

Creating A Sustainable Financial System

Introduction

The world is in the middle of a tremendous transition towards sustainability. The pledge to achieve the United Nation (UN)'s [17 Sustainability Development Goals](#) (SDGs) by 2030 is a remarkable marker of where we are in human history. The SDGs require governments and public institutions to [amend political policies and legal frameworks](#). At the same time, businesses must [rethink their practices](#) so that they align with these goals. Various industries are [shifting](#) towards Environmental, Social, and Governance (ESG) based values. In this regard, the [financial industry](#) plays a chief role in driving sustainable economic growth. The finance sector will facilitate an intermediary financial function. Therefore, implementing business models that encompass sustainability in the financial industry is imperative. We must create a sustainable financial system.

A New Sustainable Financial System

Sustainable finance will serve as the fuel to realize the 17 SDGs. Various global [organisations](#), [governments](#), and individual [businesses](#) have made pledges and devised creative schemes to fulfil sustainable financing. Initiatives such as OECD's [Sustainable Lending Recommendation](#), and [COP27's loss and damage fund](#) are pivotal in mobilising funds. They especially help lower income countries. Simultaneously, innovative and [technology](#) based financial instruments like [green bonds, environmental impact bonds, blended finance mechanisms](#), and [debt-for-climate swaps](#) are necessary to overcome difficult hurdles.

Financial companies have [enormous power](#) to direct and influence every other industry through their funding. They exercise this power by investing in sustainable portfolios. They also invest in small businesses that are vital for job creation, and incentivise sustainable firms with favourable rates. Banks are key players. They can fund students and vulnerable groups in society, educate them

on financial literacy, and offer needs-based financial products. These entities can also expand into rural and remote areas to help local communities. Through these various approaches, banks can do their bit by reducing their indirect impact on the planet. More so, they could promote sustainability.



How do we create a sustainable financial system? Source: [Unsplash.com](https://unsplash.com)

sustainable Finance explained

A business model for sustainability is a tool that “helps [in] describing, analysing, managing, and communicating (i) a company’s sustainable value proposition to its customers, and all other stakeholders, (ii) ... creates and delivers this value, (iii) and ... captures economic value while maintaining or regenerating natural, social, and economic capital beyond its organizational boundaries”.

[Schaltegger, Hansen, and Lüdeke-Freund \(2015\)](#)

Sustainable business models in the finance sector need to produce, render and retain economic value, while preserving the natural world. Financial

establishments do have the [power to drive the transition towards the circular economy](#) on a finite planet. These entities should fund purpose led projects such as this. These firms can support their customers to [reduce carbon emissions](#), and aid sustainable entities through [green financing](#). In time this will [attract new customers](#) including financiers. Public interest in sustainable practices is massively [increasing](#), so now is the time for these changes. Moves such as implementing policies that providing ethical working conditions should be carried out by financial companies now.



The most profitable industries on the planet to date are usually those producing the most carbon emissions.

Source: [Pixabay.com](https://pixabay.com)

Despite, the creation of various sustainable financing initiatives to [promote investing into green projects](#), [more financial assets](#) are still needed. The current hurdle is to make sustainable projects that [incentivise investors](#) actually viable. This is pivotal to encourage financiers to back sustainable development that promotes the long-term existence of the planet.

The importance of Creating A Sustainable Financial Sector

The banking industry may have minimal direct negative externalities. However, the projects that they invest into can have a far more substantial impact on the planet ([Yip & Bocken, 2018](#)). The banking industry needs to focus on its indirect consequences. Currently an alarming [49% of financial institutions](#) do not gauge their portfolio footprint.

Considering portfolio risk, due diligence in their evaluations can significantly reduce big banks' exposure to risky unsustainable businesses. The [CPD](#), which is a not-for-profit company that provides an international disclosure platform to report the effect of portfolios on the environment, has studied this concept. According to the CDP, companies have reported that equity investments worth a maximum of [US\\$225 billion](#) are exposed to water scarcity related risks. Industries like [coal, power utilities, oil & gas, and metals & mining](#), are significantly affected by [water scarcity](#). Thus, investments in these sectors are stranded. The only solution is [transparency and disclosure](#) in managing the adversities of water crisis.



