Green Transitions Guidance Note
Sustainable Finance

IBC Training Programme on Green Transitions

The United Nations Issue-based Coalition (IBC) on Environment and Climate Change for Europe and Central Asia

Prepared by: UNEP and UNDP

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Executive summary

This guidance note focuses on the role of finance in green transition and presents selected UN approaches to promoting sustainable finance and to supporting strategies at the national level. By taking environmental, social and governance considerations into account when making investment decisions in the financial sector, countries can steer development towards the goals of the 2030 Agenda and the Paris Agreement. In addition to public steering and investments, green transition requires a major mobilization of private sector investments. The UN Country teams (UNCT) can help to increase sustainable finance by engaging with ministries of finance, banks, insurers and business associations as well as civil society organizations interested in promoting the green transition.

The United Nations Environment Programme Finance Initiative (UNEP FI) is a partnership between the United Nations and the Global Finance Sector, catalyzing action across the financial system to align economies with sustainable development. UNEP FI helps financial institutions to develop practical approaches to setting and implementing targets in areas including greenhouse gas emissions, nature, sustainable consumption and production, and financial inclusion to address inequality. The solutions developed effectively establish industry norms and provide a blueprint for the finance sector to tackle global challenges and set strategies and operations on a sustainable pathway. UNEP FI also informs policymakers of the enabling environment needed to mainstream sustainable finance. UNEP FI works across three key industry areas: Banking, Insurance and Investment and thematic approaches.

The United Nations Development Programme (UNDP) supports countries in designing a sustainable finance architecture that is deliberately designed to i) accelerate investments in the SDGs, and ii) account for its progress to a broader range of actors. UNDP focuses its sustainable finance interventions in four interlinked areas; Public Finance for the SDGs, Unlocking Private Capital and aligning business operations for the SDGs, SDG Impact Management and Finance Tracking and Integrated National Financing Frameworks. UNDP has developed various supporting materials on sustainable finance that are briefly presented in this guidance note.

The finance industry increasingly needs harmonized and sound policies that ensure clarity of direction, facilitate a just transition in key economic sectors, support the realization of voluntary commitments and help prevent greenwashing and related reputational risks. Regulatory frameworks on sustainable finance take different shapes, the most common containing different aspects, underpinned by common definitions, disclosures and risk management rules. This guidance note presents different international examples of taxonomies, disclosures and prudential rules.

Background and Context for Green Transitions

The green transition is key to safeguarding our planet's future allowing us to turn the fossil-fuel dependent economy to a green economy, in a new sustainable paradigm that drives sustainable development and peace. It is an integral part of the 2030 Agenda and directly contributes to the achievement of most of the SDG targets. The Ukraine crisis has seriously affected the Europe and Central Asia region including exacerbating the energy crisis, increased pollutants, biodiversity loss and climate change. During this time, it is important to support member states of the region to turn environmental and climate challenges into opportunities and to make the Green Transition just and inclusive for all. The success of this transition depends on strong regional coordination, involving local authorities, state-owned enterprises, the private sector, civil society, research and education institutions, youth, the financial sector, and the development community.

In response to the request by Resident Coordinators, UN Country Teams and the Development Coordination Office, the Issue Based Coalition on Environment and Climate Change for Europe and Central Asia (IBC) offers the **Green Transition Training Programme** dedicated to RCOs and UN Country Teams in Europe and Central Asia. The Green Transition Training Programme further builds countries' capacities to design strategies and action plans for green transition. The content is based on the expertise and resources among the IBC members. The work is led by UNDP, UNECE, UNEP and UNESCO and facilitated by IISD, with contributions from the other IBC organizations and external experts.

The IBC Green Transitions Training Programme offers five webinars led by different agencies depending on capacity from September to November, with most having both a thematic and a sub-regional focus. The main themes, identified through various consultations with the RCOs and UNCTs, are: (1) Sustainable Finance; (2) Energy; (3) Circular Economy; (4) Plastics; and (5) Enabling policies and strategic frameworks for Green Transition at the country level.

This Guidance Note was prepared in support of the IBC Green Transitions Training Programme.

The Role of Finance in Green Transitions

Transition towards a green economy requires innovation and investment into employment, economic activities and assets that allow reduced carbon emissions and pollution, enhanced energy and resource efficiency, and prevention of the loss of biodiversity and ecosystem services. To make this happen at the national level, countries need to have an enabling policy framework and incentive structures that guide economic actors and their investment decisions. For a strategic approach to finance green transitions, national finance frameworks and sector finance plans (with principles, instruments and targets) are needed. In addition to public steering and investments, green transition requires a major mobilization of private sector investments.

