainable products to their financial markets. Less than half of FC4S respondents were able to provide quantitative data on issuance of green and sustainable instruments relative to vanilla bonds. This represents an obstacle which needs to be addressed, since information and transparency are required for a complete and proper measurement and understanding of the global market. Even if it entails non-negligible costs, each financial centre should be able to easily access the issuances which qualify as sustainable from its own database. Transparency at the financial institutions' and the market and also at national level is necessary to grow public accountability and generate confidence in this market and, ultimately, prove its profitability. Moreover, the financial sector is uniquely placed to require information at the firm level, since its inherent role incentivizes companies to meet its requirements.

As for listed debt instruments, the share of green and sustainable debt issuance varies significantly between financial centres. With a 12% market share in green and sustainable debt issuance, the leading FC4S member largely outcompetes the global average market share that oscillates

between 1 and 2%. Though, it remains insufficient to meet the annual needs to finance the Sustainable Development Goals.

**Figure 14.** Ratio between the volume of green and sustainable debt instruments issued in the last 12 months and the total volume of debt instruments issued in the last 12 months. 10 out of 24 respondents provided data



### 2.3.2 Investment Funds

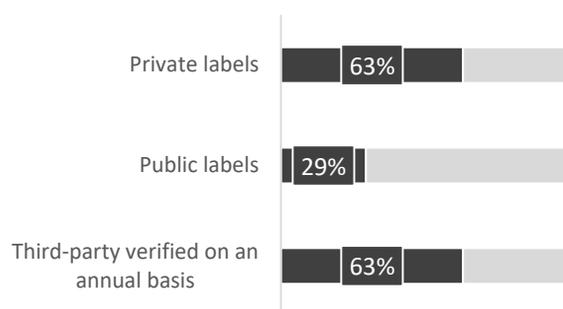
By the extent of the fall in March or the diverse recovery that followed, equity markets have experienced an unusual year 2020. As the first financial crisis since ESG funds went mainstream, the pandemic generated a real-life experiment on ESG funds, testing their resilience and ability to deliver stronger performance than benchmarks in a challenging economic environment. **ESG equity funds passed the resilience test** and in many cases were able to outperform their benchmark.<sup>26</sup> Most importantly, sustainable funds attracted record capital flows as research from Bloomberg and Morningstar showed.<sup>27</sup> The low exposure of ESG indices to fossil fuels and the boom of technology values propelled the performance of ESG equity investment funds towards new heights in 2020. **The coordination with recovery packages will be key** here since massive subsidies to fossil fuels could undermine investment towards clean and affordable energy and close the performance gap between ESG funds and their benchmark.

**A key driver outside ESG-inclined Exchange Traded Funds (ETFs) is green and ESG-labelled funds**

A key driver outside ESG-inclined Exchange Traded Funds (ETFs) is green and ESG-labelled funds. **63% of respondents indicated that private green and ESG labels are available in their centres** (Figure 15). All private labels are verified by a third party on an annual basis.

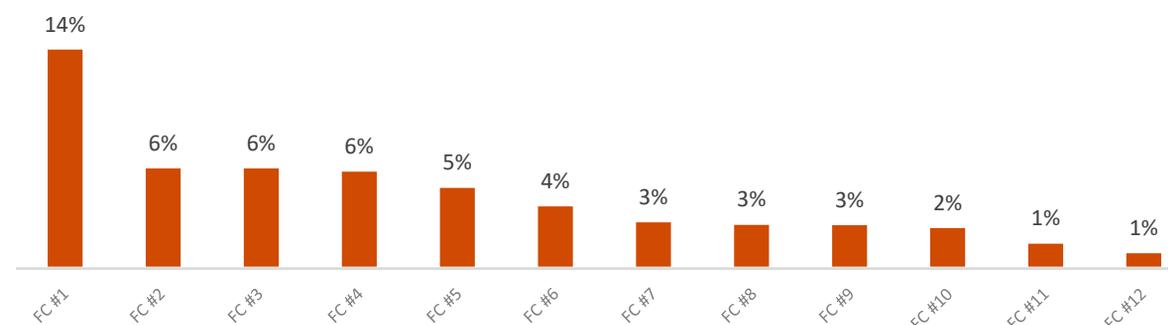
**Nearly one third of respondents (29%) also indicated that public labels are available for investment funds.** Respondents reporting green and ESG public labels systematically also signalled the presence of private labels, suggesting that private labels tend to come before the ones that are endorsed and issued by public authorities.

