UN environment programme

finance initiative

Leadership Council

Background paper

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1. Summary: From integration to alignment

The world is in crisis, and the financial sector is integral to achieving the global goals that society and the planet need.

The UN Secretary-General has declared we are at code red for humanity. With the ongoing climate, nature loss and pollution crises, growing inequality and more, we need the finance sector to help deliver systemic change.

Given the scale of the challenge and the costs of delayed action, the financial sector must accelerate action and increasingly factor in societal and environmental objectives as without alignment through the financial sector, the global goals cannot be met.

The financial sector must integrate sustainability risks and impacts and align to global goals

The integration of Environmental, Social and Governance (ESG) factors into existing risk frameworks has raised awareness and consideration of their influence on financial performance. Further action is needed to accurately capture other important topics alongside climate, such as biodiversity loss and growing inequality, and to shift towards the double or dynamic materiality lens.

Assessment and disclosure of risk and impact are building blocks but insufficient to deliver the economic transformation needed for tackling global challenges. Going further, leaders in the finance industry must now work to align their underwriting, lending and investment portfolios with societal and environment goals.

The UNEP FI community of leaders must accelerate action today to drive change across financial institutions and financial systems.

Society, business and the environment are at a critical juncture between recovery and crisis. The path that economic actors take now will determine the outcome for decades to come.

The financial sector has a critical role to play in leading the required transformation to secure a resilient and sustainable future. The sector must mobilize the US$ 500 trillion of global financial assets needed to transition to a low-carbon, sustainable economy.

Action must include aligning to a pathway that will limit the global average temperature increase to 1.5 degrees Celsius above pre-industrial levels. Leading financial institutions under UNEP FI's frameworks are moving towards developing approaches for aligning their portfolios with climate and other sustainable development goals. Financial leaders must accelerate the rate and scale of change to ensure alignment with global goals.

> **"If not us, who? If not now, when?"**

UNEP FI Partnership: Questions for consideration:

i. **What would be most useful support from UNEP FI in order to deepen and widen your strategic integration of ESG and sustainability considerations across your business?**

2. Introduction: Why we are here

Society, business and the environment are at a critical juncture between recovery and crisis. The path that governments and economic actors take now will determine the outcome and the financial sector has a critical role to play in leading the required transformation to secure a resilient and sustainable future. There are several proof points that defines this critical juncture. The recent Intergovernmental Panel on Climate Change (IPCC) report[1] highlights that current human activity is changing the climate in irreversible ways which has led the UN Secretary General to declare a code red for humanity. The recent pandemic demonstrates how easily our systems can fail, and with ongoing and worsening issues including the climate crisis, biodiversity loss, pollution and waste, growing inequality and more. Business as usual is no longer an option, our societies and economies need to transform. It will take collaboration between government policy, collective action, civil society and business to lead the change that requires addressing complex and connected issues. We need to lead a systemic change.

Global goals and commitments are being made by governments around the world in order to achieve the impactful change demanded by society and the planet. However, it is the collective action of individual companies and industry groups that can drive change through evolving business models to deliver on social and environmental value in addition to economic value. Social and environmental goals have become a strategic imperative for businesses leaders who understand that the transition to a sustainable economy will involve understanding the management of the financial risks and the full realignment of industries and portfolios. Commitments made within the Paris Agreement, and updated at COP26 in Glasgow this month, are spurring the public and private sectors to enact meaningful change to accelerate the transition. They are also being guided by the UN 2030 Agenda with its 17 Sustainable Development Goals addressing economic, social and environmental imperatives, and a shared vision for society in this, the decade for action.

1 https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_Headline_Statements.pdf

Action within the financial sector is integral to achieving these goals

With an estimated US$ 500 trillion of global financial assets[2] driving the real economy and its greenhouse gas (GHG) emissions, private finance must be mobilised towards achieving the transition to a low-carbon, sustainable economy. Given the scale of the challenge and the costs of delayed action, the financial sector must accelerate the rate and scale of change to ensure alignment of underwriting, lending and investment portfolios with a pathway that will limit the global average temperature increase to 1.5 degrees Celsius above pre-industrial levels.

Over its thirty-year history, the UN-finance sector partnership UNEP FI has worked with finance leaders to establish some of the most important sustainability-oriented frameworks within the industry, including the Principles for Responsible Investment (2006), the Principles for Sustainable Insurance (2012) and the Principles for Responsible Banking (2019). Today, as environmental and social issues heighten risks to environmental, social and economic stability, the UNEP FI community of leaders must accelerate action today to drive change across financial institutions and financial systems.