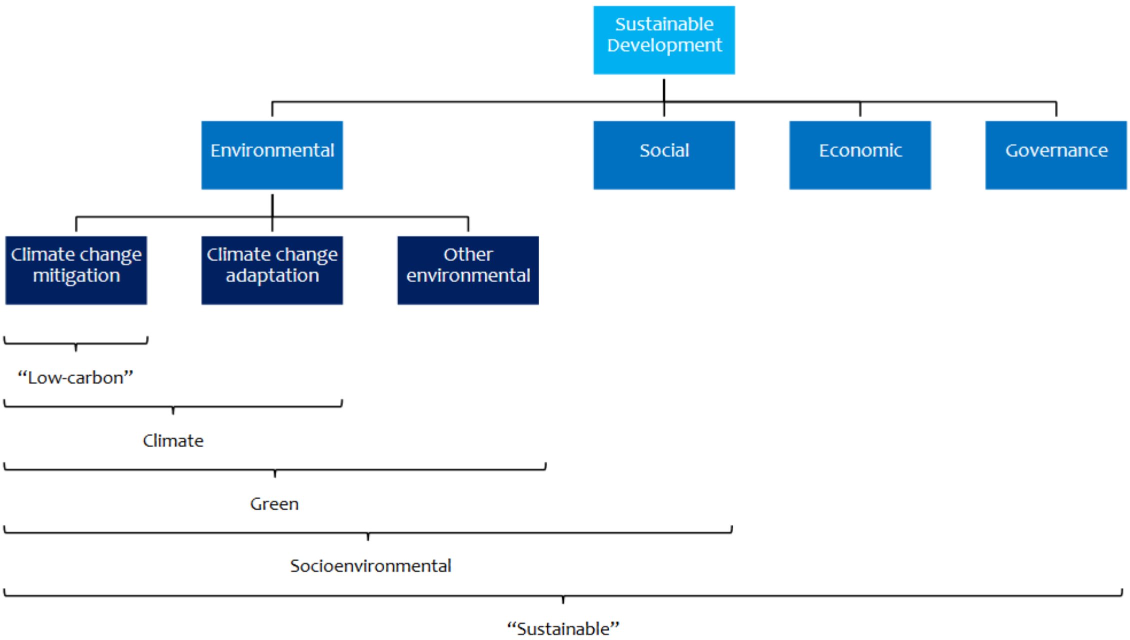
There is increasing recognition that the climate crisis can only be managed and averted through a systemic-scale rechanneling of trillions USD per annum - not billions - of largely private-sector investment and finance, appropriately enabled and incentivized by public finance, across all sectors of the economy. This recognition is captured in the Paris Agreement's Article 2.1.c that commits Governments to ensure that all financing - public and private - becomes consistent with the Agreement's objectives.

This critical mobilization needed to achieve the Paris Agreement Goals inserts itself within the overall need to achieve the SDGs and the Agenda 2030, ensuring that sustainability is integrated as a driving force in economic development, and integration of Environmental, Social and Governance considerations is properly addressed by public and private sector actors.

The UN Country teams (UNCT) are well positioned to support governments in providing leadership and creating enabling policies at both economywide and sectoral levels. The UNCTs can advance sustainable finance by engaging with ministries of finance, banks, insurers and business associations as well as civil society organizations interested in promoting the green transition.

- **What does sustainable finance mean?**

Exhibit 3: A simplified schema for understanding broad terms



Source: UNEP Inquiry - DEFINITIONS AND CONCEPTS - Background Note

Using UNEP Inquiry's framing, departing from the concept of sustainable development (development that meets the needs of the present without compromising the ability of future generations to meet their own needs), four key elements are identified – Environmental, Social and Governance concerns (that conform the ESG concept that has also been commonly attached to sustainable finance) as well as Economic concerns.

As defined by the European Commission: "*Sustainable finance refers to the process of taking **environmental, social and governance (ESG) considerations** into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects.*"

Another usual term utilized is that of "responsible", as reflected in UNEP FI's Principles for **Responsible** Investment and Principles for **Responsible** Banking. Climate finance or green finance, would thus refer to the specific areas of climate change mitigation, adaptation, as well as other environmental objectives (biodiversity, pollution, circular economy…)

This simple typology allows to understand what we mean when we talk about green and sustainable finance, and how green finance is inextricably linked to the broader concept of sustainable development, being a necessary part for further economic development. Thus, finance supports the green transition by enabling financing that supports the relevant environmental goals that will help to achieve the SDGs and the Paris Climate Agreement goals.

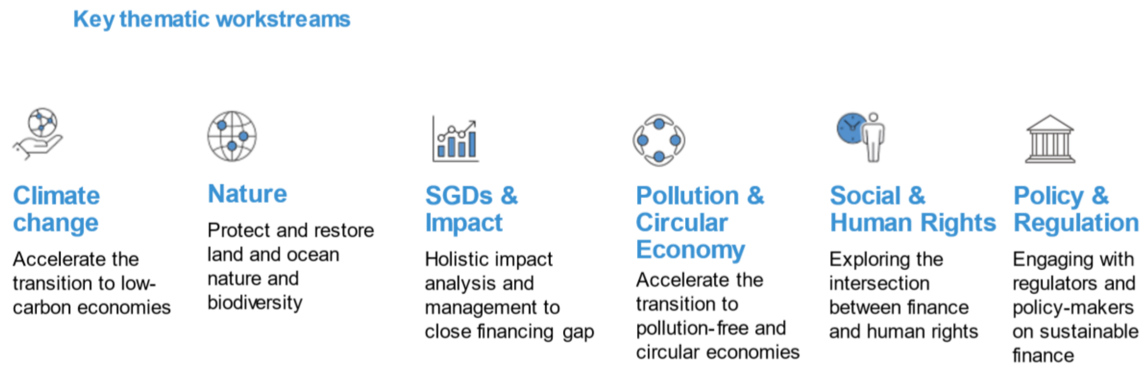
Finance Approaches and Tools for a Green Transition

The United Nations Environment Programme Finance Initiative (UNEP FI) is a partnership between the United Nations and the Global Finance Sector, catalyzing action across the financial system to align economies with sustainable development. Founded in 1992, UNEP was the first organization to engage the finance sector on sustainability. Today, UNEP FI cultivates leadership and advances sustainable market practice with more than 400 financial institutions, with assets of more than US$80 trillion, headquartered in over 85 countries. UNEP FI supports implementation of global programmes at a regional level across Africa & the Middle East, Asia Pacific, Europe, Latin America & the Caribbean and North America.

