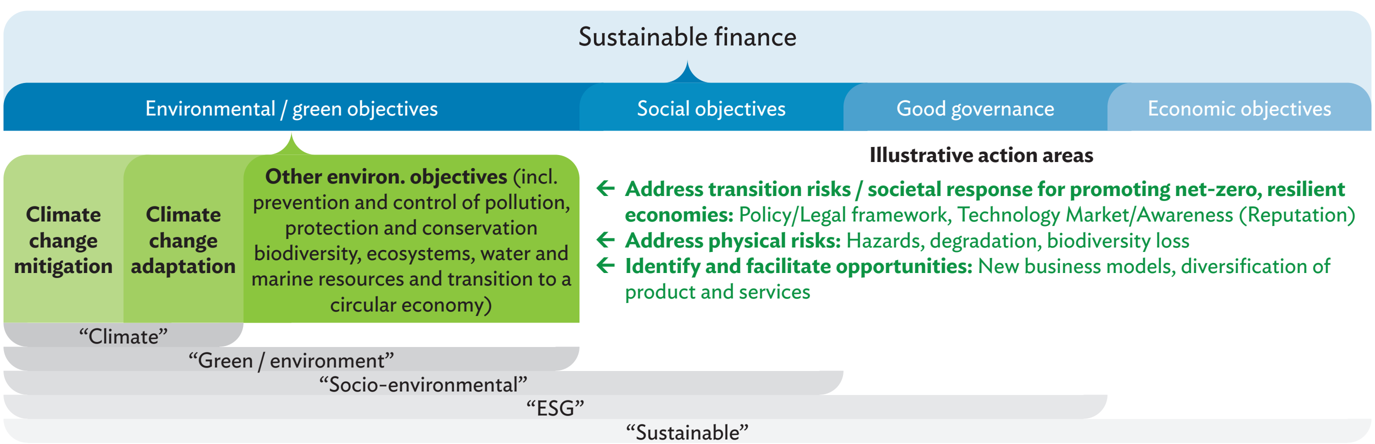
SUSTAINABLE FINANCE Q&A FOR FINANCIAL INSTITUTIONS

What is sustainable finance?

Sustainable finance encompasses the integration of environmental, social, and governance (ESG) considerations into financial services and investment decisions. Environmental finance comprises climate objectives and/or other environmental objectives like conservation of biodiversity.

Which dimensions and categories comprise sustainable finance?

The concept of sustainable finance comes with various dimensions – gradually mirrored in national frameworks (taxonomies) for transitioning to resilient and net-zero economies.



(Adapted from UNEP, 2016 Inquiry into the Design of a Sustainable Financial System, DEFINITIONS AND CONCEPTS Background Note)

Which elements of the Paris Agreement and Global Biodiversity Framework are most significant for financial institutions (FIs)?

The **Paris Agreement**, adopted at the UN Climate Change Conference COP 21 in Paris in December 2015, is an international treaty with the goal of "holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels". For this to be possible, greenhouse gas (GHG) emissions must decline 43% by 2030.

The Paris Agreement promotes climate change mitigation as well as adaptation and includes national pledges to meet these aims. Each country produces a nationally determined contribution (NDC), which must be submitted at a maximum of five-yearly intervals.

For financial institutions, one of the important elements of this Agreement is Article 2.1(c). It seeks **to align all finance flows** with low-emission, climate-resilient development pathways.

The **Kunming-Montreal Global Biodiversity Framework (GBF)** adopted at COP15 to the UN Convention on Biological Diversity in December 2022 has set four goals for 2050, with a focus on ecosystem and species health, and 23 targets for 2030, to halt and reverse nature loss. Parties committed to establishing national targets and adjusting their National Biodiversity Strategies.