2 Financial Stability Board, Global Monitoring Report on Non-Bank Financial Intermediation (2020) https://www.fsb.org/wp-content/uploads/P161220.pdf

3. Integration: Mainstreaming ESG risks and impacts (Focus area 1)

The importance of integrating ESG factors across the sector

Progress has been made in developing approaches to assess the materiality of climate, environmental and social issues on financial performance. Their integration into existing risk management frameworks has enabled further awareness and consideration of the interrelation between material financial risks and prudent asset allocation and business strategy. Although banks were the first to establish environmental and social risk management systems, the investment industry has led in integrating these factors strategically, and insurers have had a long history of embedding environmental risks such as natural hazards and pollution into insurance underwriting.

Investment sector integration—the Principles for Responsible Investment (PRI)

Launched in 2006 by UNEP FI and the UN Global Compact, the Principles for Responsible Investment (PRI) has become the de facto industry framework for integrating Environmental, Social and Governance (ESG) issues, a term first coined by UNEP FI in 2004, into investment decision-making. Today it is applied by more than 3,400 asset owners and managers representing US$ 121 trillion of global assets.[3]

Asset owners are increasingly benchmarking asset managers on their PRI implementation. Through proxy voting and other active ownership engagement including through collaborative platforms like Climate Action 100+,[4] investors are applying pressure to accelerate and improve corporate disclosure around climate and sustainability performance and positioning. During the 2021 proxy voting season, support for environmental

3 As of 31 March 2021, see Enhance our global footprint | PRI Web Page | PRI (unpri.org)
4 https://www.climateaction100.org/

and social proposals reached a new high. Climate change drew the strongest overall support, with resolutions backed by more than 50% of investors in companies including ExxonMobil, Procter & Gamble and United Airlines. UNEP FI and PRI have in 2021 launched an Investment Leadership Programme to accelerate the pace of collaboration amongst leading responsible investors.

Key issues leaders need to be considering for their organisations

- **Are social and environmental ambitions embedded in our purpose and culture?**
- **Is it properly reflected in governance and strategy?**
- **Do we understand the impact we have on our customers and suppliers?**
- **Do we have the right people driven by the right incentives?**
- **Are we ahead of the curve in our sustainability journey?**

Insurance sector integration—the Principles for Sustainable Insurance (PSI)

Insurers are increasingly integrating ESG risks into their underwriting systems and processes using the global industry framework, the Principles for Sustainable Insurance (PSI). Launched by UNEP FI in 2012, the PSI now has signatories representing over 25% of world insurance premium. Insurers taking action to implement the Principles are contributing to new norms in the insurance industry, informed by the first global insurance industry guide to manage a wide range of ESG risks in non-life insurance business—from climate change, ecosystem degradation, pollution and animal welfare and testing; to child labour, controversial weapons, bribery and corruption. The guide raises awareness of the potential benefits of ESG integration in the insurance business model, including mitigating reputation risk, managing societal expectations, understanding the financial benefits of clients with strong ESG performance, and engaging and supporting clients and employees.

Meanwhile, compared to non-life insurance business, there has generally been less understanding of and discussion on the key ESG risks for life & health insurance business. The PSI Secretariat is currently working with members to better understand key risk management and insurance challenges and opportunities for life & health, particularly in a post-COVID world, and in 2022 will release a strategy paper outlining the global sustainability agenda for the life & health insurance industry.

Getting started on climate risk disclosure

The Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) recommendations have been seminal in elevating climate risk to board-level governance and strategic consideration. UNEP FI has fostered the preeminent community of banks, insurers and investors working together to establish good practice standards on climate disclosure.[5] Technical developments under UNEP FI's TCFD pilots, including on stress testing, climate risk management and the novel area of litigation risks for insurers, are informing regulatory approaches to implementing the recommendations in national disclosure rules.