As the UN network for the finance sector, UNEP FI has established the world's foremost sustainability frameworks within the finance industry to address global environmental, social and governance (ESG) challenges. UNEP FI incubated the Principles for Responsible Investment, now the world's leading proponent on responsible investment, and are facilitating implementation of UNEP FI's Principles for Responsible Banking and Principles for Sustainable Insurance, as well as the UN-convened net-zero alliances. UNEP FI convenes financial institutions to apply the industry frameworks on a voluntary basis and develop practical guidance and tools to position their businesses for the transition to a sustainable and inclusive economy.

UNEP FI helps financial institutions to develop practical approaches to setting and implementing targets in areas including greenhouse gas emissions, nature, sustainable consumption and production, and financial inclusion to address inequality. The solutions developed effectively establish industry norms and provide a blueprint for the finance sector to tackle global challenges and set strategies and operations on a sustainable pathway. UNEP FI also informs policymakers of the enabling environment needed to mainstream sustainable finance.

UNEP FI as such works across three key industry areas: Banking, Insurance and Investment and thematic approaches:



UNEP FI presence in the Europe region

UNEP FI as a global membership-based organization, is as present in different regions as there are members in it. This regional dimension is managed across the industry and thematic approaches identified above by a network of Regional coordinators (located in North and South America, Europe, MENA and Sub-Saharan Africa, and Asia-Pacific regions), who work with UN RCOs and regional offices of relevant actors as well as with relevant partners and supporting institutions that can enable further membership growth and uptake of UNEP FI principles (Industry Associations, academic institutions, banking training centers, etc.).

Europe is by far the region where most members of UNEP FI are located, but with notable differences across subregions. As of 10 August 2022, UNEP FI counts a total of 496 members, with 272 located in Europe. Almost 55% of our membership is located on the continent.

Europe strategy interacting with global goals

To deal with such a massive membership and be able to deliver a relevant level of attention to all regions, UNEP-FI's European strategy has prioritized the following actions:

- Engaging with EU regulators – especially for testing and developing approaches to implement the regulation and to align global and regional approaches
- Expanding membership in Eastern Europe, Balkans, Caucasus and Central Asia
- Engaging with supporting institutions and partners in the region to expand our presence and impact especially in priority regions.

Regarding the efforts of UNDP, some of the priorities include:

- Country office presence in Europe/CIS region
- Policy and programming

- Large portfolio of climate finance projects to build on, combining policy aspects with project implementation
- Support to issuance of themed bonds and debt-nature swaps
- BioFin programme

Risk & Alignment – Portfolio approaches

Industry-based principles

UNEP FI supports global finance sector principles to catalyze integration of sustainability into financial market practice. The frameworks UNEP FI has established or co-created include:

- Principles for Responsible Banking (PRB), launched in September 2019 and now signed by some 300 banks representing over 45% of global banking assets. Signatories are working to align their strategies and practice with the vision society has set out for its future in the Sustainable Development Goals and the Paris Climate Agreement, and relevant national and regional frameworks.

- Principles for Sustainable Insurance (PSI), established 2012 by UNEP FI and today applied by one-quarter of the world's insurers (25% of world premium). The PSI has developed industry guidance on integrating ESG risks in non-life and life & health insurance businesses.

- Principles for Responsible Investment (PRI), established in 2006 by UNEP FI and the UN Global Compact, and applied by half the world's institutional investors (USD 83 trillion) by 2022. We now operate the Investment Leadership Programme together with the PRI, to catalyse trail-blazing cross-industry and investment initiatives to inform the wider responsible investment agenda.

These frameworks establish the norms for sustainable finance, providing the basis for standard-setting and helping to ensure private finance fulfils its potential role in contributing to achieving the 2030 Agenda for Sustainable Development and Paris Agreement on Climate Change agreed by governments around the world in 2015.

In-depth thematic research, guidance and communities of practice – Climate change focus

UNEP FI convenes financial institutions to advance knowledge and practice in areas including climate, nature, pollution and circular economy, the SDGs & impact and social issues.

UNEP FI has a long-standing programme on climate change, which has accelerated action to contribute to achieving the goals of the UN Paris Agreement. Aligning all public and private financing with pathways to net-zero by 2050 is critical to limit the average global temperature rise to 1.5°C above pre-industrial levels by 2100.

