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Report of the Secretary-General

Summary

The present report, submitted pursuant to General Assembly resolution [76/192](#), provides a review of the implications of the coronavirus disease (COVID-19) pandemic and new and emerging challenges, including from non-economic risks, for the international financial system. The report contains proposals for reforming the international financial architecture in support of sustainable development, sustained by enhanced international cooperation. It includes sections on (a) sovereign borrowing for investment in the Sustainable Development Goals; (b) mitigating capital flow volatility, strengthening the global financial safety net and enhancing debt sustainability; (c) addressing systemic financial stability risks from all sources; and (d) strengthening global governance and policy coherence.

* [A/77/150](#).



I. Introduction

1. The coronavirus disease (COVID-19) pandemic set back progress on sustainable development dramatically, exacerbating poverty and inequalities and curtailing investment in education, infrastructure and the Sustainable Development Goals in the poorest countries. Progress, however, had already been faltering: macroeconomic and debt risks were mounting even in 2019, investment growth was tepid and carbon emissions were continuing unabated.

2. The war in Ukraine is the latest crisis, with food and fuel price rises exacerbating hunger and poverty globally. The growing frequency of global shocks reflects a broader increase in systemic risks, driven by ever more integrated and interdependent economies and societies in a highly globalized world. Rapid technological change has created new opportunities, including for a more inclusive and efficient financial system, but it also poses risks and can create new forms of exclusion.

3. The international financial system (which includes both private and public institutions) should facilitate the allocation of resources for investment in sustainable development as well as countercyclical access to financing in times of crises. It needs to be coherent with other relevant parts of the international architecture, including international tax norms and the global trading system, to best contribute to sustainable development. Yet the current international financial architecture – the governance arrangements for both safeguarding the functioning of the global monetary and financial systems and ensuring that the system is aligned with sustainable development – is failing to facilitate such a productive role and has not kept pace with the changing global landscape. Not only does the current architecture fail to align the global financial system with the Sustainable Development Goals but in a much narrower context it fails as well to allocate capital to its most productive uses and avert boom-and-bust cycles. Some have used the term “non-system”¹ to describe the existing set of international financial frameworks and rules, institutions and markets that has evolved with different phases of economic globalization, often in ad hoc fashion and in response to economic and financial shocks and crises.

4. These shortcomings contribute to the “great finance divide” laid bare by the COVID-19 pandemic: while developed countries were able to borrow record sums at ultra-low interest rates to respond to and recover from the crisis, developing countries’ responses were curtailed by their lack of access to affordable finance. The high cost of financing for developing countries further limited their fiscal space and exacerbated debt vulnerabilities for many.²

5. In the Addis Ababa Action Agenda of the Third International Conference on Financing for Development,³ Member States recognized the importance of a stable international financial architecture in intermediating credit and investment for sustainable development. Also recognized were both the importance and the limits of commercial creditors with regard to financing sustainable development, particularly when risks are perceived as high or when expected returns are not competitive with other opportunities. Member States thus emphasized the role of public development banks as well as the importance of incorporating sustainability into the rules that govern the financial system.

6. The present report reviews the implications of the COVID-19 pandemic and new and emerging challenges for the international financial system. It contains proposals

¹ See, for example, José Antonio Ocampo, *Resetting the International Monetary (Non)System* (Oxford, Oxford University Press, 2017).

² *Financing for Sustainable Development Report 2022* (United Nations publication, 2022).

³ Resolution 69/313, annex.

for reforming the international architecture in support of sustainable development, supported by enhanced international cooperation.

II. Sovereign borrowing for investment in the Sustainable Development Goals

7. Sovereign borrowing is an important tool for financing Sustainable Development Goal investments and supporting countercyclical fiscal policies, as seen during the pandemic response in 2020–2021. For countries most in need, however, high borrowing costs limit their access to additional financing. While the low interest environment of recent years reduced the average interest cost of outstanding sovereign debt for developed countries to about 1 per cent, least developed countries that tapped international capital markets often paid rates of over 5 or even 8 per cent. As a result, least developed countries on average dedicate 14 per cent of their domestic revenue to interest payments compared with developed countries which despite their much larger debt stocks dedicate only about 3.5 per cent on average.

8. The challenge is to increase access to long-term, affordable and stable financing and to use the proceeds productively so that public policy goals are achieved and fiscal capacity is enhanced, while addressing debt distress when necessary. Solutions require a multifaceted approach, including both national actions to lower risks and invest resources productively and improving access to international public finances and enhancing the terms of market financing.