**Figure 15.** Presence of private and public green and ESG labels



**Together, responding FC4S members represent more than 1,730 ESG-labelled investment funds and 315 green-labelled investment funds.** Green and sustainable investment funds are flourishing on many asset classes and the share of labelled funds is growing even more rapidly both in terms of number of funds and assets under management. The overall market trend shows that investors are allocating more resources to ESG-themed funds, ETFs and indices, driven by better risks management strategies responding to an increasing demand to consider ESG issues by asset owners and retail investors.<sup>28</sup>

**Figure 16.** Ratio between the number of green and ESG-labelled funds and the total number of funds registered. 12 out of 24 responding financial centres provided data



<sup>26</sup> S&P Global (2020), ESG funds outperform S&P500 amid COVID-19, helped by tech stock boom. <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/esg-funds-outperform-s-p-500-amid-covid-19-helped-by-tech-stock-boom-59850808>

<sup>27</sup> Bloomberg (2020), Record Flows Pour Into ESG Funds as Their "Wokeness" Is Debated <https://www.bloomberg.com/news/articles/2020-10-25/record-flows-pour-into-esg-funds-as-their-wokeness-is-debated>

Institutional Investor (2020), U.S. Investors Are Getting Serious About ESG. This Year's Fund Flows Prove It.

<https://www.institutionalinvestor.com/article/b1p0s505nsj9lr/U-S-Investors-Are-Getting-Serious-About-ESG-This-Year-s-Fund-Flows-Prove-It#:~:text=According%20to%20Morningstar%2C%20U.S.%20sustainable,hitting%20%2430.7%20billion%20in%20September>

<sup>28</sup> Wall Street Journal (June 2020) *Investors Channel Over \$150 Billion Into Coronavirus Bonds.*



Consumers and employees are pushing for more sustainability across all sectors and are demanding that companies build diverse workforces, create sustainable products, and care for communities, all while reducing their environmental footprint. One of the fastest growing allocations is listed ESG-themed ETFs/ETPs, which globally reached US\$100 billion at the end of July 2020.<sup>29</sup>

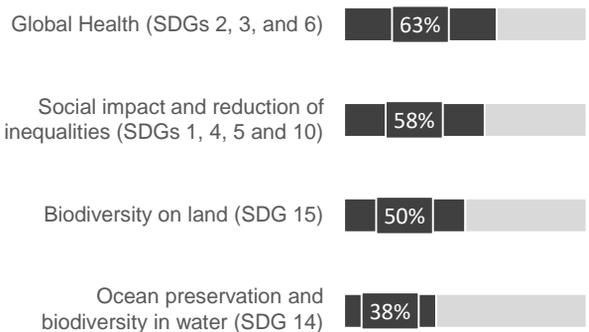
**One of the fastest growing allocations is listed ESG-themed ETFs/ETPs, which globally reached US\$100 billion at the end of July 2020**

Half of the respondents provided the total number of registered investment funds in their financial centre and the total number of green and ESG-labelled investment funds. Again, more transparency in this regard is required to allow for more in-depth analysis of the current global sustainable finance market. Figure 16 shows that green and ESG-labelled investment funds generally still represent less than 5% of all registered funds. However, this share is rapidly growing in leading financial centres, new

investment funds are directly labelled, and existing ones are again labelled to gain competitive advantage or as a response to direct competition.

The total number of green and ESG-labelled investment funds in three leading financial centres has been multiplied by more than 3 between 2018 and 2020. One of these three centres even saw green and ESG-labelled investment funds multiplied by 6.2.

**Figure 17.** Thematic funds available, excluding thematic investment funds strictly related to the low-carbon transition



<sup>29</sup> ETFGI (2020) ETFGI reports assets invested in ESG ETFs and ETPs listed globally broke through the US\$100 billion milestone at end of July 2020. <https://etfgi.com/news/press-releases/2020/08/etfgi-reports-assets-invested-esg-etfs-and-etps-listed-globally-broke>.