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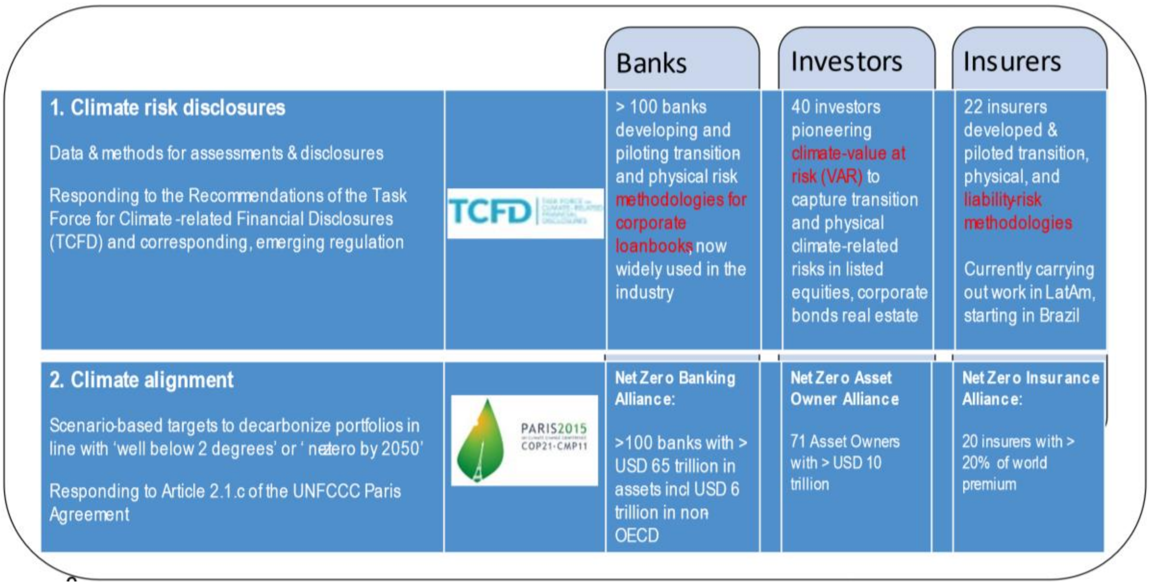

		Banks	Investors	Insurers
1. Climate risk disclosures Data & methods for assessments & disclosures Responding to the Recommendations of the Task Force for Climate-related Financial Disclosures (TCFD) and corresponding, emerging regulation	TCFD	> 100 banks developing and piloting transition and physical risk methodologies for corporate loanbooks now widely used in the industry	40 investors pioneering climate-value at risk (VAR) to capture transition and physical climate-related risks in listed equities, corporate bonds real estate	22 insurers developed & piloted transition, physical, and liability-risk methodologies Currently carrying out work in LatAm, starting in Brazil
2. Climate alignment Scenario-based targets to decarbonize portfolios in line with 'well below 2 degrees' or 'net-zero by 2050' Responding to Article 2.1.c of the UNFCCC Paris Agreement	PARIS2015 COP21·CMP11	Net Zero Banking Alliance: >100 banks with > USD 65 trillion in assets incl USD 6 trillion in non OECD	Net Zero Asset Owner Alliance 71 Asset Owners with > USD 10 trillion	Net Zero Insurance Alliance: 20 insurers with > 20% of world premium

UNEP FI convenes three finance sector 'net-zero' alliances, and is working with key stakeholders to help members align portfolios with science-based greenhouse gas emissions pathways through interim targets:

1. Net-Zero Asset Owner Alliance ('AOA'), launched in 2019, now signed by more than 70 institutional asset owners (pension funds, insurers, sovereign wealth funds) with over USD 10 trillion in assets, about 7% of global investment.

2. Net Zero Banking Alliance ('NZBA'), launched in 2021 with over 100 banks and USD 65 trillion, about half of global banking industry assets. The majority of NZBA members are PRB signatories that are setting ambitious climate targets.

3. Net-Zero Insurance Alliance ('NZIA'), launched in 2021, convening 25 leading insurers representing about 12% of world premium, working together to establish the transition to net-zero insurance.

The Alliances form the asset owner, banking and insurance elements of the Global Financial Alliance for Net-Zero (GFANZ) and are accredited by the UN-backed Race to Zero.

UNEP FI's logic and approach

This work on alignment, is not undertaken at the level of individual financial transactions but at the level of the financial institution in its entirety, as a corporate entity, with the objective to help equip them with all they need to transition their portfolios into alignment with the Paris Agreement.

What a financial institution (FI) needs for that is the following:

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1. A **strong**, **credible, formal and explicit commitment** that it makes publicly, that is at the appropriate level of ambition (as provided by the Paris Agreement), that has the appropriate scope (the full portfolio), and that includes key transparency and accountability parameters.

For each of the Alliances the formal commitment document can be retrieved as follows:

Net-Zero Asset Owner Alliance	Net-Zero Banking Alliance	Net-Zero Insurance Alliance

2. A **strong internal mandate**, with the formal commitment signed by the CEO and implementation preferably driven from the C-suite (e.g. Chief Investment Officer for AOA).

3. **Guidelines** that operationalize committed level of ambition into 'executable' organizational strategies, including decisions, milestones, tangible targets and concrete measures

Near-term targets ensure that the ambition is appropriately operationalized by members. These are based on specific guidelines, agreed Alliance-wide and consulted on by a wide range of stakeholders. They are publicly available, as follows:

Net-Zero Asset Owner Alliance's Target Setting Protocol	Net-Zero Banking Alliance – UNEP FI Guidelines for Target-Setting by Banks	Net-Zero Insurance Alliance – *Guidelines currently under development*

4. **Robust reporting and monitoring framework** that is publicly recognized, well governed and ensures accountability over time – such reporting is a key requirement in each alliance.