Building towards nature risk disclosure

Although less understood than climate, a focus is now shifting towards consideration of the risks posed by biodiversity loss[5] on the financial system. UNEP FI helped establish in 2021 the Task Force on Nature-Related Financial Disclosures (TNFD) that will provide a risk management and disclosure framework for organisations to report on natured-related risks. An example nature-related liability is Bayer's 2018 purchase of Monsanto which led to a claims settlement for the pesticide Roundup of US$ 11.6 billion and an ongoing provision of US$ 4.5 billion. A positive example is research showing that between 2013 and 2018, 90% of the fastest growing consumer goods products in the US, by sales, were marketed as sustainable.[6]

From risks to impact

Expectations around fiduciary duties is shifting towards double materiality considerations of sustainability impact, as illustrated by new disclosure rules in Europe. The IFRS foundation is establishing an International Sustainability Standards Board while new legal frameworks for impact[7] are established. Starting in 2021 UNEP FI will co-host with OECD the Impact Management Platform, a unique collaboration between sustainability norm-builders tasked with developing globally consistent sustainability impact measurement, assessment and reporting methodologies. The work of the Platform will feed into a variety of policy and regulatory discussions at the global and local level.

5 https://www.unepfi.org/climate-change/tcfd/
6 Reference: Whelan, T., Kronthal-Sacco, R. (2019). Research: Actually, Consumers do buy sustainable products. Harvard Business Review. https://hbr.org/2019/06/research-actually-consumers-do-buy-sustainable-products cited in CISL handbook.
7 https://www.unepfi.org/legal-framework-for-impact/

Taxonomies addressing greenwash

Taxonomies to define sustainable economic activities are being established in different jurisdictions, with a view to have a common language across sectors and financial intermediaries. These "dictionaries" of what activities can be called sustainable aim to help address concerns over the potential for green-washing and to ultimately scale up sustainable finance aimed at addressing wider national and regional climate, environmental and societal goals. The EU Taxonomy Regulation (2020) requires the screening of economic activities against six environmental objectives. Activities must substantially contribute to one objective, while not significantly harming the others, and complying with minimum social safeguards, so as to have a "net positive impact". UNEP FI is an Observer to the EU Sustainable Finance Platform and is work to enhance the usability of the Taxonomy through piloting its' use with European members. In addition, with similar classification systems being developed around the world, coordination on taxonomies is a key focus of the International Platform on Sustainable Finance.[8]

Leading practice today requires shifting the risk lens forward to manage those of a changing climate and transitioning policy and technological landscapes, a broadening of materiality scope and a new emphasis on understanding the client generated outcomes and impacts of financial products and services.

Integration: Mainstreaming ESG risks and impacts (Focus area 1): Questions for consideration

i. Sustainability risk disclosure can drive, systematic risk management but only if taxonomies and disclosures are standardised, comparable, and widespread. How can finance leaders, working with the UN and in partnership with financial regulators, help harmonize taxonomies/disclosures and close the data gap?

ii. The lens of materiality is evolving quickly on ESG and climate risks and impacts. How can finance leaders ensure their organisations evolve quickly enough to meet new expectations and market dynamics?

8 https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/international-platform-sustainable-finance_en

4. Alignment: From green transactions to green institutions (Focus area 2)

Moving beyond ESG integration

With international standards bodies and regulators starting to mandate taxonomy-based sustainability impact reporting, leading financial institutions are stepping up ambition from simply classifying green transactions to greening, or aligning, entire portfolios with climate and other global challenges.

Assessment and disclosure of risk to strengthen the resilience of the financial system will in itself not deliver the economic transformation needed for tackling global challenges. Beyond ESG disclosure, there is a critical urgency to ensure that the financial system aligns with societal goals, without which they cannot be met. Through UNEP FI's frameworks leading financial institutions are developing approaches for aligning their portfolios with climate and other sustainable development goals.

Leading banks establish the first alignment-focused sustainable finance framework

UN Secretary-General Antonio Guterres and UNEP FI's banking leaders from around the world met at UN General Assembly in September 2019 to launch the UN Principles for Responsible Banking. More than 250 banks today from 66 countries are signatories, accountable for US$ 65 trillion or roughly 40% of global banking assets and serving 1.6 billion customers. Signatories commit to setting core business targets where they can have the most significant impacts across their portfolios.

Key findings from the recently published PRB Collective Progress Report, the first biennial assessment, found that 94% of signatories identify sustainability as a strategic priority for their organisation while 93% have completed or are working to complete an analysis of the environmental and social impacts of their core business activities. Regarding alignment, 30% have already set at least one SDG-focused target or are in the process of setting one. The PRB Civil Society Advisory Body provided an independent view on progress, welcoming the work done to date but encouraging a more holistic focus, comprehensive goal setting and demonstrated execution with indications of meaningful progress in the interim.