Two thirds of respondents declared that at least one thematic investment fund related to sustainable finance is available in their centre – this result excludes investment funds related to the low-carbon transition<sup>30</sup> (Figure 17). These investment funds are still very diverse in their strategies, from thematic selection to social impact, but are widespread and their appearance constitutes an encouraging sign for the achievement of the SDGs. Remarkably, health and other social impacts (i.e. inequalities reduction, among others) funds are leading in presence. This also constitutes a milestone, since generally the environmental aspect of ESG initiatives and target largely prevails.<sup>31</sup> Advances in social areas are not only required, but urgent.

**Two thirds of respondents declared that at least one thematic investment fund related to sustainable finance is available in their centre**

Showcases of high ESG rating companies proving more resilient in the COVID-19 market crash and outperforming ESG laggards showed the fiduciary value of ESG investing strategies.<sup>32</sup> Recent research from data provider Morningstar examining the long-term performance of nearly 4,900 funds domiciled in Europe, including 745 sustainable open-end and exchange-traded funds, compared average returns among the sustainable and traditional fund cohorts over the past one, three, five and ten years through December 2019, as well as during the COVID-19 crisis (first quarter of 2020). The study shows that the majority of these strategies have delivered higher returns than equivalent non-ESG funds over one, three, five and ten years (as well as during the COVID-19 sell-off, delivering superior returns in all but one category). Up until now there has been limited data on sustainable funds' long-term performance due to the relatively short track records of many strategies and huge variety in ESG approaches. Thus, this demonstrates the improved long-term returns potential. This could prove to be a decisive argument in the development of thematic and impact funds.

It has already been proved that integrating sustainability within financial systems will not only help develop a more resilient global economy, but also triggers a set of beneficial consequences for humanity as a whole- ranging from improved life quality to cleaner oceans and fewer endangered species. This is regardless of the economic benefits which this shift has also shown to entail. The World Economic Forum (WEF) recently noted<sup>33</sup> that 15 priority transitions in 3 major sectors of the economy (food, land and ocean use; extractives and energy; and infrastructure and the built environment) onto “nature-positive” paths could create US\$10.1 trillion of economic growth and 395 million jobs by 2030. Thus, and recognizing we have already less than ten years to 2030, although many advances are being developed, the speed at which the recognized challenges are overcome will also determine the smoothness of the low-carbon and sustainability transition.

<sup>30</sup> Green labelled funds, funds specialized in green infrastructure, renewable energy, low-carbon technologies, etc.

<sup>31</sup> FC4S update to its Nudging the System report analysis (2020)

<sup>32</sup> AXA IM (2020), How ESG scores signalled resilience in the Q1 market downturn [https://realassets.axa-im.com/content/-/asset\\_publisher/x7LVZDsY05WX/content/insight-ri-coronavirus-how-esg-scores-signalled-resilience-in-the-q1-market-downturn/23818](https://realassets.axa-im.com/content/-/asset_publisher/x7LVZDsY05WX/content/insight-ri-coronavirus-how-esg-scores-signalled-resilience-in-the-q1-market-downturn/23818)

<sup>33</sup> WEF (2020), New Nature Economy Report II- The future of nature and business [http://www3.weforum.org/docs/WEF\\_The\\_Future\\_Of\\_Nature\\_And\\_Business\\_2020.pdf](http://www3.weforum.org/docs/WEF_The_Future_Of_Nature_And_Business_2020.pdf)

# 3

## ■ Challenges and Opportunities Ahead



The FC4S Assessment Programme is the first framework of its kind that crucially enables financial centres measure their alignment with the Paris Agreement. For the members, it allows them to assess their current alignment and overall relative performance, building the basis for further strategic action plans or roadmaps at financial centre or national level.

This year's analysis highlights that not even the pandemic stopped the sustainability drive within financial centres. On the contrary, it has demonstrated that sustained and resilient economic growth requires financial system's alignment with the UN SDGs (as one framework of sustainability principles), in order to preserve the long-term value of assets.

The commitments of financial centres – including banks, institutional investors, and insurers – are increasing, demonstrating that additional allocation on green and/or sustainable finance is being increasingly targeted and commitments to ban or exclude firms engaged in coal activities and fossil fuel financing are multiplying. This is in line with the current upsurge in active ownership by institutional investors, which reflects the potential of shareholder climate action to become mainstream.

Also, financial authorities have stepped up their guidance and regulation on the adoption of ESG factors and clarifying that these factors are consistent fiduciary duty. Collectively, the regulations in place in the 24 analysed financial centres reached over 200 policies, and more than half of them (55%) target most, if not all asset classes and financial services, and a similar share include specific requirements that financial actors need to apply. All these findings suggest that the regulatory environment of financial centres tends to swell progressively as public and private actors are gaining maturity. Stronger interactions between public sector institutions translate into a clear signal from regulators to market players, increasing the urgency and driving further action.