5. **Collective platforms of likeminded and equally committed FI peers**, through which relevant stakeholders can be engaged, systemic topics addressed, and key agendas advanced

For the approach to work across regions, UNEP FI aims at need to increasing its membership and community of FIs, so they can commit to the UNEP Principles, join the Alliances and start their journey in managing their risks, assessing their impacts and setting targets to achieve the SDGs and Paris Climate Agreement. For more information on how to achieve these objectives, see Part 2 on strategic and programmatic guidance.

Financial Products & Market Approaches – Specific instruments to promote sustainable finance in Europe and CIS region

UNDP has been supporting countries in integrating climate and green agenda into financing systems for a long time. Starting with the Asia-Pacific region for climate and environment related finance, the process then gradually expanded to cover a more comprehensive sustainable finance agenda, including in our region.

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The challenges with sustainable finance in Europe and CIS region (and other regions too) are not solely in the lack of finance but more on the financing architecture overall. Since Paris, the financial institutions and governments have continued investing and subsidizing in fossil fuels at very large scales. Foreign direct investments continue to flow predominantly into the developed countries. And this is at the time of an increased pressure on the SDG agenda progress due to the pandemic, conflicts and economic/energy crises. Hence, the supply of the existing finance mismatches with the needs/demand in both its targeting and the geography.

UNDP supports countries in addressing these issues in a systematic manner. And while governments may opt for deploying individual sustainable finance tools (primarily in the public sector domain), the solution is in designing a sustainable finance architecture that is deliberately designed to i) accelerate investments in the SDGs, and ii) account for its progress to a broader range of actors.

As such, UNDP focuses its sustainable finance interventions in four distinct, but very much interlinked service offers:

- Public Finance for the SDGs
- Unlocking Private Capital and aligning business operations for the SDGs
- SDG Impact Management and Finance Tracking
- Integrated National Financing Frameworks (INFF)

When landing those service offers onto the green/climate areas, the choice of the most effective interventions mix depends on the objectives that countries pursue. As per the illustrative table below, the objectives of deploying a specific mix of climate/green finance tools may vary from country to country. Some countries may prefer to focus on revealing the situation on how much they spend on climate mitigation and/or adaptation, while others may opt for a wider range of objectives and address both the information reveal and then follow-up actions on improving financing decision-making process and doing that in a systematic way by integrating the climate agenda into the existing governance, planning, budgeting and monitoring and evaluation systems and business processes.

Objective	Tool
UNDERSTAND HOW MUCH GOVERNMENT SPENDS ON CC	▪ CPEIR (Climate Public Expenditure and Institutional Reviews)
MAKE CC FINANCE VISIBLE IN BUDGETS	▪ CC budget tagging ▪ Budget annex on CC allocations ▪ CC Citizen's Budget
MOBILIZE AND ALIGN MORE RESOURCES FOR CC	▪ CC criteria as an additional weight in project prioritization process ▪ Engage with the Parliament on CC budget scrutiny ▪ Green Bonds

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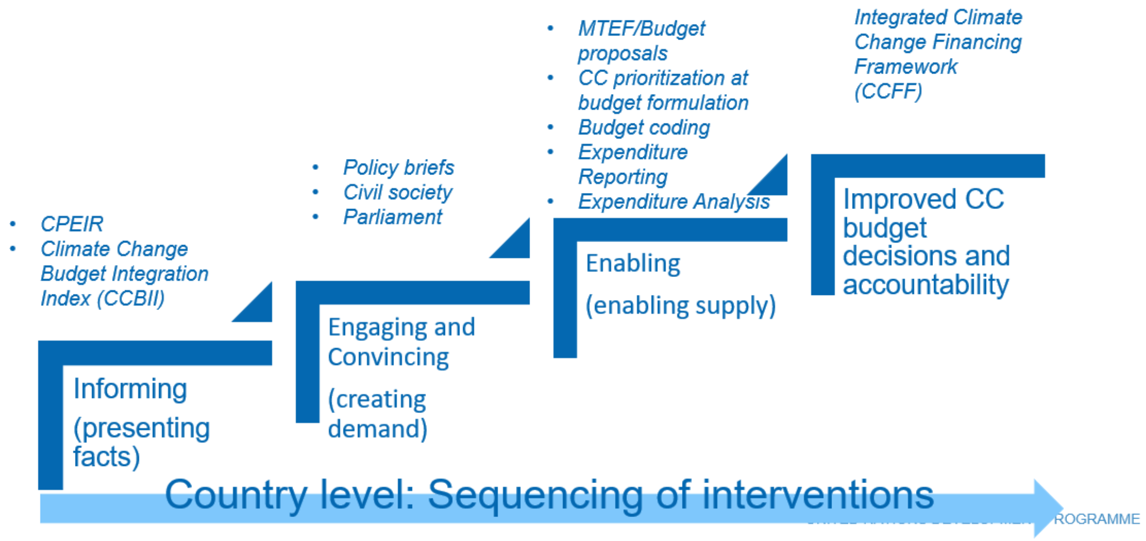
INCREASE ACCOUNTABILITY FOR BUDGET SPENDING ON CC	▪ CC budget reporting ▪ Collaborative research on CC expenditures (CSOs)
BRIDGING CC PLANNING WITH REGULAR BUDGETING PROCESSES	▪ CC Financing Framework integrated into Medium-Term Expenditure Framework and budget templates of a government ▪ Climate Change Budget Integration Index (CCBII)

Ideally, when designing the sequence of interventions and support to the countries by UNDP, the experts would follow the natural sequence of evolution of the relevant tools, i.e., starting with informing, engaging, enabling and then systemically moving to action, as illustrated below. As said above, some countries may choose to deploy a specific tool (e.g., on budget tagging) without necessarily considering the capacity and demand factors that exist (or may not exist) in the country – hence, significant efforts and investments deployed with suboptimal results achieved.