Investments with water risks are stranded. Source: [Pixabay.com](https://pixabay.com)

Financial entities are certainly influential, and can lead their associated firms to be transparent in their sustainable practices. This was also proven by the [CPD](#), which revealed that a [substantial increase in response](#) from companies was evident when financial institutions directly engaged with these firms through the CPD's Non-Disclosure Campaign (NDC).

Big Banks

Moreover, Bank of America Merrill Lynch has reported that companies with healthier ESG history were more [financially sound](#), and that this was reflected in their stable share prices. Another study observed similar prospects for banks that [offer green lending](#). It revealed that these banks [gain higher spreads](#) and superior investments with a low risk of default. Big investors are also becoming more conscious about green projects to the extent that they allocated a record [\\$89 billion](#) into sustainable financing in 2019. It is expected that this figure will continue to rise with more [precise data driven analytics](#).

How A Sustainable financial System promotes Societal and Economic Development

Every individual must have access to [basic financial products](#) and have fundamental [financial literacy](#). Banks can play a stewardship role in educating and encouraging needs - based solutions to clients ([Yip & Bocken, 2018](#)). Banks can be instrumental in bolstering this change by reforming systemic structural barriers ([Yip & Bocken, 2018](#)). This empowers social inclusion, and fosters economic upliftment. Credit facilities need to be equitably distributed to encourage self employment and economic development. This can reduce poverty and solve many issues such as [hunger](#), access to education, etc. It is important for a country's financial system to be aligned towards sustainability. If so, it has a [high likelihood of attaining the SDGs](#), according to research.

In a similar vein, a study has examined [big banks' contribution](#) towards achieving the SDGs in Spain. This study showed that the [large Spanish banks](#) with strong capital bases made massive contributions to the SDGs. These banks

prioritised fulfilling SDG8 by providing employment opportunities. Next, they focused on **funding student loans and training programmes** in order to realize SDG4 concerning quality education.



Banks provide employment and financial education to clients, and help them obtain need based solutions.

Source: [Pexels.com](https://www.pexels.com)

Another good example of the positive influence that sustainable financing can have is an innovative investment scheme by Social Finance, which is a not-for-profit organization. This scheme is supported by the **Google Career Certificates Fund** which is worth \$100 million. This program aims to upskill and reskill **20,000 students in the most-in-demand skills** in the current world. Students must **pay back the program fees** only if and when they land a job, and only if that job offers salaries above a minimum amount. The principle behind this project is to **gain over \$1 billion** in total earnings over the next ten years.

Why A Sustainable financial System

Benefits small and medium enterprises

Small and medium enterprises (SMEs) are responsible for an astounding [70% of world employment](#), and are a major source for creating new job opportunities. To support such socially critical entities, some [European value based banks](#) along with the European Investment Fund are offering guarantee schemes to bankroll their activities.

Another aspect related to SMEs involves reducing [Scope 3 emissions](#), which refer to all the indirect carbon emissions in the reporting entity's value chain. On that note, HSBC launched [Sustainable Supply Chain Finance \(SSCF\)](#) in 2019. This scheme motivates Walmart's suppliers to lower their carbon footprint, through [better fund rates](#). Based on these [science based targets](#), all member SMEs as well as HSBC and Walmart see decreases in their Scope 3 emissions. This ultimately supports [global climate action](#).



SMEs account for a stunning 70% of world employment, and need to be financially supported. Source: [Pexels.com](#)

Barriers to Sustainable finance Globally

Bridging the financial gap needed to tackle global sustainability challenges, and the [immobilisation of financial flows](#) to [developing nations](#) are two major threats to achieving the SDGs. There is a shortage of [Internationally recognised financial vehicles](#) to facilitate needed fund arrangements for less developed countries. At the same time, these finances should not exacerbate the debt burden of these states. The OECD has reported that this was indeed the case in [2020](#).