A. The system of public development banks

9. Public development banks are uniquely placed to provide affordable long-term financing for investments in recovery, the Sustainable Development Goals and climate action. The time-horizons of development banks are typically longer than those of private investors and their sustainable development mandates enable them to provide concessional financing for investment which would otherwise not be competitive on a risk-return adjusted basis (protecting financial viability rather than maximizing returns). Enhanced cooperation through the network of public development banks can benefit multilateral development banks (MDBs) and regional and national development banks through co-financing, building greater capacities, strengthening governance and drawing on local knowledge.

10. Development banks have played an important countercyclical role during the COVID-19 pandemic. Total lending by multilateral development banks increased sharply, growing 34 per cent during 2020 (to reach \$96 billion) and with further growth expected for 2021. Subregional and national development banks provided additional support and in Latin America and the Caribbean subregional and national development banks had lending levels significantly above those of MDBs. A total of 527 development banks and development finance institutions together control assets of \$13 trillion, which they can leverage for greater impact.⁴

11. Capital increases for non-concessional windows and early replenishment of concessional financing mechanisms could expand the lending capacity of multilateral development banks. Channelling special drawing rights (SDRs) through MDBs could further increase their capacity for long-term financing, as discussed below. In addition, MDBs still have room to make optimal use of their balance sheets to enhance lending, as called for in the Addis Ababa Action Agenda. According to a recent

⁴ For a deeper discussion of public development banks, see *Financing for Sustainable Development Report 2022* (United Nations publication, 2022).

independent review, commissioned by the G20 International Financial Architecture Group, multilateral development banks could free up several hundreds of billions of dollars in financing, including by better incorporating callable capital in their capital adequacy assessments; improving credit rating agencies' understanding of the financial strengths of MDBs; and increasing access to MDB data/analysis.⁵

B. Improving terms of market borrowing: the role of credit rating agencies

12. High perceived risks and uncertainty drive up sovereign borrowing costs. To overcome this challenge, countries can first and foremost aim to reduce risks through domestic policies.⁶ However, borrowing costs can also be reduced by enhancing transparency and strengthening the broader information environment.

13. Credit rating agencies play an important role in the allocation of resources by providing information that helps investors and financial markets price risk. Negative warning announcements by credit rating agencies have been linked to increases in the cost of borrowing, particularly for developing countries, of 160 basis points versus 100 basis points for advanced economies. Since sovereign ratings often act as a country-level baseline for corporate ratings, they also affect the cost of corporate borrowing and investment in the Sustainable Development Goals.

14. Valid criticisms of credit rating agencies are focused not so much on the fact that they impact market prices (which would be expected) but on whether they transmit inaccurate information and/or exacerbate market reactions and procyclicality. Sovereign ratings are structurally different from corporate ratings in that analyst judgment plays a much greater role in sovereign rating decisions. The more subjective nature of sovereign ratings has opened up credit rating agencies to criticisms of potential bias.

15. Credit ratings also reflect short-termism in markets (their time-horizon on sovereign debt is generally about three years). This has led them to under-estimate some risks, such as climate-related risks, and overlook opportunities, such as the longer-term impacts of investments in Sustainable Development Goals on economic growth, resilience and debt servicing capacity. In addition, there have been concerns about the impact of ratings on volatility. The fear of credit rating downgrade also discouraged several eligible countries from accessing the G20 and Paris Club Debt Service Suspension Initiative (though ultimately none of the participating countries were downgraded).

16. To address these challenges and ensure high-quality information which encourages sustainable investment, there is a need to (a) enhance transparency (including by distinguishing between model-based assessments and judgment) and update ratings methodologies, making use of technological innovation; (b) develop longer-term ratings based on scenario analyses and probabilistic approaches as a complement to existing assessments; (c) increase dialogue with the public sector to improve understanding of public actions to strengthen debt sustainability; and (d) move from a cliff edge, when downgrading a sovereign issuer from investment-grade to speculative-grade status causes a wave of forced selling of its debt, to a graduated approach to rating downgrades. There are also proposals for structural reforms and regulation to reduce conflicts of interest in credit rating agencies and to

⁵ *Boosting MDBS' Investing Capacity: An Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks* (2022).