More details on the above toolkit are presented at the designated knowledge website for climate finance initiatives at www.cfade.org.

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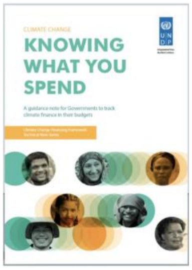
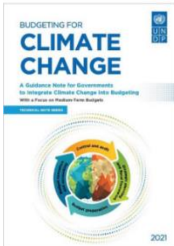
<u>Supporting Guidance Notes</u>

UNDP has recently developed a series of supporting materials on sustainable finance and few selected ones are presented below:

- Knowing What you Spent
  This guidance note is intended for government agencies responsible for climate finance within Ministries of Finance, Ministries of Planning, or climate change policy making bodies (e.g., Climate Change Commissions, Ministry of Climate Change, Ministry of Environment and Forests etc.) that wish to set up a Climate Budget Tagging (CBT) system or strengthen an existing one. The note focuses on the design of a CBT system that is grounded in government financial management and, as such, covers public sector expenditure – while acknowledging that a significant portion of climate relevant spending occurs in the private sector and non-governmental organizations.



- Budgeting for Climate Change: A Guidance Note for Governments to Integrate Climate Change into Budgeting
  The Guidance Note:
  - Provides a step-by-step approach to integrating climate change into the budget preparation and approval stage, in line with public finance management (PFM) principles.
  - Suggests possible interventions at each sub-stage for different sets of stakeholders.
  - Provides supplementary information on relevant tools and case studies of various countries.
  - Outlines principles that are responsive to the gradual strengthening of PFM reforms across the different stages of the budget cycle.



- UNDP Guidebook on Budgeting for SDGs - , and its subsequent deep dives into specific areas – the Modular Handbook.
  The primary focus of this Note is in supporting the improvement of public expenditure effectiveness, efficiency, and equity pattern in delivering the SDGs. UNDP Finance Sector Hub has also developed various methodology tools and service offers addressing other aspects of Financing for SDGs, including on budget revenues and debt instruments, aligning with and unlocking private sector financing for SDGs, Integrated National Financing Frameworks, impact measurement, etc.
  B4SDG solutions may vary in their nature and are short-term and long-term in their reforms path. Some tools can be applied in isolation from others, others need an orchestrated effort throughout the whole Agenda-2030 timeframe. The paper discusses a range of challenges and building blocks to address those challenges and tries to filter down the number of options to four basic models of budgeting for SDGs presented in the Note. The primary

audience of this paper are UN agencies that support countries in mainstreaming the SDGs into national policy formulation, strategic and annual planning, budgeting, monitoring, reporting and evaluation processes. This paper can also be used as guidance for designing the budgeting component of various programmes, projects and interventions.

Sustainable Finance Regulation. Focus on Taxonomies, disclosures and prudential regulation

Global private finance interest for sustainable finance has grown considerably in recent years. The success of market-based, voluntary initiatives such as the PRI, PRB, PSI, the net-zero global alliances suggest the private finance industry is committed to making a substantial contribution and to driving the low-carbon and sustainability transition in the real economy.

Similarly, policy and regulatory frameworks increasingly play a key role in supporting the finance industry to meet these targets as well as reducing exposure to sustainability-related risks (i.e., double materiality). The UNEP Green Finance Measures Database registers over 680 sustainable finance policy measures from 100 countries.

In addition to key actions undertaken to adjust the way financial institutions manage their risks, impacts and set targets, regulatory action is also a necessary tool to curb behavior, and make sense at jurisdictional level of the key measures needed to foster the transition to a more sustainable economy. In that respect, sustainable finance can be seen as a situation where the market has imperfect information and there are no clear short-term incentives to act. To bridge this, usual measures go in the direction of defining sustainability, clarifying risks and opportunities, bringing more data and information to the market, introducing risk regulation, defining roles and responsibilities at the FI level, as well as promotional policies looking at evolving the debate and opportunities in the market.

The finance industry increasingly needs harmonized and sound policies that ensure clarity of direction, facilitate a just transition in key economic sectors, support the realization of voluntary commitments and help prevent reputational risks/fight greenwashing.

Regulatory frameworks on sustainable finance take different shapes, the most common containing different aspects, underpinned by common definitions, disclosures and risk management rules.

By using EU and international examples we will briefly examine:

- Taxonomies
- Disclosures
- Prudential rules

By financial regulation we mean:
Integration of sustainability considerations across financial regulatory frameworks*. :
1.Disclosures of institutions, activities, products, instruments;
2.Governance, duties and processes of institutions, activities, products, instruments. Including for both risk and impact management of sustainability issues;
3.Taxonomies, standards, tools;
4.Financial system stability and risk mitigation mechanisms (macroprud).