Aligning the insurance sector to global goals

A priority of the PSI in 2022 is to define sustainable insurance business in the context of the UN Sustainable Development Goals (SDGs), highlighting the enabling role of insurance and taking into account positive and negative impacts. In this regard, the PSI aims to scale up action and impact by developing a set of “Insurance SDGs” that would harness insurance products and solutions to help achieve the SDGs. Currently, many insurance products and solutions already support achieving the SDGs but the industry lacks a systematic mapping of such products and solutions, a clear narrative, and methods to measure impact. There is also a lack of understanding on the types of insurance products and solutions needed—both existing and new—to support the achievement of various SDGs, and how such products and solutions can be developed and brought to scale. Finally, there are no global goals or targets for the insurance industry linking its insurance portfolios to the SDGs.

Aligning with net-zero climate objective

UNEP FI is an important supporter of the Glasgow Financial Alliance for Net Zero (GFANZ) umbrella programme led by Mark Carney in his role as UN Special Envoy. Specifically, UNEP FI convenes three of the largest GFANZ initiatives, including the Net-Zero Asset Owner, Banking and Insurance Alliances.

Over 50 institutional investors have been collaborating since 2019 under the UN-convened Net-Zero Asset Owner Alliance to transition investment portfolios to align with a 1.5 degree scenario. Alliance members represent USD10 trillion in assets under management committed to net-zero carbon emissions by 2050. By COP26, 28 of its member investors have committed to reduce portfolio emissions 25–30% by 2025 across the asset classes public equity, publicly traded corporate debt, and real estate, as well as setting sectoral targets across seven hard-to-abate sectors including oil and gas, utilities, steel, heavy and light duty road, shipping and aviation. In addition to facilitating the setting of portfolio decarbonization targets, the Alliance already is supporting members to implement and achieve such targets. This happens through a number of work-tracks and instruments, including in particular Alliance-wide Positions on key industries, technologies and policy matters, such as on the phase out of thermal coal and the need for Governmental carbon pricing.

The UN-convened Net-Zero Banking Alliance (NZBA) which was launched in April, 2021, now has a coalition of 92 banks from 36 countries managing 43% of global banking assets committing to aligning their portfolios with the 1.5 degree objective. Focusing on the most carbon intensive sectors, NZBA banks have 18 months to set interim 2030 and long-term targets, supported by key performance indicators and action plans. Interim and long-term targets will have to cover a significant majority of banks' portfolio-level emissions as well as exposures to the following emissions-intensive sectors: agriculture; aluminium; cement; coal; commercial and residential real estate; iron and steel; oil and gas; power generation; and transport. As of COP26, three NZBA signatories have issued 2030 targets, including Morgan Stanley, BBVA and Amalgamated Bank.

The UN-convened Net-Zero Insurance Alliance (NZIA) was launched by eight leading global insurers and reinsurers at the G20 Climate Summit in Venice in July 2021 to pioneer the transition of insurance and reinsurance underwriting portfolios to net-zero emissions by 2050. These insurers are building on their climate leadership as investors through their membership in the Net-Zero Asset Owner Alliance (NZAOA). They are therefore demonstrating the key role of the insurance industry as risk managers, insurers and investors in supporting the transition to a net-zero economy. The NZIA is collaborating with the Partnership for Carbon Accounting Financials (PCAF) to develop the first global standard to measure and disclose insured greenhouse gas emissions. A global, standardised methodology to measure and disclose the GHG emissions of insurance portfolios would give insurers deepen insight into the risk profile of their respective underwriting portfolios, stimulate innovative approaches to decarbonisation, and create comparability for stakeholders. This should help insurers understand the climate impact of their underwriting decisions, laying the foundation to decarbonise their insurance portfolios through target setting, scenario analysis, strategy development, and taking concrete actions that have real-world impact through emissions reduction in the real economy.

Aligning with the post-2020 Global Biodiversity Framework

UNEP FI members are being primed to set biodiversity targets aligned to the post-2020 Global Biodiversity Framework, expected in April–May 2022. CBD COP15 was postponed several times due to the pandemic and is now being held in two parts. Currently more than 30 members of the PRB biodiversity working group have contributed to new guidance on portfolio biodiversity target-setting, with at least five having set preliminary targets. A capacity building roadmap is under development to support the largest possible number of PRB Signatories to ready themselves for setting targets. A collective commitment to nature-positive banking portfolios is under development for launch in late 2022. Dedicated target-setting efforts are also taking place at thematic levels to promote members' leadership emerging issues such as food systems, deforestation and sustainable commodities, and blue economy (oceans).