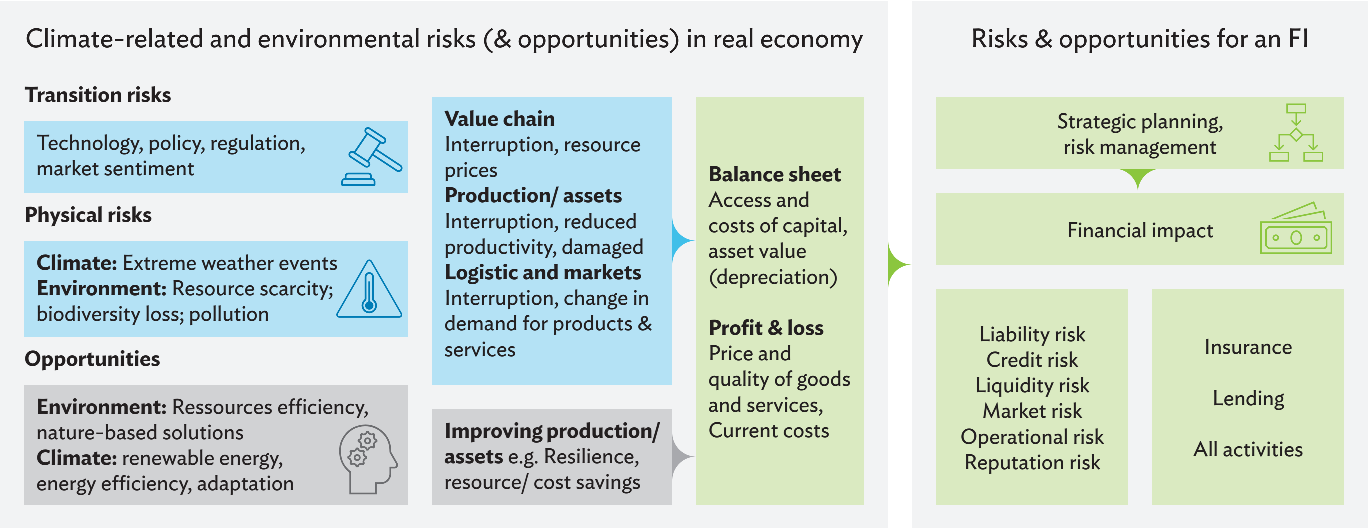
For FIs, one important element is the long-term Goal D. **All financial flows - public and private sector – need to be aligned to deliver the objectives of the GBF**, i.e., reducing negative impacts and supporting nature across economic sectors. Finance should be scaled up for solutions to mitigate biodiversity loss. A sample of a medium-term target is Target 15. It calls for large businesses and **financial institutions to be transparent and to regularly monitor, assess and fully disclose risks, dependencies and impacts on biodiversity** along their operations, value chains and portfolios.

Available frameworks, for instance those provided by the Taskforce on Climate-related Financial Disclosures (TCFD) and the Taskforce on Nature-related Financial Disclosures (TNFD), support the process of strengthening disclosure practices. Providing sustainable finance can enable the necessary investments to reach the objectives of the Paris Agreement and the GBF and contribute to the mitigation and prevention of environmental risks.

Why should financial institutions align with the Paris Agreement and the Global Biodiversity Framework?

Financial institutions are not only materially vulnerable to climate-related events and risks but also nature-related events. They also materially contribute to enabling harmful activities and environmental degradation. They hence must consider both, inward impacts (financially material ESG/climate topics for enterprise value) and outward impacts (material impacts on people, the environment, and the economy)."This is also known as **double materiality**.

These transition and physical risks also present opportunities in areas such as facilitating climate actions (e.g. renewable energy generation, businesses providing climate adaptation solutions), resource efficiency and nature-based solutions.



(Adapted from NGFS and INSPIRE (2022), Central banking and supervision in the biosphere: An agenda for action on biodiversity loss, financial risk and system stability)

How can financial institutions respond to transition and physical risks and opportunities?

Responding to transition and physical risks and opportunities should not be a one-off action point. The assessment and management of risks and opportunities should be incorporated strategically and operationally. This, however, requires strong management commitment. Governance and board functions may set climate and nature-related objectives and ensure that resources and processes enact them. For those steps and operational actions, TCFD recommendations provide guidance.

Transition risks	Board / management	Business areas / Branches / Subsidiaries
Roles and responsibilities should reflect climate-related risks and opportunities	Oversight of the management of climate-related risks and opportunities	Reflect climate-related risks and opportunities when setting strategic targets, implementing processes and when formulating internal and external communication
Strategic role	Approve targets, strategy, and resources, etc.	Adjust risk management and investment processes, measure target achievements according to target agreement, etc.
Operative role	Provide commitments, approve reports, etc.	Apply adjusted risk management and investment processes, ensure consistent data consolidation

How can financial institutions set strategic climate and environment-related targets?