The absence of a [standardised international framework](#) and [viable projects](#) are other factors aggravating the immobilisation of money flows. Risk free finances are also crucial to [cut down the costs](#) related to establishing markets for green products. For instance, regardless of various proposals to use green hydrogen as clean energy, only 10% worth of investments have reached a final investment decision. This shows that sustainable finance is key to reaching the SDGs.

how to ensure global financial sustainability

Digital banking, encouraging needs-based solutions, taking on a stewardship role, and implementing the [social impact virtuous circular model](#) used by value-based banks are a few recommended business models for achieving sustainable finance ([Yip & Bocken, 2018](#)). Similarly, innovative financial tools and mechanisms such as [green bonds, environmental impact bonds, blended finance mechanisms](#), and [debt-for-climate swaps](#) can be effective funding vehicles that can be instrumental in implementing sustainable projects.

Fintech firms can facilitate greater access to sustainable funds through online applications and [platform marketplaces](#). These firms can utilise [big data and advanced Artificial Intelligence \(AI\)](#) to make better informed investment decisions, to analyse and predict ESG trends, identify possible risks, and implement regulatory requirements and disclosures. Technological innovative solutions such as this can be conducive to expedite the transition to a sustainable financial system.

We must measure impacts properly in order to take the correct actions in the sustainability space. Current tools using the latest [AI](#) and Machine learning technologies aid this purpose. For instance, the Partnership for Carbon Accounting Financials (PCAF) has created a free, balanced tool to measure the [carbon intensity of any credit facility or investment](#) that any bank has extended. Another example is the [Global Impact Investing Network](#) (GIIN) which presents metrics to support investors gauge and manage the impact. The Global Alliance for Banking (GABV)'s [Scorecard](#) also provides a tool to quantify the societal impact.

Recent developments Towards A Sustainable Financial System

Sustainable finance in the global arena is only possible through concerted action. In this regard, a few developments have arisen in the last few years that are paving the way. As an example, COP27 has called for landmark arrangements such as the formation of the [loss and damage fund](#) to provide [adaptation finance](#). The purpose of this is to [protect marginalised groups](#) from climate catastrophes, aid in the net zero transition, and restore natural assets.

COP27 also emphasises that international development banks and global financial entities need to [revamp their processes](#) to provide easier access to climate finance. At the same time, the World Bank has recently (in early 2023) put forward a proposal to lift its loaning ability and [refurnish its functional model](#). This step will be vital to handle worldwide challenges and provide better assistance to developing economies.

[Building guidelines, classifications and certification methods](#) and streamlining reporting standards with the SDGs are crucial to financing the SDGs. Accordingly, the European Union (EU) published the [Sustainable Finance Taxonomy](#) in 2019, and the United Nations Development Programme (UNDP), et al. founded the [UNDP SDG Finance Taxonomy](#) in 2020. In May 2022, European multi-utility body Hera [pioneered a €500million seven-year Green Bond](#), in complete alignment with the EU Taxonomy. The [UN Environment programme finance initiative](#) representing almost half of the global banks, works to align the UN's responsible banking principles with current approaches in the sector.

States that are part of the OECD follow a [**Sustainable Lending Recommendation**](#) to mobilise funds to lower income countries. These governments observe [**sustainable lending policies**](#) in providing official export credit to the most disadvantaged nations. This also prohibits these lower income countries from [**accumulating excessive amounts of debt**](#) in the process.

Recent data on sustainable investments

Financial companies with [**\\$8.7 trillion**](#) under their asset management have pledged to address deforestation. Simultaneously, 126 financial organisations with an asset base of 18.8 trillion euro have signed the [**Finance for Biodiversity Pledge in 2023**](#). A global investment firm that manages over \$1 trillion in assets, has launched the [**Nuveen Global Timberland strategy**](#) that can provide investors exclusive exposure to sustainable timberland investments.