Supported by adequate supervisory frameworks to ensure enforcement, compliance and fight greenwashing.
Entities in scope of financial regulation can include (varies across jurisdictions):
•Non-financial corporates
•Banking, investment services and activities
•Insurance
•Pensions providers (and/or under labour regulation)

- **Taxonomies**

As the BCBS has identified in their paper "A taxonomy of sustainable finance taxonomies":

"A taxonomy for sustainable finance is a set of criteria which can form the basis for an evaluation of whether and to what extent a financial asset can support given sustainability goals. Its purpose is to provide a strong signal to investors, and other stakeholders, and assist their decision making – by identifying the type of information investors need to assess the sustainability benefits of an asset and to classify an asset based on its support for given sustainability goals.

Currently many taxonomies exist, and others are still under development

- **Deep dive on EU Taxonomy**

The EU Taxonomy is the most developed Taxonomy globally.

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Overview of the framework

The EU taxonomy Regulation (2020/852) is the cornerstone of the EU Sustainable Finance agenda. It is a classification system that identifies activities that can be considered environmentally sustainable against the EU climate goals of reaching a 55% GHG reduction by 2030 and climate neutrality by 2050 while ensuring that the transition is just and fair as enshrined in the EU Climate Law.

Who is concerned by the framework?

Under the EU Taxonomy regulation, there are disclosure obligations for three key users: three key user obligations of disclosure (1) Financial market participants, (2) Large companies, and (3) The EU and Member states as shown below.

Mandatory disclosures: The Taxonomy Regulation mandates three user obligations:

Financial market participants
Offering financial products in the EU, including occupational pension providers
Article 5 – Article 7

- How and to what extent the Taxonomy was used in determining the sustainability of the underlying investments;
- To what environmental objective(s) the investments contribute; and
- The proportion of underlying investments that are Taxonomy-aligned, as a percentage of the investment, fund or portfolio.

Large companies
Who are already required to provide a non-financial statement under the Non-Financial Reporting Directive
Article 8

- The proportion of turnover aligned with the EU taxonomy;
- CAPEX and OPEX aligned with the EU taxonomy.
- This requirement includes FI's portfolios, with specific KPIs based on their financing of the abovementioned activities

→KPIs established in the Article 8 Disclosures Delegated Act

The EU and Member States
Article 4

When setting out measures on standards or labels for green financial products or green (corporate) bonds

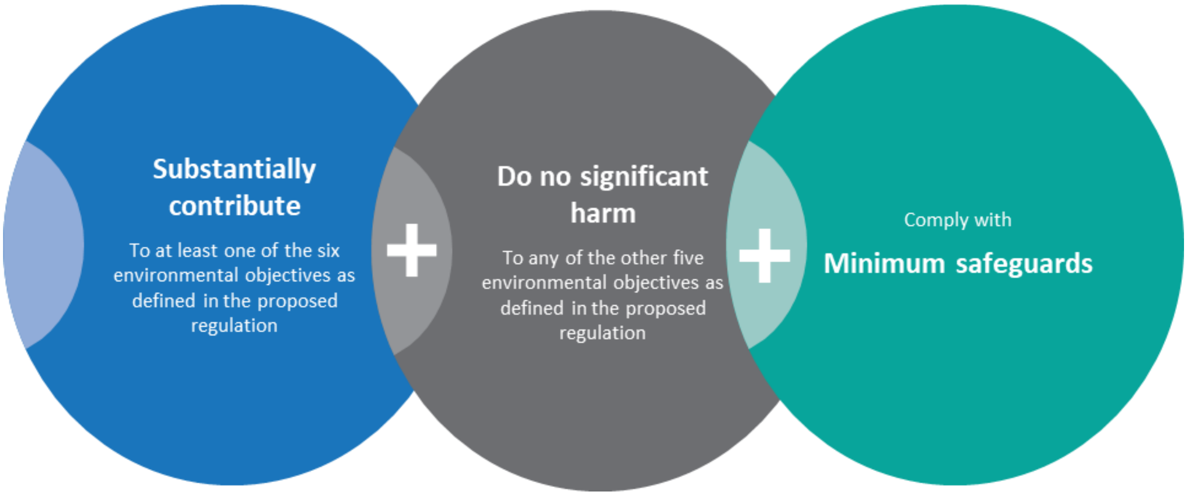
What are the key pillars/principles/criteria in the framework?

Not all economic activities undertaken in the EU Economy (the total economic activities) are defined under the EU Taxonomy. Only a subset of those is defined (taxonomy-eligible), and only those that comply with the three requirements below are considered environmentally sustainable (taxonomy-aligned).

The EU Taxonomy Regulation sets three broad requirements for an activity to be aligned, and thus environmentally sustainable:

1. Substantially contribute (SC) to at least one of the six environmental objectives as defined in the Climate Delegated Act

2. Do no significant harm (DNSH) to any of the other five environmental objectives as defined in the Climate Delegated Act
3. Comply with Minimum safeguards (MS) as defined in Article 18 of Regulation 2020/852



The six environmental objectives for the identification of SC and DNSH are following:

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable and protection of water and marine resources
4. Transition to a circular economy
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems

For now, SC and& DNSH criteria have been only defined for Climate Change Mitigation and Adaptation. Minimum Safeguards: Article 18 of the EU Taxonomy Regulation stipulates that, to comply with them, procedures shall be implemented by an undertaking carrying out an economic activity to ensure the alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the ILO Declaration on Fundamental Principles and Rights at Work and the International Bill of Human Rights.

