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Report of the Secretary-General

Summary

The present report, submitted pursuant to General Assembly resolution 75/204, provides a review of the impacts of the coronavirus disease (COVID-19) pandemic and new and emerging challenges, including from non-economic risks, on the international financial system. The report contains proposals for enhanced international cooperation and strengthening the international safety net in support of countries in need. It includes sections on: the international response to the crisis; strengthening the global financial safety net; addressing volatility in international capital flows; managing financial risks; managing non-financial risks, including climate change; digital finance; and global governance and policy coherence.

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I. Introduction

1. The coronavirus disease (COVID-19) crisis triggered the largest economic recession in 90 years and set back hard-earned development progress, threatening the achievement of the Sustainable Development Goals by 2030. It also further exposed and exacerbated global inequalities.

2. Aggressive fiscal and monetary policies in major economies at the onset of the pandemic helped avert a full-fledged financial crisis. Most developing countries, however, lacked the resources to implement such large-scale responses. There is a risk of a sharply diverging world, with one group of countries recovering and many others sinking deeper into a cycle of poverty, unsustainable debt and austerity, and potentially facing another lost decade of sustainable development. While the international community has taken steps to help countries in need, efforts have been insufficient given the uncertain prospects for economic recovery, which are aggravated by the emergence of new and possibly more dangerous variants of the coronavirus.

3. The structure and governance of the international system and its institutions – in which developing countries continue to be heavily underrepresented – have hampered the global community's ability to provide support at the speed and scale necessary to prevent sharp economic contractions in many developing countries. At the same time, the emergency financing instruments of international financial institutions have become stretched due to financial capacity constraints.

4. The pandemic has also brought to the fore the growing importance of non-economic risks, including climate risks, as well as opportunities and risks associated with the rapid digitization of the economy, and of financial services in particular. The far-reaching implications of these shifts are only just beginning to be addressed in the institutions that shape the international system. To "future-proof" the system, enhanced cooperation will be needed to address and mitigate risks, integrate them more fully into risk frameworks and response mechanisms and take advantage of opportunities.

5. The present report reviews the functioning of the international system during the COVID-19 crisis and puts forward recommendations to make the system more responsive and inclusive, and fit-for-purpose for current and future challenges.

II. International crisis response

6. The international community has stepped up cooperation to address the immediate health crisis, including through growing support for the Access to COVID-19 Tools Accelerator and its vaccine pillar COVAX. However, despite recent commitments by countries of the Group of Seven, as at 24 June 2021 the financing gap was $17 billion. In May 2021, the International Monetary Fund (IMF), the World Bank, the World Health Organization and the World Trade Organization presented a joint $50 billion road map to accelerate the equitable distribution of health tools to help end the pandemic. The proposal identified a need for additional grants of at least $35 billion, with the remainder to be paid by national Governments, potentially with the support of concessional financing.[1] The crisis has also highlighted systemic weaknesses in global health financing, which must be addressed in order to deal with current and future health crises.

[1] Kristalina Georgieva and others, "A new commitment for vaccine equity and defeating the pandemic", World Health Organization, 31 May 2021.

7. The Group of 20 extended its Debt Service Suspension Initiative for the poorest countries to December 2021 and established the Common Framework for Debt Treatments Beyond the Debt Service Suspension Initiative. The Common Framework aims at going beyond debt service suspension (under which debt service still needs to be repaid at a later date) to allow for coordinated debt relief for the poorest countries on a case-by-case basis.

8. Despite economic contractions in donor countries, official development assistance (ODA) rose by 3.5 per cent during 2020, underpinned by COVID-19-related activities and bilateral loans. While ODA as a share of donors' gross national income increased from 0.30 per cent in 2019 to 0.32 per cent in 2020, it remained below the United Nations target of 0.70 per cent (see A/76/229).

9. By the end of May 2021, IMF had granted $726 million in debt relief to 29 poor countries and approved some $110 billion in emergency financing for 84 countries. Multilateral development banks collectively announced over $200 billion in support to developing countries, particularly least developed countries.

10. Despite these measures, debt risks and liquidity constraints remain elevated for many developing countries. Over half of the least developed and other low-income countries are assessed to be at a high risk of or are already in debt distress, while only three have sought relief within the Common Framework. Middle-income countries with high debt burdens remain ineligible to benefit from the Debt Service Suspension Initiative and the Common Framework. International support for middle-income countries has been limited by eligibility restrictions due to income-based country classifications, as well as the financial capacity constraints of multilateral development banks. Replenishing the funding of international financial institutions, including multilateral development banks, will be critical in order to enhance their lending capacity. Further consideration should also be given to a review of eligibility for concessional windows, balance sheet optimization (to allow for increased lending while maintaining financial integrity) and governance reform.

11. The Secretary-General's policy brief from March 2021, entitled "Liquidity and debt solutions to invest in the SDGs: the time to act is now", lays out a set of recommendations to create space for investment in pandemic response and the Sustainable Development Goals, including: fresh financing; a new allocation of special drawing rights, along with channelling those rights to countries in need and the establishment of a trust fund hosted by IMF to support middle-income countries; and debt relief initiatives that build on and complement the Common Framework.[2] During 2020, the Prime Ministers of Canada and Jamaica and the Secretary-General convened a series of high-level events on financing for development in the era of COVID-19 and beyond that produced a menu of policy options, including on issues of external financial flows, debt and liquidity. The United Nations system is pursuing this work further to support Member States in the implementation of some of the most urgent policies from the menu of options.

III. Strengthening the global financial safety net

12. The COVID-19 crisis has further exposed and exacerbated gaps and vulnerabilities in the global financial safety net, lending new urgency to long-standing calls to make it stronger, more coherent and equitable. With IMF at its centre, the global financial safety net also includes bilateral swap arrangements and regional financing arrangements, and, at the national level, countries' own foreign exchange reserves. While the global financial safety net has expanded substantially since the

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[2] See also A/76/214.