⁶ For a deeper discussion, see *Financing for Sustainable Development Report 2022* (United Nations publication, 2022).

establish public rating agencies (although a public agency might have its own conflicts of interest and would need to build market confidence in its assessments).⁷

III. Mitigating capital flow volatility, strengthening the global financial safety net and enhancing debt sustainability

17. Theoretically, finance should flow to countries and sectors where capital is scarce and returns are high, thus providing the resources necessary for development. However, capital has not always flowed to areas where needs are greatest, while volatile boom-bust patterns have led to instability in the real economy and made macroeconomic policy management more challenging. The COVID-19 pandemic, compounded by the impacts of the war in Ukraine, has exposed once again the vulnerability of many developing countries to external shocks and large swings in short-term international capital flows, which constrain access to international liquidity just when countries need it most.

18. To overcome the current crises and make the international financial system fit for future challenges, Member States should work together to address capital flow volatility, strengthen the global financial safety net and enhance debt sustainability.

A. Addressing capital flow volatility

19. The onset of the war in Ukraine in early 2022 triggered a sharp increase in global financial market volatility and a reversal of capital flows from developing countries, albeit with large differences across regions. The effects of heightened geopolitical uncertainty were compounded by rapidly rising interest rates, inflationary pressures and a weakening global economic outlook. In May 2022, emerging markets experienced non-resident portfolio outflows of \$4.9 billion, following outflows of \$4.0 billion and \$9.8 billion in April and March, respectively. This was in stark contrast to the average net monthly inflows of about \$30 billion in 2021. A further rise in risk aversion and more aggressive monetary tightening of global interest rates would exacerbate financing risks. Countries with structural vulnerabilities, such as elevated debt levels, could experience sharper capital outflows.⁸

Managing capital flow volatility

20. As during the onset of the COVID-19 pandemic, the drivers of the latest capital flow reversal – the war in Ukraine and the sharp increase in global interest rates – are outside the control of recipient countries. Yet, national policymakers must contend with the impact on their domestic economies. They need to have all the tools – monetary, exchange rate, macroprudential, capital flow management and others – at their disposal that are required to mitigate the impacts of volatile international capital flows.

21. At the start of the COVID-19 crisis, more countries than in the past were able to deploy countercyclical monetary policies, including interest rate cuts and, in some cases, quantitative easing; foreign exchange interventions; easing of macroprudential regulations; and, in a few cases, capital flow management measures. More recently,

⁷ Shari Spiegel and others, “Credit rating agencies and sovereign debt: four proposals to support achievement of the SDGs”, Department of Economic and Social Affairs of the United Nations Secretariat Policy Brief No. 131 (March 2022).

⁸ International Monetary Fund, *Global Financial Stability Report: Shockwaves from the War in Ukraine Test the Financial System’s Resilience* (Washington, D.C., April 2022); and Institute of International Finance, Capital flows tracker.

monetary policy space has shrunk amid rising inflationary and exchange rate pressures, with most developing countries beginning monetary tightening before large developed economies.⁹

22. The initial impact of the shock of the COVID-19 pandemic on capital flows also confirmed the effectiveness of capital flow management measures (CFMs) in countries with pre-emptive CFMs for capital inflows. Those countries experienced relatively lower financing costs and exchange rate volatility during the period of capital outflows and were, on average, more able to retain access to external financing.¹⁰

23. In a recent review of its 2012 institutional view on capital flows, IMF recognized the potential role of measures that combine elements of both CFMs and macroprudential measures, such as limits on or taxation of banks' foreign currency exposures, for reducing capital inflows and limiting the build-up of financial vulnerabilities. As a result, new IMF guidance sees a role for pre-emptive measures not only when capital inflows surge but also at other times.¹¹ This is in line with Member States' recognition in the Addis Ababa Action Agenda of the potential role of CFMs. An integrated policy framework could help countries determine the best policy mix and could be implemented as part of a broader integrated national financing framework.

24. International coordination and transparent forward guidance on monetary policy decisions in source countries for capital flows are important in helping to reduce negative spillovers. Source countries should also continue efforts to enhance financial stability and incentives for long-term sustainable investment, which would reduce cross-border capital flow volatility.

B. Strengthening the global financial safety net amid growing insecurity

25. The global financial safety net is meant to support short-term liquidity needs for countries in balance-of-payments crises, which may be triggered or exacerbated by capital flow volatility. With IMF at its centre, the global financial safety net also includes regional financing arrangements, bilateral swap arrangements and countries' own foreign exchange reserves.