As a result, economic activities can be classified into three categories under the taxonomy: (1) Eligible and Taxonomy-aligned activities, (2) Eligible but not Taxonomy-aligned activities, and (3) non-eligible activities.

- **Lessons learned and how to expand**

In February 2022, UNEP FI together with the European Banking Federation (EBF), published a report on the application of the EU Taxonomy in bank lending.

This project allowed to how banks are able to comply with the disclosure requirements, collecting relevant data with regards to client engagement, as well as making sense of the other extra, voluntary uses that could come attached.

Taxonomies are critical elements of an appropriate financial regulatory landscape, enabling clarity in the market to understand which products can be considered as sustainable and being a catalyst for transparency and a common language useful for disclosures.

UNEP in LAC, together with UNDP and other partners have kicked off a working group on the development of a common ground for taxonomies in the region.

- **Disclosures and standards.**

Sustainability disclosures to date either address entities (e.g., disclosure guideline for listed companies), financial products (e.g., disclosure requirements for sustainable retail investment products) or both (e.g., institutional investors must report on the entity and on the product level). Entities are non-financial corporates, banks, asset managers, and institutional investors and financial advisers. Financial products can be funds, bonds, loans, and others, whereas financial services are financial advice or discretionary mandates.

To correctly assess, report on and manage the full spectrum of inside-out (i.e., impacts on the environment and people) and outside-in (i.e., climate / environmental risks for entities) arising from ESG factors, comprehensive disclosure requirements at product, investees corporate and investor financier level are needed.

Sustainability disclosures at the company and issuer level is a prerequisite for-related transparency at the financial product or service level. To disclose the sustainability performance of any financial product, for example a retail investment fund, the sustainability performance and financial performance related to sustainability / ESG-factors of the firms of the underlying investment universe needs to be known. This requires meaningful and comparable information at the company and issuer level. If a financial institution is to disclose its own sustainability risk and/or impacts, the financial firm needs to know the impacts and risks of the projects it finances, of the underlying entities of the financial products it sells, and of the firms it invests in.

Currently we have seen an increased relevance at the global level of disclosure regimes, with critical evolutions happening as well in Europe and the US:

- The EU Taxonomy is a disclosure regime as we have seen previously
- The International Sustainability Standards Board (ISSB) – part of IFRS has released their initial Exposure Drafts on Sustainability reporting and climate-related reporting
- At EU level, EFRAG released 13 Exposure Drafts covering general and climate topics, but also all other elements relating to E, S and G – this is an update to the CSRD that requires large companies to disclose sustainability data
- CSDD will work on further disclosures as well on due diligence, value chains and related elements
- Pillar 3 disclosures (prudential approach) – disclosing transition and physical risks
- The US SEC released their climate disclosure rules, bringing the need to report not only on outside risks but also GHG emissions.

- SFDR (EU) – disclosures at product level for retail financial products

All of these disclosures need to be underpinned by robust data collection for availability and usability.

- **Prudential / risk regulation – the role of Central Banks and financial regulators**

Prudential regulators are a key pillar for financial stability worldwide, ensuring that financial institutions under their supervision are behaving responsibly. In recent years, their responsibilities have also expanded, with global initiatives such as the Network for Greening the Financial System, and relevant papers published by the BIS & BCBS showcasing the importance to manage and consider ESG risks (especially climate risks) in their activities.

Their toolbox is quite varied, being able to act upon different streams and activities of the FIs they regulate:

- Pillar 1 measures. Regulators can impose penalizing or supporting factors into the Basel capital requirements on how banks manage their portfolios
- Pillar 2 measures. Regulators can monitor how FIs are performing and how sound their business model is to tackle ESG risks, adjusting capital requirements as necessary if risks are identified.
- Pillar 3 disclosures. Requiring banks to disclose how their portfolio is prepare to withstand outside climate risks, as well as how well it is adjusted to finance more sustainable assets.
- Stress testing is an increasingly utilized tool, that benefits from being known on the financial front by the supervised institutions, as well as being a good way for institutions to plan ahead and manage risks actively.
- In addition, central banks can also incorporate sustainability considerations in monetary policy and their own operations

Financial regulation is a key aspect for a well-functioning Sustainable Finance framework in a country, given the necessary connections between public and private actors it generates, and the possibilities of interaction it brings. Collaboration with financial regulators (MoF, Central Bank), can be an enabling entry point for this further engagement.

References

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UNEP FI Principles For Responsible Banking

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UNEP FI /EBF report - Practical approaches to applying the EU Taxonomy to bank lending.

EU Taxonomy Regulation - Regulation (EU) 2020/852 (Taxonomy) / Implementing and delegated acts for The EU Taxonomy Regulation / EU Taxonomy Compass

EBA Draft Final ITS and annexes included in the EBA's Pillar 3 disclosures on ESG risks site:

EU Platform Draft report by the Platform on Sustainable Finance on an extended taxonomy to support economic transition

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Info www.unece.org/runcwelcome/issue-based-coalitions/environment-and-climate-change.html
Email Regional.Bureau-SC@unesco.org