2008 global financial crisis, gaps remain, and many countries do not have access to one or more of its layers.

13. For most developing countries, IMF lending facilities were the main source of external liquidity during the past year. Almost half of the total IMF support ($52 billion) was provided through Flexible Credit Lines: a precautionary facility available to countries with very strong policies and fundamentals. Another $30 billion was made available without formal adjustment programmes ($8 billion for low-income countries and $22 billion for all IMF member States).[3] In April 2020, IMF established a new short-term liquidity line for member countries with very strong policies and fundamentals, though it has not yet been used. IMF also implemented several short-term measures to enhance the impact of its financial support, including increasing access limits to lending facilities and streamlining approval processes.[4]

14. Additional reforms can further strengthen the response capacity of IMF, including a review of conditionalities of its financing facilities. For example, "ex ante" conditionalities (including requirements for strong macroeconomic fundamentals and policies) limit access to some of the more flexible instruments. "Ex post" conditionalities, such as required fiscal policy adjustments once a loan is approved, create disincentives for countries to request support.[5]

15. Efforts are currently under way to replenish the Poverty Reduction and Growth Trust and Catastrophe Containment and Relief Trust of IMF, which fund its concessional and grant financing. In addition, a general quota increase could strengthen its overall lending capacity while reducing its dependency on borrowed resources from member countries. The ongoing sixteenth general review of quotas is an opportunity for member States to revisit the adequacy of quotas, and speed up the process of IMF governance reform to further strengthen the voice and representation of developing countries.

Other layers of the global financial safety net: swaps, regional financing arrangements and reserves

16. Voluntary bilateral currency swap lines between central banks, which give receiving central banks access to foreign currency loans, provided international liquidity, particularly during the early phase of the crisis – reaching $1.75 trillion and eclipsing other sources of international liquidity.[6] However, most developing countries lack access to such arrangements. In March 2020, the Federal Reserve System of the United States of America temporarily expanded the number of countries that are offered swap lines from 5 to 14 (including 4 developing countries).[7] The People's Bank of China also engaged in large-volume bilateral currency swaps, while other central banks, including the Bank of Japan and the Bank of England, did so to a lesser degree. To reach more developing countries, there have been calls for the

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[3] A breakdown of IMF COVID-19 financial assistance and debt service relief is available at www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker.

[4] IMF, "IMF Executive Board approves temporary extensions and modification of access limits in the fund's lending facilities", 25 March 2021.

[5] IMF, "2018 review of program design and conditionality", Policy Paper No. 19/012, 20 May 2019.

[6] Laurissa Mühlich, Barbara Fritz and William N. Kring, "Towards the marginalization of multilateral crisis finance? The global financial safety net and COVID-19", GEGI policy brief 015, April 2021.

[7] Board of Governors of the Federal Reserve System, "Federal Reserve announces the extension of its temporary U.S. dollar liquidity swap lines with nine central banks through December 31, 2021", press release, 16 June 2021.

expansion of multilateral swap arrangements through regional financing arrangements and/or the establishment of a multilateral swap facility at IMF.[8]

17. Over the past two decades, regional financing arrangements have become an increasingly important element of the global financial safety net. They offer support to their member countries through regional reserve pooling arrangements, swap lines, lending facilities and/or technical support. Developing countries have access to six regional financing arrangements, with an estimated lending capacity of $376 billion (covering 61 countries).[9]

18. However, during the height of the recent economic crisis, between February 2020 and March 2021 regional financing arrangements disbursed only around $3.8 billion, often in combination with IMF programmes. Some regional financing arrangements stepped up other measures, such as the development of new financing instruments (Eurasian Fund for Stabilization and Development, Latin American Reserve Fund); guidelines for central banks to deal with COVID-19 (Arab Monetary Fund); and intensified regional surveillance efforts (Chiang Mai Initiative Multilateralization).[10]

19. The role of regional financing arrangements in the global financial safety net could be strengthened by expanding their member bases and, in some cases, increasing their resource envelopes (depending on political will). While some North African countries are part of the Arab Monetary Fund, the creation of a more comprehensive African regional financing arrangement – possibly with the support of donor funding – could increase emergency liquidity access for many countries.[11] Regional financing arrangements could also benefit from the enhanced exchange of experience and peer learning. Continuing cooperation with IMF will also be important, while at the same time such arrangements should maintain sufficient autonomy to best serve their member countries' needs.

20. Countries' foreign exchange reserves are considered the national layer of the global financial safety net. In the aftermath of the financial crises of the 1990s, many developing countries turned to the accumulation of reserves as a form of "self-insurance" against the effects of capital flow volatility and sharp exchange rate fluctuations. Reserve accumulation by developing countries slowed during the global financial crisis, and eventually reversed in 2015. Since then, reserve levels had been relatively constant, only to be drawn down sharply during the early phase of the COVID-19 crisis.[12]

21. Most developing country reserves are invested in low-yield United States Treasury securities. While such policies can be effective in shielding the domestic economy from short-term fluctuations owing to a balance of payment pressures, they

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[8] United Nations, *Financing for Development in the Era of COVID-19 and Beyond: Menu of Options for the Considerations of Heads of State and Government, Part II* (New York, 2020); and Kevin P. Gallagher and others, "Safety first: expanding the global financial safety net in response to COVID-19", *Global Policy*, vol. 12, No. 1 (February 2021).

[9] These are the Arab Monetary Fund, the Contingent Reserve Arrangement of the New Development Bank, the Chiang Mai Initiative Multilateralization, the Eurasian Fund for Stabilization and Development, the Latin American Reserve Fund and the South Asian Association for Regional Cooperation swap arrangement.