As per this year's results, the Assessment has shown that data quality and availability is still a top challenge for financial institutions worldwide.

Issues regarding data accessibility, reliability, incompleteness, non-comparability, as well as lack of necessary skills or analytical capabilities are currently hindering progress in mainstreaming sustainable finance globally. More consistent, granular, and comprehensive data is both a regulatory and market requirement, as more transparency is being demanded. Current advances in data analytics – including big data uses, machine learning and artificial intelligence – have proven valuable in climate and social finance and represent a potential shortcut to embrace ESG data's inherent complexities. Moreover, the fact that generally few financial centres are able to provide quantitative data on sustainable solutions, products or issuances relative to their traditional respective counterparts signals the work ahead.

FC4S analysis has also shown that the sustainable finance skills gap is also a concern for the sustainability transition, since markets will not move at scale without the skills necessary to meet the current and future needs of our global economy. Overcoming it requires effort from multiple stakeholders' which financial centres are uniquely positioned to convene and ultimately address.

Also, inadequate investment pipelines and the lack of green and sustainable products are persistent challenges for scaling-up sustainable finance. Demonstrating financial centres' efficiency, FC4S analysis showed respondents' top priorities reflect the main challenges they are facing. The main priority is supporting the development of new products and services, followed by the call to strengthen the ecosystem and building connectivity. Actions have been taken in this regard, both by market actors as well as policymakers. In December 2020, the US\$1 trillion global milestone of cumulative green bonds issuance was hit, with 2020 issuances representing more than 22% of the total. At the same time, listed green and sustainable debt instruments reported by FC4S members exceeded the US\$1 trillion threshold, reaching a record high US\$1.195 billion. Nevertheless, when put in perspective with the total volume of debt instruments, the growth of green bonds issuance still represents a small fraction of global capital.

This year's assessment demonstrated that nearly half of responding financial centres have seen the emergence of a recovery package that includes sustainability conditions. This direct consequence of the pandemic initiates a series of unprecedented opportunities across financial centres to put sustainability at the core of public-led economic development for the years to come, while at the same time, address one of the surveyed financial centres' selected top challenges.

Ambitious recovery plans could provide a swell of green and sustainable investments if well-designed policies and incentives are able to bolster private actors' participation. Although green and sustainable investment products and vehicles are emerging as attractive to professional and retail investors alike, a significant share of 2020 record flows were directed towards secondary capital markets in developed countries. Green and sustainable investments need to increasingly finance projects, required in least developed and developing countries, which usually do not have the fiscal capacity to do so that contribute to the achievement of the SDGs.

Last but not least, the sustainability transition also presents countless development opportunities for the whole world. This assessment clearly shows that the financial system's transition towards a low-carbon and more sustainable economy is already happening.

The chosen path to reach a more sustainable global economy will ultimately determine the extent to which climate change and inequalities will affect us, as well as the global shape of the new economy.



# 4 ■ Appendix



# 4.1 Members of the FC4S Network

As of January 2021, the Network has attracted 33 financial centres as members across Africa, the Americas, Asia and Europe.



## 4.2 Establishment of the FC4S Network

The United Nations Environment Programme (UNEP) Inquiry first began exploring the role of financial centres as hubs for sustainable finance, in partnership with the 2017 Italian G7 Presidency. Following the submission of a ministerial report, G7 Environment Ministers recognized the potential for financial centre action to be furthered through international cooperation. To build on this positive momentum and shape a practical agenda, a first global meeting of financial centres was hosted in Casablanca in

September 2017.

At the meeting, 11 financial centres supported the Casablanca Statement on Financial Centres for Sustainability, agreeing to promote strategic action in their financial centres on green and sustainable finance, and to launch the International Network of Financial Centres for Sustainability (FC4S Network).