Similarly, 450 entities, managing about [**40% of global assets**](#) have committed to combat [**global warming**](#), which can unlock substantial amounts of funds for green projects. At the same time, circular-economy-based [**public equity funds**](#) rose massively to about 10 times its previous size between 2018 and 2020. Annual issuance of corporate and sovereign bonds based on the circular economy jumped to five times its previous worth between year-end 2019 and 2021.



A sustainable financial system priorities and supports the Green Economy and the Circular Economy. Source: [Pexels.com](https://www.pexels.com)

Global examples of sustainable finance

Various financial institutions have launched unique financial products and programs specifically to address sustainability goals. Vancity, a bank in Canada has committed to a [net-zero loan book by 2040](#). A bank in Nigeria organised events to alter the [culture of the finance industry](#) with regard to sustainable finance in Africa.

A few other financial institutions cater to particular segments of society. For example, Hiver, initiated by the [Teachers Mutual Bank in Australia](#), is the first digital mutual bank. [Eligible essential workers](#) such as teachers and paramedics receive loans backed by member deposits. In Nepal, an inclusive financial entity provides energy loans to SME clients who use renewable energy sources such as [solar power or bio gas](#) in their livestock facilities.

Global Examples Of Inclusive Sustainable Finance

Some banks focus on minority groups that are the most disadvantaged socially

and economically. For instance, Finca DRC, a bank in the Democratic Republic of the Congo has established a sponsorship programme to [support blind beggarwomen](#) on the streets of the capital city of Kinshasa. The bank assisted them to [start and build small retail businesses](#) to be able to self-sustain, and lead dignified normal lives.

Similarly, [migrants experience extensive financial exclusion](#) due to a lack of paper work and [migration status](#). Sunrise Banks in Minnesota have created an [Open Door Mortgage](#) which attempts to close this gap. This venture provides [financial solutions for long-term housing](#) to foreign born residents with documentation problems that prevent them from accessing conventional mortgages.

Furthermore, some banks provide financial accessibility to small and local producers in remote locations. ABACO Credit Union in Peru issues loans to [small-scale fishers](#) from regions with minimal political administration, and underdeveloped infrastructure. Similarly, Credo Bank in Georgia supports [local farmers to recover](#) from the adversity of the COVID pandemic. The bank helps to sustain [cultivation and food manufacture](#), in collaboration with the Asian National Bank. Likewise, [Southern Bancorp in the United States](#) opens branches in rural/remote areas to promote financial inclusion and equitable opportunity.



A sustainable financial system supports small local businesses instead of destroying them.

Source: [Unsplash.com](https://unsplash.com)

moving forward

Sustainable finance is critical to creating a sustainable future. Financial institutions have the ability to reinvent their business models to align with SDGs. Funding initiatives that support environmentally and socially responsible businesses and projects can have a massive impact. Green bonds and sustainable investments can preserve nature, promote [biodiversity](#) and [climate action](#) and more. The financing of SMEs and local small scale enterprises can foster job creation, the development of local communities, and economic growth. Segment targeted schemes focusing on advocacy and financial education can uplift societies through quality education, gender equality, financial [inclusion](#), and [poverty eradication](#) by fostering informed financial decisions. Numerous examples showcase that this transition is underway.

Simultaneously, the bottlenecks in deploying monies to underdeveloped nations are slowly being overcome. The main factors are recent technological

advancements and innovative financial solutions. On a global scale, international organizations and financial establishments are revamping their frameworks and policies to provide more sustainable financing products. Favourably, sustainable investments are also escalating every year.

However, it is pivotal to measure the direct and indirect impact made by financial organisations. [**The Thrive Platform**](#) is a unique free online tool that measures the impact of strategies and business models based on sustainability performance. This tool quantifies the effects of any entity on society and the environment at any scale, and also forecasts how sustainability will be achieved in the future.

To learn more about how The THRIVE Project is researching, educating, and advocating for a future beyond sustainability, visit our [**website**](#). You can follow our informative blog and podcast series and learn about our regular live webinars featuring expert guests in the field. [**Sign up for our newsletter**](#) for regular updates.