[10] Laurissa Mühlich, Barbara Fritz and William Kring, "Towards the marginalization of multilateral crisis finance?"; and Thomas Stubbs and others, "Whatever it takes? The global financial safety net, COVID-19 and developing countries", *World Development*, vol. 137 (January 2021).

[11] The African Union approved the creation of an African Monetary Fund in 2014, but thus far not enough member States have become signatories for it to become operational.

[12] IMF, "Appendix I. International reserves", in *IMF Annual Report 2020* (Washington, D.C., 2020); and Tom Arnold and Karin Strohecker, "Running on empty? Emerging markets burn through reserves fighting virus", Reuters, 27 August 2020.

represent a net transfer of wealth from developing to developed economies and come at a high opportunity cost for domestic investment.[13] Strengthening the other layers of the global financial safety net could help reduce these costs, as it would lower the need for "self-insurance" by developing countries.

Strengthening the impact of special drawing rights

22. In July 2021, the Executive Board of IMF approved a new allocation of special drawing rights equivalent to $650 billion. Final approval by the Board of Governors is expected by August 2021. Special drawing rights supplement member countries' official reserves, which can boost their access to international liquidity.

23. Since special drawing right allocations are distributed in proportion to IMF quota shares, only one third would go to developing countries, with least developed countries receiving just over $15 billion and small island developing States just over $9 billion.

24. Discussions are ongoing about how to increase the impact of special drawing rights by channelling them to countries most in need and reviewing mechanisms that might increase their developmental impact. Proposals (with varying degrees of political support) include:

(a) The onlending of special drawing rights through the IMF Poverty Reduction and Growth Trust. Some countries have already channelled their existing special drawing rights this way, which tripled the concessional lending capacity of IMF in 2020.[14] It lets lending countries earn the special drawing right interest rate, thus offsetting the cost of a deficit in their special drawing right accounts, and covers the credit risk associated with onlending.[15] However, access to concessional financing through the Poverty Reduction and Growth Trust is limited to low-income countries;

(b) The establishment of a resilience and sustainability trust at IMF, particularly for lower-middle income countries, in line with calls from the Secretary-General for the establishment of a new trust fund at IMF to address the needs of vulnerable middle-income countries and especially small island developing States.[16] The proposed trust could, for example, help eligible countries strengthen health-care systems and address climate-related challenges;

(c) The channelling of special drawing rights, to increase their developmental impact, through new or existing trust funds at multilateral development banks and/or regional development banks (which are already prescribed holders of special drawing rights, and thus would require no changes to the IMF Articles of Agreement).[17] These

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[13] See, for example, José Antonio Ocampo, *Resetting the International Monetary (Non)System* (Oxford, Oxford University Press, 2017).

[14] Kristalina Georgieva, "Managing Director Kristalina Georgieva's Remarks at summit on the financing of African economies", speech at the summit on the financing of African economies, Paris, 18 May 2021.

[15] Lenders can also seek early repayment of their loans if needed, allowing them to retain the reserve asset characteristics of their special drawing rights.

[16] United Nations, "Liquidity and debt solutions to invest in the SDGs: the time to act is now", policy brief, March 2021.

[17] There are 15 prescribed holders: four central banks (European Central Bank, Bank of Central African States, Central Bank of West African States, Eastern Caribbean Central Bank); three intergovernmental monetary institutions (Bank for International Settlements, Latin American Reserve Fund, Arab Monetary Fund); and eight development institutions (African Development Bank, African Development Fund, Asian Development Bank, International Bank for Reconstruction and Development, International Development Association, Islamic Development Bank, Nordic Investment Bank, International Fund for Agricultural Development). See also www.imf.org/en/About/FAQ/special-drawing-right.

funds could contribute to financing health needs and/or longer-term investment in the Sustainable Development Goals and climate action.

25. Some proposals go further in rethinking the potential role of special drawing rights for supporting long-term sustainable development, but would require a change to the IMF Articles of Agreement. Such proposals include:

(a) The designation of new prescribed holders to allow for further leveraging of special drawing rights, for example through a "Green Fund" for climate finance (first suggested by IMF staff in 2010),[18] or a new liquidity and sustainability facility proposed by the Economic Commission for Africa and PIMCO;[19]

(b) A change in the distribution formula to take into account factors beyond IMF quotas, such as a country's demand for reserves;

(c) A broader increase of the use of special drawing rights as a global currency or as an investment asset, including by private actors.

26. While the new allocation of special drawing rights is now expected in late August 2021, some of the proposed mechanisms to channel them could take longer to establish. Discussions on their design and setup must advance quickly to provide urgently needed liquidity to countries most in need. Countries should also ensure that the impact of channelling special drawing rights remains additional to and does not crowd out existing ODA commitments.

IV. Addressing volatility and imbalances in international capital flows

27. The COVID-19 crisis highlighted again the risks of volatile short-term capital flows for developing economies, with potential impacts on exchange rates, debt sustainability and financial stability. While capital flows have returned to developing countries as a group, following the sharp outflow in the first half of 2020, many countries still lack access to market finance, which helps explain the further drawdown in international reserves in 2020. Increased volatility in early 2021 was another reminder that international capital flows can reverse quickly in response to external conditions.

A. Capital flows

28. Global foreign direct investment (FDI) fell by 35 per cent in 2020, to $1.0 trillion (from $1.5 trillion in 2019). Developed economies bore the brunt of this decline, while flows to developing countries decreased by a more moderate 8 per cent, albeit with large regional differences. FDI flows to developing countries in Asia were broadly resilient, while flows to Africa fell by 16 per cent, and flows to Latin America and the Caribbean fell by 45 per cent. Greenfield investment, which typically has a stronger impact on economic growth and job creation than cross-border mergers and acquisitions, fell by 42 per cent in developing countries. Overall FDI flows are expected to increase by 10 to 15 per cent in 2022, remaining below 2019 levels.[20]

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[18] Hugh Bredenkamp and Catherine Pattillo, "Financing the response to climate change", IMF Staff Position Note No. SPN10/06, 25 March 2010.