Alignment: From green transactions to green institutions (Focus area 2): Questions for consideration

i. Portfolio-level alignment will only make a real difference if this results in more financing for sustainable activities and less for unsustainable activities. What is needed so that FIs are better able to perform, in particular, the latter? How can this be compatible with the need for providing support and funding to those unsustainable activities to become more sustainable.

ii. How can you make sure to be aligned with scientific approaches to reach net zero by 2050 across your portfolios, and the need to stay profitable?

iii. How are you planning internally to adjust your business models to portfolio alignment/transition finance in a scientifically based manner which responds to the increased scrutiny of regulators?

iv. Emerging countries are critical in this transition. How are you managing asymmetries between developed and developing countries when aligning your portfolios?

Regulators are leaning in

- Bank of Japan has joined the European Central Bank (ECB) and the Bank of England (BoE) in announcing plans to incorporate climate criteria into their monetary policy frameworks. Both the ECB and the BoE will begin giving preference to green assets for purchases, while the ECB will adjust its collateral framework to make eligible a wider range of green securities.
- At COP26, it was announced that GFANZ, including the Net-Zero Asset Owner, Banking and Insurance Alliances, will start to report regularly to the G20 Financial Stability Board.
- G20 Sustainable Finance Working Group new Roadmap focuses on: market development and alignment; Data consistency and comparability; Assessment of climate and sustainability risks; and leveraging public finance, policies, and incentives.
- At COP26, the UK government announced plans for a mandatory requirement of companies to publish net-zero transition plans.
- The European Commission in July, 2021, adopted measures to increase ambition on sustainable finance, including a new Sustainable Finance Strategy, a green bond standard proposal, and a Delegated Act on disclosures based on the EU Taxonomy of sustainable economic activities.

- International Platform on Sustainable Finance, a multilateral forum of dialogue between policymakers in charge of developing sustainable finance regulatory measures have also been working on the area of taxonomy and disclosures.
- Network for Greening the Financial System has been developing climate scenarios for central banks and supervisors, has been working to address data gaps and most recently has issued a report on biodiversity and financial stability.
- Coalition of Finance Ministers for Climate Action brings together fiscal and economic policy-makers from over 60 countries help countries mobilize and align the finance needed to implement their national climate action plans; establish best practices such as climate budgeting and strategies for, green investment and procurement; and factor climate risks and vulnerabilities into members' economic planning.

Annex: UNEP Finance Initiative Partnership

UNEP FI has played a crucial part in many key events of its 30-year lifetime. The initiative works with more than 400 banks, insurers, and investors and over 100 supporting institutions to advance action within the financial sector and create a positive future for society and the planet.

Looking ahead

UNEP FI's 2022–2025 strategic work program will provide members with opportunities to participate in our community of practice for collaboration, technical work and peer learning. This includes taking part in a range of leadership initiatives, research projects, training, consultations and piloting of practical methodologies, guidance and tools.

Key areas of focus for the next four years include:

- **Providing implementation support** for signatories of the Principles for Responsible Banking, Sustainable Insurance, and collective commitments including the UN-convened Net-Zero Alliances.
- Intensifying the **delivery of global programs at regional level,** balancing a focus on the collective global membership and regional implementation support.
- Expanding industry leadership by **building technical sustainability capabilities of members.**
- **Enhanced engagement with financial regulators** to strengthen sustainable finance industry positioning and relevance. This includes collaborating to create common approaches and aligning practices to facilitate systemic change throughout the sector.

UNEP FI is continuing to scale and strengthen action on sustainability throughout the financial sector.

UNEP FI Partnership: Questions for consideration:

- **i.** What would be most useful support from UNEP FI in order to deepen and widen your strategic integration of ESG and sustainability considerations across your business ?
- **ii.** How can UNEP FI help you to accelerate action on sustainable finance within your region and sector and help create an enabling environment across the financial system?
- **iii.** Are there any extra areas of engagement where further action is warranted?

UN environment programme

finance initiative

United Nations Environment Programme Finance Initiative (UNEP FI) is a partnership between UNEP and the global financial sector to mobilize private sector finance for sustainable development. UNEP FI works with more than 400 members—banks, insurers, and investors—and over 100 supporting institutions– to help create a financial sector that serves people and planet while delivering positive impacts. We aim to inspire, inform and enable financial institutions to improve people's quality of life without compromising that of future generations. By leveraging the UN's role, UNEP FI accelerates sustainable finance.

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