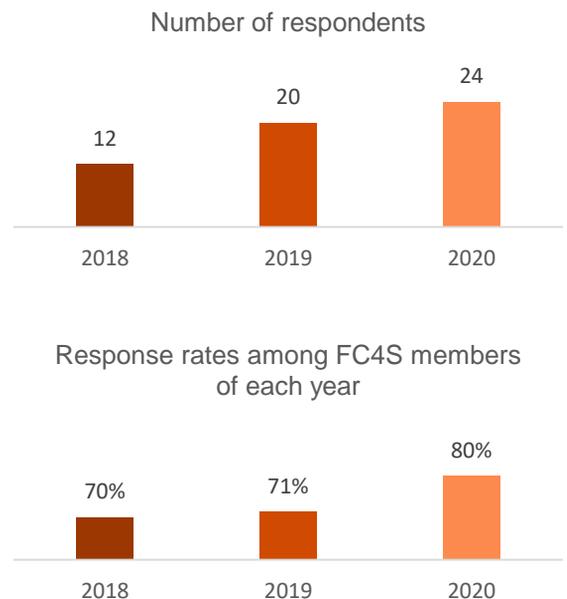
## 4.3 Development and Expansion of the Assessment Programme

After a first assessment of green finance in G7 financial centres in 2017, members recognized the value of broadening the scope of this initial exercise across FC4S members in the form of an Assessment Programme. A pilot was launched in 2018, the ensuing report, “Shifting Gears”, was released in March 2019 and measured for the first time the contribution of financial centres to sustainable development. The Assessment Programme was then updated and renewed in 2019 and 2020. Its objectives are to:

- Track positive trends through the transformation of financial centres and identify best practices.
- Explore new ways of measuring the progress of financial centres towards mainstreaming sustainable finance.
- Provide financial centres with a global framework and a toolkit to collect meaningful data and develop relevant strategies.
- Encourage continued and enduring action by financial centres to align flows, products, services, and institutional strategies with the needs of sustainable development and the low-carbon transition.

Since 2018, the participation of FC4S members to the Assessment Programme has been steadily growing both in terms of number of participants

**Figure 18.** Participation rates for the FC4S Assessment Programme in 2018, 2019 and 2020



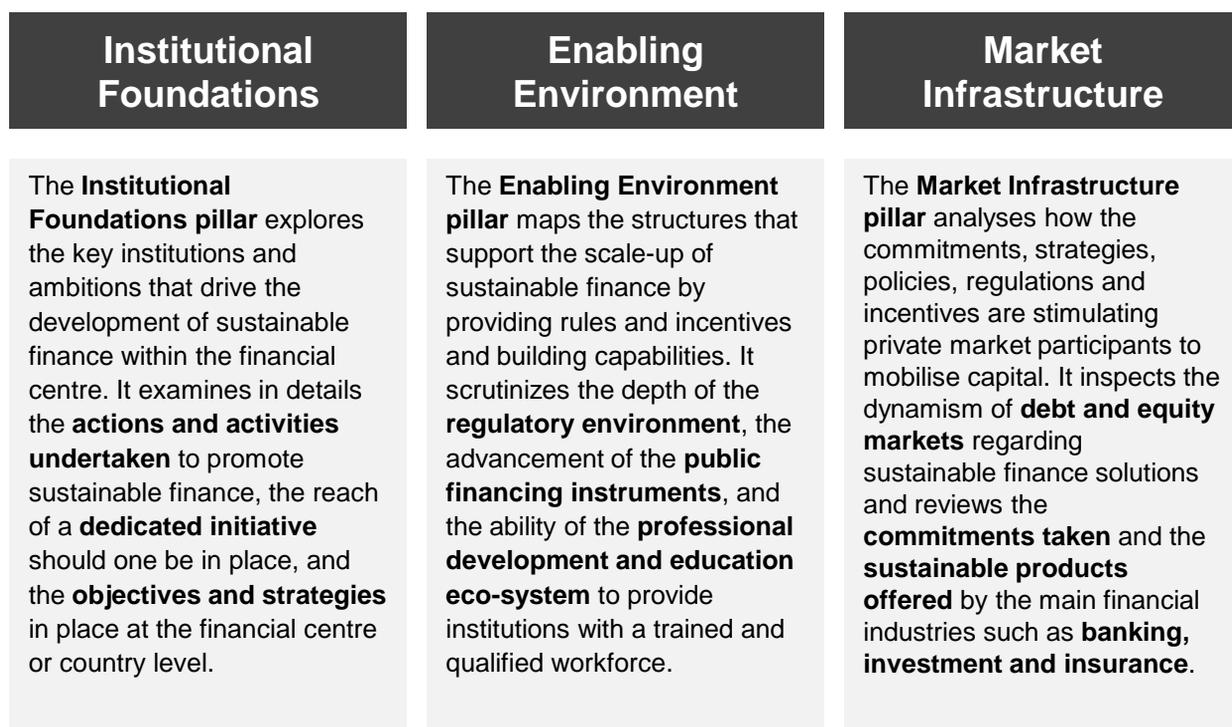
and response rate (Figure 18). 2020 is no exception with 24 centres having submitted a survey, corresponding to a response rate of 80% (the FC4S Network was comprised of 30 members in September 2020).