[19] Daniela Gabor and Crystal Simeoni, "Time to tap SDRs to boost African bond liquidity?", *Financial Times*, 12 March 2021; and Economic Commission for Africa, "ECA launches LSF, a vehicle for debt management and fiscal sustainability", 23 March 2021.

[20] See United Nations Conference on Trade and Development, *World Investment Report 2021* (United Nations publication, 2021).

29. After record capital outflows from developing countries in the first quarter of 2020, international financial markets stabilized and portfolio flows returned to more advanced developing economies, thanks in large part to unprecedented stimulus by the Federal Reserve of the United States and other major central banks. During 2020 as a whole, non-resident portfolio inflows to emerging markets amounted to $313 billion, only 13 per cent lower than in 2019. However, flows remain volatile, reflecting uncertainties regarding the pandemic, the global inflation outlook, potential monetary tightening in some major economies and the sustainability of debt burdens. These uncertainties continue to weigh on the near-term outlook, as a tightening in global financial conditions could trigger another capital flow reversal.[21]

B. Manging capital flow volatility

30. Along with global efforts to strengthen the global financial safety net, countries can use the full policy toolkit – monetary, exchange rate, macroprudential, capital flow management, and other policies – to manage capital flow volatility.

31. As laid out in the *Financing for Sustainable Development Report 2021*, monetary and exchange rate adjustments typically work better in more advanced economies that have deeper financial markets. However, during the early phases of the COVID-19 pandemic, a greater number of developing countries were able to implement countercyclical monetary policies than during past crises. Many developing countries employed active foreign exchange rate interventions, and several eased macroprudential regulations. Several countries also used capital flow management measures.

32. An integrated policy framework, put forward by IMF, could help countries determine the best policy mix by considering the country situation and possible interactions between different policies. Implementing an integrated policy framework in conjunction with a broader integrated national financing framework could strengthen the coherence between policies for financial and macroeconomic stability, debt sustainability, trade, and public and private financing strategies for sustainable development.

33. International cooperation can help strengthen developing countries' capacities to manage the impact of capital flows, including through coherent guidance and technical assistance. Source countries can also consider policy combinations that meet their domestic objectives while reducing international spillovers and volatility. Indeed, efforts to enhance domestic financial stability and incentivize long-term investment for sustainable development could contribute to this objective.

C. Mobilizing and aligning finance with the Sustainable Development Goals

34. Nevertheless, capital flows can play an important role, as long-term financing and investment can spur growth and development. Most developing countries need an investment push to overcome the immediate challenges of the COVID-19 crisis and achieve sustainable development. Investments in sustainable and resilient infrastructure and productive capacity should enhance productivity and growth, thereby improving debt sustainability in the long run, even while raising debt levels in the near term.

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[21] See IMF, *Global Financial Stability Report: Preempting a Legacy of Vulnerabilities* (Washington, D.C., April 2021); and Institute of International Finance, Capital Flows Tracker database, data for January–May 2021.

35. Longer-term credit ratings and debt sustainability analyses could help overcome some of the financial markets' short-term bias by incorporating the expected positive effects of sustainable investment on growth and, ultimately, fiscal revenues. The Inter-Agency Task Force on Financing for Development is analysing these issues for inclusion in the forthcoming *Financing for Sustainable Development Report 2022*.

36. However, market finance alone will not be sufficient to fill all the gaps, nor is it suitable in all Sustainable Development Goal contexts. In some cases, risk mitigation and blended financing mechanisms (such as guarantees) can reduce the cost of long-term financing. In other cases, such as social investments without near-term financial returns, grants or very long-term official financing options (e.g. 50 years) will be necessary.

37. The system of public development banks can play an important role in supporting sustainable investment aligned with the Sustainable Development Goals, including by providing such ultra-long-term non-concessional official financing to developing countries and helping countries develop investable project pipelines.

V. Managing financial risks

38. Despite the global economic slowdown and continued uncertainties regarding the future course of the pandemic, equity markets in most major economies have been setting new records since late 2020, suggesting a growing disconnect between financial markets and the real economy.[22] High liquidity has contributed to exuberance across asset classes, including real estate, commodities and cryptocurrencies, as well as equity markets, in part due to growing borrowing by non-bank financial intermediaries (such as hedge funds and other investment funds).[23] While reforms after the 2009 financial crisis reduced risks in the banking sector, much of this risk has now migrated to the non-bank financial sector.

A. Growing financial risks

39. The "lower for longer" interest rate environment that followed the global financial crisis of 2008 had already increased leverage in financial markets to record levels, as investors "searched for yield". Since the onset of the crisis, leverage has increased further, driven in part by highly accommodative monetary policies. This may pose financial stability risks if or when interest rates rise, as highly leveraged investors might be forced to sell assets as a result of the higher cost of borrowing.

40. Current developments build on longer-term trends towards increased financialization that have led to concerns about the effect of financial development on financial stability and inequality. Between 2012 and 2019, the value of global financial assets rose from 3.7 times global GDP to 4.6 times global GDP.[24] In the United States, the financial sector represents around 7 per cent of the economy, and creates 4 per cent of all jobs, but captures 30 per cent of all private sector profits. In Europe, financial sector workers represent 19 per cent of the top 1 per cent of earners, with the overall employment share of the financial sector at 4 per cent.[25]

[22] IMF, *Global Financial Stability Report*.

[23] Bank for International Settlements, *Annual Economic Report 2021* (Basel, Switzerland, 2021).

[24] Based on Financial Stability Board data on global financial assets and World Bank World Development Indicators.

[25] *Financing for Sustainable Development Report 2019* (United Nations publication, 2019).