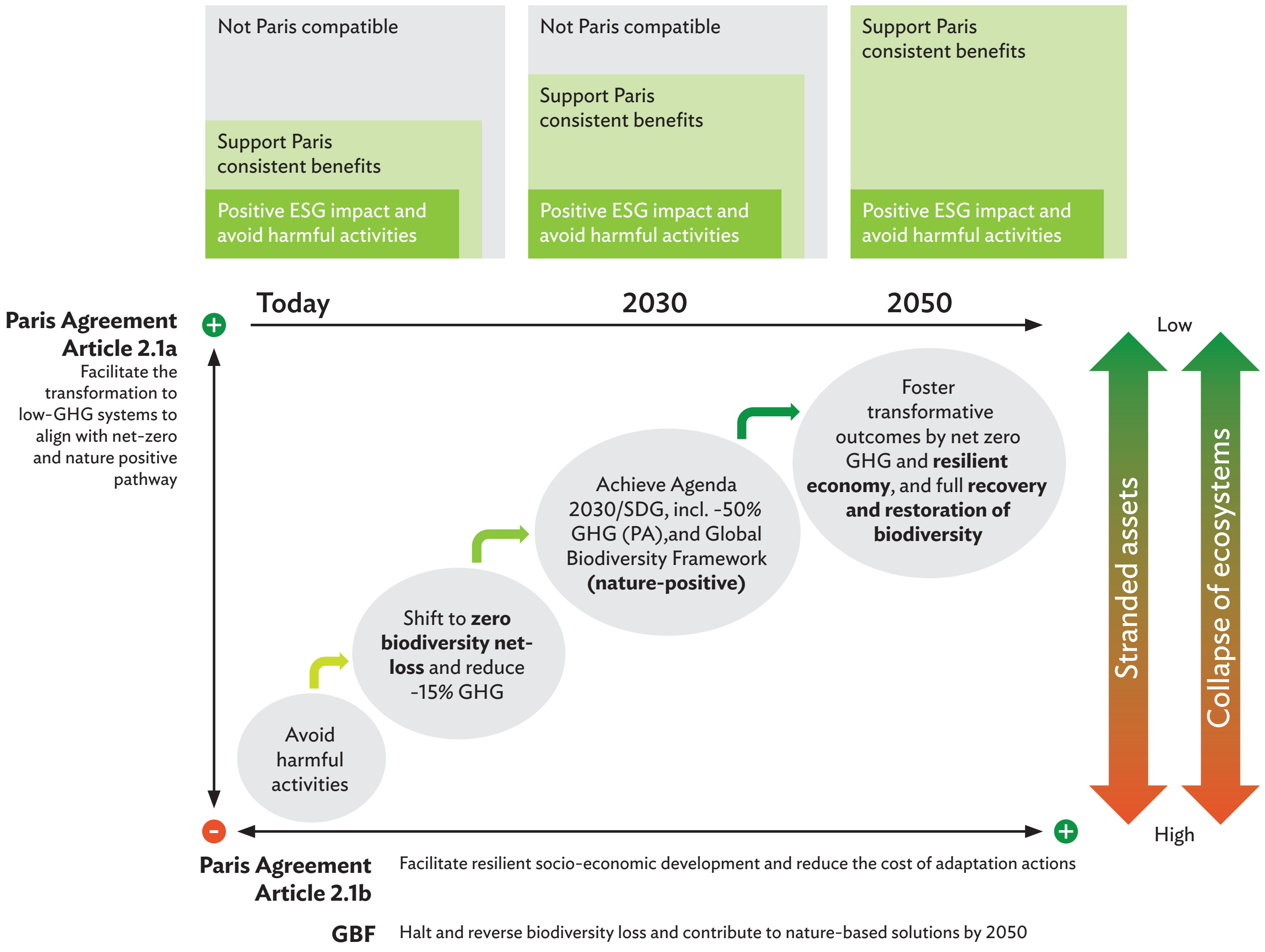
ESG targets, especially net-zero targets, require a rethinking and adjustment of business models along a transition path. Objectives defined in international agreements and priorities emphasized in national policy frameworks (such as climate change strategies and national sustainable finance frameworks) provide orientation.

The following resources can help with taking the next steps and defining climate and nature-related targets:

- **Commitment to sector initiatives** such as UNEP FI's Principles or **sector frameworks** (Partnership for Carbon Accounting Financials (PCAF), TCFD, TNFD, etc.) that provide guidance and **standards that strengthen transparency**, such as the International Financial Reporting Standard (IFRS) S1 for sustainability-related financial information and IFRS S2, for identifying, measuring and disclosing information about climate-related risks and opportunities .
- **Target setting** – for example, using the Science Based Targets-Initiative (SBTi), Science-based Targets for Nature (SBTN)

The **SBTi** for instance, shows financial institutions how much and how quickly they need to reduce their (financed) GHG emissions and set net-zero targets in line with climate science. Over 2,000 organizations worldwide are leading the transition to a net-zero economy by setting emissions reduction targets grounded in climate science through SBTi.

The transition pathway to net-zero emissions is a phased approach, as indicated below. This can be complemented by other environmental objectives, such as strengthening resilience and halting and reversing nature loss.



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If you have further questions, please contact us by email at womenfinx@adb.org or through the contact form on our website.