During the summer of 2020, in partnership with I4CE, UNEP, UNDP, and PwC, the FC4S Secretariat updated the three-pillar assessment framework (Figure 19) and the Member survey tool. The summary of the results of the 2020 Assessment Programme are provided in the sections below.

As mentioned in the executive summary of this report, in 2021 the secretariat and its partners developed personalised reports based on three years' information of each financial centre. This

represents a milestone since it constitutes the first financial centre's alignment framework globally, which allows each of them to assess their current alignment and overall relative performance, building the basis for further strategic action plans or roadmaps at financial centre or national level. Furthermore, currently FC4S is providing one-to-one meetings to the assessed members, including strategic recommendations based on their results and benchmark performances.

**Figure 19.** Three-pillar structure of the FC4S Assessment Programme



## Further information

As of January 2021, the FC4S Network had 33 members from Africa, Asia, Europe, and the Americas.

Centre	Country	Institution/Authority
<b>Abidjan</b>	Côte d'Ivoire	Abidjan International Finance City
<b>Abu Dhabi</b>	United Arab Emirates	Abu Dhabi Global Market
<b>Barcelona</b>	Spain	Barcelona Centre Financer Europeu
<b>Beijing</b>	China	Beijing Green Finance Association
<b>Cairo</b>	Egypt	Financial Regulatory Authority
<b>Casablanca</b>	Morocco	Casablanca Finance City Authority
<b>Dublin</b>	Ireland	Sustainable Nation Ireland
<b>Frankfurt</b>	Germany	Green and Sustainable Finance Cluster Germany
<b>Geneva</b>	Switzerland	Sustainable Finance Geneva
<b>Guernsey</b>	Guernsey	Guernsey Green Finance
<b>Hong Kong</b>	China	Hong Kong Green Finance Association
<b>Lagos</b>	Nigeria	FC4S Lagos
<b>Liechtenstein</b>	Liechtenstein	Liechtenstein Bankers Association
<b>Lisbon</b>	Portugal	Portuguese Think Tank on Sustainable Finance
<b>London</b>	United Kingdom	City of London Corporation
<b>Luxembourg</b>	Luxembourg	Luxembourg for Finance
<b>Madrid</b>	Spain	Sustainable and Responsible Financial Center in Spain (Madrid) - FINRESP
<b>Malaysia</b>	Malaysia	Capital Markets Malaysia
<b>Mexico City</b>	Mexico	Green Finance Advisory Board (CCFV)
<b>Milan</b>	Italy	Centro Finanziario Italiano per la Sostenibilita (CFIS)
<b>Montréal</b>	Canada	Finance Montréal
<b>Nairobi</b>	Kenya	Nairobi International Financial Centre Authority
<b>New York</b>	United States	U.S. Alliance for Sustainable Finance
<b>Nur-Sultan</b>	Kazakhstan	Astana International Financial Centre
<b>Paris</b>	France	Finance for Tomorrow
<b>Rio de Janeiro</b>	Brazil	The Laboratory of Financial Innovation
<b>Seoul</b>	South Korea	Seoul Metropolitan Government
<b>Shanghai</b>	China	Lujiazui Financial Green Finance Committee
<b>Shenzhen</b>	China	Shenzhen Green Finance Committee
<b>Stockholm</b>	Sweden	Stockholm Green Digital Finance
<b>Tokyo</b>	Japan	Tokyo Metropolitan Government
<b>Toronto</b>	Canada	Toronto Finance International
<b>Zurich</b>	Switzerland	Swiss Sustainable Finance

Further information on the Network can be found at [www.fc4s.org](http://www.fc4s.org)

Financial centres interested in joining the Network are invited to contact the FC4S Secretariat:

Stephen Nolan, Managing Director (Stephen.Nolan@un.org)

Florencia Baldi (flor.baldi@gmail.com)



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