B. Reforms strengthened financial sector resilience

41. The financial turmoil in March 2020 was the first real test for the financial system since the implementation of most of the regulatory reforms agreed by the Group of 20 in the wake of the 2008 crisis. The banking sector, in particular, showed increased resilience, though it was aided by unprecedented fiscal, monetary and supervisory support, which helped the financial system in many countries absorb the macroeconomic shock rather than amplify it.

42. Prior to COVID-19, the Financial Stability Board carried out an evaluation of reforms to address financial institutions that were deemed “too big to fail”. Its final report of April 2021, which also incorporated lessons from the crisis, found that systemically important banks were better capitalized than they were before the 2008 global financial crisis, and that progress in the implementation of resolution regimes has given authorities more options for dealing with banks experiencing stress.[26]

43. During the COVID-19 crisis, financial supervisors in many countries used flexibility within global standards to support liquidity provision and maintain business continuity, including through the use of firm-specific and system-wide capital and liquidity buffers. International standard-setting bodies supported national authorities through monitoring and the provision of technical advice, and provided additional breathing space by extending deadlines for the implementation of pending financial regulatory reforms agreed by the Group of 20.[27]

C. Managing new and emerging risks

44. While regulatory efforts have increased the resilience of the banking sector, the COVID-19 crisis highlighted the shift of financial activity to less regulated non-bank financial intermediaries. By 2019, the share of global financial assets held by these institutions had risen to almost 50 per cent, up from 42 per cent in 2008. Their growing interconnectedness with banks increased liquidity stress across market segments during the market sell-off in March 2020.[28]

45. In response to the growing systemic importance of non-bank financial intermediaries, there have been calls for increased supervision and regulatory reforms. Recent proposals include new mechanisms for strengthening the resilience of money market funds, some of which had been at the centre of the market turmoil in March 2020.[29]

46. Macroprudential tools can help rein in excessive leverage and the effects of excess financialization to a certain degree. Such tools – including measures aimed at borrowers (such as loan-to-value or loan-to-income ceilings) and measures aimed at lenders (such as capital adequacy and liquidity measures or foreign currency exposure limits) – could help policymakers navigate the transition towards economic recovery. For instance, the tightening of banks’ liquidity requirements has been associated with a reduction in corporate leverage. In developing countries, the tightening of foreign exchange-related measures can also help reduce corporate leverage. As most of these

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[26] Financial Stability Board, *Evaluation of the Effects of Too-Big-To-Fail Reforms: Final Report* (Basel, Switzerland, 2021).

[27] Ibid., *Implementation and Effects of the G20 Financial Regulatory Reforms: 2020 Annual Report* (Basel, Switzerland, 2020).

[28] Ibid., *Holistic Review of the March Market Turmoil* (Basel, Switzerland, 2020).

[29] Ibid., *Policy Proposals to Enhance Money Market Fund Resilience: Consultation Report* (Basel, Switzerland, 2021).

tools are currently restricted to the banking sector, further efforts are needed to develop a toolkit for non-bank intermediaries.[30]

47. Other measures that have been suggested to rein in excess financialization, such as ceilings for financial sector remunerations or financial transaction taxes, have so far received limited political backing, but could be explored further – including through strengthened international cooperation.

VI. Non-financial risks

48. The COVID-19 crisis has also highlighted the growing interlinkages between economic, social and environmental risks and their implications for financial stability. In turn, the large and unconventional policy responses to the pandemic have brought renewed attention to the effects of financial regulation and monetary policy on sustainable development.

49. Increasing climate-related physical risks and hazards could erode the value of financial assets and/or increase liabilities, while rising transition risks can affect the value of financial assets and liabilities. Similarly, other social and environmental risks may affect asset valuation – for example, through the negative impact of social unrest on labour costs.

A. Impact on the financial sector

50. The number of financial institutions that take a comprehensive approach to addressing climate and other relevant risks remains low.[31] Such risks should be integrated into financial institutions' credit analysis, and, for countries that have implemented Basel II or Basel III frameworks, considered part of the internal capital adequacy assessment process. Financial standard-setting bodies and supervisory authorities can give financial institutions guidance on how to incorporate climate-related risks into their risk assessments. Where needed, they can help improve institutions' data collection, analysis and risk modelling capacities, building for example on work by the Network for Greening the Financial System. Authorities can also incorporate climate-related stress tests to assess the exposure of financial institutions against scenarios for physical and transition risks.[32]

51. Internationally comparable mandatory reporting standards and risk disclosures could further help safeguard financial stability, while measuring banks' contributions to climate goals. The Task Force on Climate-related Financial Disclosures created a common standard for the voluntary disclosure of climate-related financial information. Several jurisdictions have committed to requiring that the reporting of financial and non-financial companies be in line with the Task Force's disclosure recommendations. Meanwhile, the United Nations-convened Net-Zero Asset Owner Alliance has defined a protocol for setting targets in portfolio emission reduction and reporting on progress. Expanding such initiatives to cover other Sustainable Development Goals is progressing in some areas, such as biodiversity,[33] but remains a challenge.

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[30] IMF, *Global Financial Stability Report*.

[31] Financial Stability Board, "The implications of climate change for financial stability", 23 November 2020.

[32] Pietro Calice and Ezio Caruso, "Supervisory guidance on risk management can foster a greener financial sector", World Bank Blogs, 6 May 2021.

[33] See https://tnfd.info/.

B. Monetary policy in a changing world

52. Insofar as non-economic risks and sustainable development issues affect financial stability, their consideration is squarely part of central banks' mandates. Recently, some central banks have also undergone strategic reviews that explicitly include climate and/or inequality goals.[34] For instance, while the Federal Reserve of the United States has always had a "dual mandate" to pursue the two goals of price stability and maximum sustainable employment, it recently revised its strategy statement specifying the inclusive role of its maximum employment goal.[35] In March 2021, the mandate of the Bank of England was modified to explicitly consider environmental and climate goals, including as part of its quantitative easing programme.[36] The People's Bank of China, which has been leading an effort to green the Chinese financial system since 2014, announced further plans to incorporate sustainable development measures into its financial plans over the next five years.[37] In July 2021, the European Central Bank committed to more ambitious climate-related action, including by tilting its collateral rules and future corporate bond purchases – as part of quantitative easing measures – towards less polluting companies.[38]

53. Some central banks are moving ahead with protective measures to safeguard financial stability and protect their own balance sheets, for instance by using climate change considerations to assess collateral. To support central banks' efforts to include sustainability objectives in their reserve management, the Bank for International Settlements launched two green bond funds (denominated in United States dollars and in euros) that together manage $2 billion in green bonds.[39]

54. While there has been less consensus about a more proactive role by central banks to support climate change mitigation, recent strategy reviews have created the potential for further action. Policymakers should continue to explore the climate impact of their bond purchasing strategies, which may not be as "neutral" as presumed, since they tend to reflect market biases towards heavy carbon emitters. They could also further consider collateral frameworks and credit allocation polices that take climate change into account.[40]

VII. Digital finance

55. The COVID-19 pandemic also underscored the growing role of digital technologies in all areas of the economy. Digital financial services helped maintain economic activity, but also raised concerns about equity and financial stability. Developments regarding digital assets and "stablecoins" have accelerated, as has work on central bank digital currencies. International cooperation can help develop and implement comparable standards to help policymakers balance opportunities and risks.

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[34] See also A/75/325.

[35] In December 2020, the Federal Reserve also joined the Central Banks and Supervisors Network for Greening the Financial System.

[36] Claire Jones, "The Old Lady turns green: the Bank of England becomes the first major central bank to commit to offloading brown assets", *Financial Times*, 3 March 2021.

[37] Wang Liwey and Luo Meihan, "Central bank steps up green finance efforts", *Caixin*, 15 February 2021.

[38] European Central Bank, "The ECB's monetary policy strategy statement", 8 July 2021.

[39] Bank for International Settlements, "BIS launches second green bond fund for central banks", 25 January 2021.

[40] See, for example, *Financing for Sustainable Development Report 2020* (United Nations publication, 2020).

A. Financial technology and financial stability

56. The use of digital financial services – including innovative financial technology (fintech) solutions – has increased sharply during the COVID-19 pandemic, accelerating longer-term trends. While supporting the functioning of the financial system and allowing many households and micro-, small and medium-sized enterprises to maintain some level of economic activity, this rapid growth has also raised equity and regulatory concerns. Financial stability could be affected, in particular, by the expanding role of big technology (frequently referred to as "big tech") companies in financial services, which could reduce the resilience of incumbent financial institutions, either by affecting their profitability or by reducing the stability of their funding. Increasing market power and concentration could also make large fintech companies "too big to fail", posing financial stability risks similar to those of systemically important banks.

57. To mitigate financial stability risks, authorities will need to carefully monitor the financial services activities of big tech and large fintech companies and close regulatory gaps with regulated financial institutions, following the principle of "same business, same risk, same rules". As markets and actors continue to evolve, this may require a mixed or hybrid regulatory framework that combines elements of both activity- and entity-based approaches. Regulators will need to collaborate with other authorities, including in information and communications technology and competition. In the case of data governance, which is key for consumer protection and fair competition, this may also require international cooperation to regulate cross-border data flows.[41]

58. New digital business models also prompted a review of international tax norms. In July 2021, preliminary agreement was reached by the Organisation for Economic Co-operation and Development/Group of 20 Inclusive Framework on Base Erosion and Profit Shifting on reallocating the taxing rights on some profits of some of the largest businesses to the jurisdiction where revenues are earned, regardless of physical presence.[42] While this may eventually affect large unregulated fintech providers, traditional financial institutions are excluded from the proposed new rules in their current form.[43]

B. Digital assets and "stablecoins"

59. Interest in cryptoassets and digital currencies, including "stablecoins", continued to grow during the past year. However, cryptoassets such as bitcoin keep experiencing large swings in their valuations, making them ill-suited to fulfil a currency function. It was therefore a surprise to many when El Salvador became the first country to adopt bitcoin as legal tender in June 2021. While this may help reduce remittance costs for citizens working abroad, there remain serious doubts about its effectiveness for increasing financial inclusion, as only around one third of the population are currently active Internet users. The pseudo-anonymous nature of bitcoin transactions also raises concerns about financial integrity, making it vital for the operationalization of the new law to ensure compliance with the 2019 Financial

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[41] See Financial Stability Board, "BigTech in finance: market developments and potential financial stability implications", 9 December 2019, and "BigTech firms in finance in emerging market and developing economies: market developments and potential financial stability implications", 12 October 2020.

[42] Organisation for Economic Co-operation and Development, "Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy", 1 July 2021.

[43] S. Fatica and W. D. Gregori, "How much profit shifting do European banks do?", *Economic Modelling*, vol. 90 (August 2020).

Action Task Force guidance on virtual currencies.[44] Further developments in El Salvador should be closely monitored to adjust policies and regulation when necessary and extract lessons learned for other jurisdictions.[45]

60. Stablecoins have more currency-like features than cryptoassets, as they are generally tied to a currency or a basket of currencies, which is intended to stabilize their value. However, as they are issued by private companies – including big tech companies – that operate outside the well-regulated parts of the financial system, they can create significant operational and consumer protection risks (for instance, customer balances are not covered by government deposit insurance). Their widespread adoption could also affect macroeconomic policies, including by disrupting monetary transmission channels, and may pose a threat to financial stability.[46] So far, stablecoins pose limited systemic risks owing to their limited scale. However, given network effects and the global reach of big tech companies, stablecoins could grow and reach global usage quickly.

61. Global stablecoins have been touted for their potentially favourable impact on efficiency and cost of cross-border payments, although there are ways to make cross-border payment systems more efficient without creating new global currencies. Global stablecoins also raise new risks, for instance if economic actors were to choose to substitute them for domestic currencies (similar to the cases of dollarization that can sometimes be observed in developing countries). In the extreme, the large-scale adoption of a global stablecoin would mean that countries would be subjected to monetary policy decisions made by a private currency provider.

62. Recognizing the importance of the ability of payment systems to quickly and efficiently send and receive payments across borders, the Financial Stability Board has developed a road map for improving cross-border payments. The road map sees a potential role for global stablecoins, provided they meet all applicable regulatory requirements, including on anti-money laundering/combating the financing of terrorism.[47] Following up on its road map, the Financial Stability Board published a consultative document entitled "Targets for addressing the four challenges of cross-border payments" (cost, speed, transparency and access) in May 2021.[48] A final version is expected in October 2021.

C. Central bank digital currencies

63. The increasing digitization of financial service provision and a longer-term trend towards increased use of cashless payment methods in many countries has also raised interest in central bank digital currencies. The balance of benefits and risks of central bank digital currencies will be determined by their technical design choices, which must be tailored to the characteristics of each economy and their financial sectors.

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[44] Financial Action Task Force, *Guidance for a Risk-Based Approach: Virtual Assets and Virtual Asset Service Providers* (Paris, 2019).

[45] For an overview of risks associated with cryptocurrencies, see, for example, *Financing for Sustainable Development Report 2019* and *Financing for Sustainable Development Report 2020*.

[46] See *Financing for Sustainable Development Report 2020* and *Financing for Sustainable Development Report 2021* (United Nations publication, 2021) for a detailed discussion on opportunities and risks of stablecoins.

[47] Financial Stability Board, "Enhancing cross-border payments: stage 3 roadmap", 13 October 2020.

[48] Ibid., "Targets for addressing the four challenges of cross-border payments: consultative document", 31 May 2021.

64. At the end of 2020, 86 per cent of central banks were engaged in central bank digital currency work, up from 80 per cent in 2019 and 70 per cent in 2018, citing financial inclusion and domestic payment efficiency as their main motivations.[49] This was also the explicit goal of the first "live" retail central bank digital currency launched in the Bahamas in October 2020. However, recent studies on different aspects of financial inclusion (including access, efficiency and costs) have not shown a clear effect of central bank digital currencies.[50] The implementation of the Sand dollar in the Bahamas, and its effect on financial inclusion, should be closely monitored, and tailored policy adjustments implemented where needed.

65. One of the many design choices of central bank digital currencies has to do with the openness of payment networks and their interoperability. Similar to global stablecoins, central bank digital currencies could help enhance cross-border payments, but they also carry risks, especially in relation to possible currency substitution and capital flow volatility for countries that cannot adopt their own central bank digital currency – particularly small developing countries.[51] Specific design choices could help mitigate those risks: by using an account-based system and tying the central bank digital currency to digital identification, issuing central banks could retain control over their user base and the kind of transactions performed (i.e. they could limit non-residents' access to the central bank digital currency).[52]

66. Further research and peer learning is needed to gain more clarity about the potential benefits and risks of cryptoassets and digital currencies, including different design choices for central bank digital currencies, and to develop internationally comparable regulatory frameworks.[53] A group of central banks and the Bank for International Settlements published a set of common principles for central bank digital currencies in October 2020,[54] and the Group of Seven is working towards common principles for Group of Seven countries to be published later this year.

VIII. Global governance and policy coherence

A. Governance reform at international financial institutions

67. In the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, Member States recommitted to strengthening the voice and participation of developing countries in international economic decision-making and reiterated their commitment to further governance reform at IMF and the World Bank. However, the voting shares of developing countries in major international institutions have hardly changed in recent years, and major advanced economies continue to hold de facto veto powers in their decision-making boards.

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[49] Codruta Boar and Andreas Wehrli, "Ready, steady, go? – results of the third BIS survey on central bank digital currency", BIS Papers, No. 114 (January 2021).

[50] G. Bull, W. Cook, M. Kerse and S. Staschen, "Is financial inclusion a reason to push central bank digital currencies?", Consultative Group to Assist the Poor (CGAP), 13 May 2021.

[51] While the Financial Stability Board road map was developed for cross-border payments in the context of global stablecoins, many aspects also apply to central bank digital currencies and should be considered in future central bank digital currency discussions as well.

[52] Bank for International Settlements, "III. CBDCs: an opportunity for the monetary system", *Annual Economic Report 2021*.

[53] Chapter III of the Bank for International Settlements' *Annual Economic Report 2021* underlines the important role of central banks in payment systems and identifies a two-tiered, account-based system that is tied to a digital identity as the most promising design choice for central bank digital currencies.

[54] Bank for International Settlements, *Central bank digital currencies: foundational principles and core features* (Basel, Switzerland, 2020).

68. As the COVID-19 pandemic highlighted gaps and vulnerabilities in the global financial safety net, it also opened a new window for reform. It forced the international community to review the capital adequacy and shareholding structure of international financial institutions and reconsider the representation of developing countries in international decision-making bodies. Upcoming capital replenishments and quota reviews are an opportunity to make progress towards global governance reform.

69. The ongoing IMF sixteenth general review of quotas is expected to conclude no later than 15 December 2023, though there have been calls for its acceleration. The review can help move IMF governance reform forward and strengthen the voice and representation of developing countries, including by using a new quota formula as a guide. In April 2021, the World Bank launched an early twentieth replenishment process of the International Development Association, to be concluded in December 2021. Some member countries have requested that the ongoing voting rights review of the Association be completed before pledging for the twentieth replenishment process.[55]

B. Policy alignment with sustainable development

70. The Addis Ababa Action Agenda builds on a long-standing concern regarding the financing for development process: the need to strengthen the coherence and consistency of the international financial, monetary and trading systems. It broadens the call for coherence to include investment, development policy and environmental institutions and platforms, and calls on development finance institutions to align their practices with the 2030 Agenda for Sustainable Development. Deeper coordination is also needed in the areas of tax, competition and non-economic issues such as climate change, disaster risk, human rights, gender and migration.

71. The United Nations provides a unique platform for bringing together all Member States and other stakeholders, including international organizations, to foster greater policy coherence. The General Assembly and the Economic and Social Council are the main forums for forging consensus on key economic and social policy norms and targets. The Council's forum on financing for development follow-up provides a platform to discuss all policies that could advance sustainable development financing. Another recent example of the convening power of the United Nations was the series of High-level Events on Financing for Development in the Era of COVID-19 and Beyond during 2020.

72. In November 2021, the Conference of Parties to the United Nations Framework Convention on Climate Change will be a milestone for aligning national and global policies with the Paris Agreement. Developing countries, particularly least developed countries and small island developing States, will need support to enhance their climate ambitions and make the necessary investments in resilience. The Conference of the Parties to the Convention on Biological Diversity, also scheduled for the last quarter of 2021, is an opportunity to better align national and global policies with biodiversity.

73. IMF, the World Bank and other multilateral development banks have continued to align their strategies with the Sustainable Development Goals and the Paris Agreement. For instance, in April 2021, IMF launched a new long-term macroeconomic framework to support its members in the design and analysis of development financing strategies to achieve the Goals, which could become part of a

[55] World Bank, "IDA19 implementation review and launch of IDA20 replenishment", Co-Chairs' summary, virtual meeting, 14–15 April 2021.

broader integrated national financing framework.[56] In its new Climate Change Action Plan, the World Bank committed itself to aligning all new operations with the Paris Agreement by mid-2023.[57] In 2020, the multilateral development banks and IMF launched a joint report highlighting their contributions to helping countries emerge from the current crisis and achieve the Goals.[58] The United Nations and international financial institutions, including multilateral development banks, should further strengthen their cooperation on the ground in support of Member States' sustainable development policies.

C. Women's leadership in the economy

74. Similar to previous years, only one in three businesses worldwide are owned by women – with variations across and within regions.[59] The percentage of director seats held by women was 20.6 per cent in 2020, up only slightly from 20.0 per cent in 2019 and marking a noticeable slowdown in the rate of increase. Based on the current four-year trend, it would take until 2045 to reach gender parity.[60] In addition, even slightly improving parity at the board level might not be representative of the whole economy.

75. In a recent survey, women-led firms indicated more often (63 per cent) that they were strongly affected by COVID-19 compared with firms led by men (52 per cent). Probable causes include the sector (women are especially engaged in retail), the size of firms and differences in access to capital and credit. Data also show a decline in the hiring of women in leadership roles, reversing one to two years of progress.[61]

IX. Conclusions

76. **The COVID-19 crisis exposed large gaps and vulnerabilities in the international system, lending new urgency to long-standing calls for its reform. Endeavours to overcome the current crisis must go beyond short-term relief. United Nations Member States and all relevant stakeholders, including international financial institutions, must realign the system to work together towards the realization of the 2030 Sustainable Development Agenda, the Paris Agreement and the Addis Ababa Action Agenda.**

77. **Returning to a sustainable development path requires a significant investment push in people, planet and peace. However, many vulnerable developing countries are unable to access affordable market financing. Countries that lack sufficient fiscal space will need grants and very long-term financing options, along with the mobilization of private sector resources through innovative financing mechanisms and incentives for sustainable investment. Public development banks will need to be adequately capitalized to fulfil their role in long-term financing.**

78. **The crisis has also highlighted the need to make the global financial safety net fit-for-purpose to support a greener and more inclusive recovery, prepare better for future crises and leave no one behind. This includes the replenishment**

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[56] IMF, "Sustainable Development Goals: SDG Financing" (accessed July 2021).

[57] World Bank, "World Bank Group President's statement on Climate Change Action Plan", 2 April 2021.

[58] Asian Development Bank and others, "Financing the Sustainable Development Goals: the contributions of the multilateral development banks", 2020.

[59] Daniel Halim, "Women entrepreneurs needed – stat!", World Bank Blogs, 5 March 2020.

[60] Christina Milhomem, "Women on boards: 2020 progress report", MSCI, 30 November 2020.

[61] International Labour Organization, *World Employment and Social Outlook: Trends 2021* (Geneva, 2021).

and redesign of IMF instruments to make them more responsive to members' needs, and a quota review and governance reform of international financial institutions that increases the voting shares of developing countries while protecting the voice and representation of their poorest members.

79. **The agreed new allocation of $650 billion in special drawing rights will immediately boost IMF member countries' access to international liquidity. Countries with strong external positions should voluntarily channel unused special drawing rights to countries most in need – including middle-income countries. The current crisis is an opportunity to rethink the potential role of special drawing rights for supporting sustainable development, for example through the establishment of new dedicated funds to leverage special drawing rights for sustainable financing. Special drawing rights could, for example, be channelled to multilateral development banks (without changing the IMF Articles of Agreement) to support health care and climate-related uses.**

80. **The crisis has increased the focus on the gaps in the international financial architecture, as well as the interlinkages between social, environmental and economic risks in the financial system and in monetary policy. The integrated nature of risks can only be addressed through joint action. The United Nations provides a unique platform for bringing together all stakeholders – the official sector, including the international financial institutions and standard-setting bodies; Governments; the private sector; and civil society – across the three dimensions of sustainable development, to jointly work towards strengthened policy coherence and the implementation of the Sustainable Development Goals and the Paris Agreement.**