26. Since 2020, the global financial safety net has provided emergency support to countries suffering from the impacts of the COVID-19 pandemic and shocks from the war in Ukraine, including through the historic \$650 billion allocation of IMF special drawing rights in 2021. While countries have accessed all four layers of the global financial safety net, the recent crises have exposed gaps and revealed uneven access. For instance, while bilateral currency swaps accounted for most of the liquidity support during the COVID-19 crisis, only a few developing countries have access to such voluntary bilateral agreements. Amid worsening impacts from the war, tightening global financial conditions and a deteriorating economic outlook, more countries are expected to require support going forward.

27. Given the growing systemic risks from cascading economic and non-economic shocks (including climate-related hazards), the global financial safety net urgently

⁹ United Nations, Economic and Social Council, "World economic situation and prospects as of mid-2022" (E/2022/60), 10 May 2022.

¹⁰ Mitali Das, Gita Gopinath and Şebnem Kalemli-Özcan, *Preemptive Policies and Risk-Off Shocks in Emerging Markets*, IMF Working Paper, No. 22/3 (January 2022).

¹¹ International Monetary Fund, "Review of the institutional view on the liberalization and management of capital flows", IMF Policy Paper, No. 2022/008 (Washington, D.C., 30 March 2022).

needs to be further strengthened and made fit for purpose. This will require (a) a larger total resource envelope; (b) new instruments for addressing emerging challenges, including potentially state-contingent issuance of IMF special drawing rights; (c) enhanced access of countries to all layers of the global financial safety net; and (d) an increased voice and participation of developing countries in governing mechanisms, as discussed in section V below.

IMF crisis response and new instruments

28. The new allocation of special drawing rights in 2021 helped bridge some of the gaps in the global financial safety net. It provided member countries with liquidity without creating additional debt, allowing them to boost their international reserves and/or exchange their SDRs for freely usable currencies to cover spending needs in accordance with national legal frameworks. By the end of January 2022, 35 countries had reportedly exchanged all or part of their allocations (equivalent to \$14.8 billion).¹²

29. In addition, IMF increased emergency lending and created some new instruments. IMF lending to developing countries between March 2020 and March 2022 totalled \$170.6 billion, including \$32.9 billion in disbursements without formal adjustment programmes through the concessional Rapid Credit Facility and the non-concessional Rapid Financing Instrument. In April 2020, IMF established a new short-term liquidity line for countries with very strong policies and fundamentals, the first addition to the IMF financing toolkit in almost 10 years. Yet, it took over two years for the first country (Chile) to access this instrument in May 2022, after recovering from the immediate economic impact of the pandemic. IMF also implemented several short-term measures including increasing access limits to lending facilities and temporarily streamlining approval processes. From January 2022, cumulative access limits were reduced to their pre-pandemic levels for most facilities.¹³

30. Growing systemic risks from more frequent and interconnected economic and non-economic shocks will require new financing instruments to meet evolving needs, including those of middle-income countries. They should be quick disbursing, with low interest rates and parsimonious conditionality. Suspending interest surcharges – which affect more heavily indebted countries and those with outstanding debt after four years – would reduce procyclical pressure on countries in times of crisis.

31. To increase access to swap lines for all, IMF could facilitate a multilateral currency swap facility, with the participation of global reserve currency issuing central banks, to provide access to emergency liquidity for a broader set of developing countries.¹⁴

32. The ongoing sixteenth general review of quotas offers an opportunity to recapitalize IMF and expand its lending capacity to prepare for future challenges, while strengthening the voice and representation of developing countries.

¹² IMF, *Quarterly Report on IMF Finances for the Quarter Ended January 31, 2022* (Washington, D.C., 2022).

¹³ Enhanced cumulative access limits for the Rapid Credit Facility and the Rapid Financing Instrument were extended through end-June 2023. See IMF, “Review of temporary modifications to the Fund’s access limits in response to the COVID-19 pandemic”, *IMF Policy Paper*, No. 2021/077 (Washington, D.C., 22 December 2021).

¹⁴ Edwin M. Truman, “Central banks and the global financial safety net”, in *Building Back a Better Global Financial Safety Net*, Kevin P. Gallagher and Haihong Gao, eds. (Boston, Massachusetts, Global Development Policy Center, Boston University, 2021), chap. 3.

Harnessing special drawing rights

33. The mechanism for allocating special drawing rights in proportion to countries' quota shares at IMF meant that developing countries received only about one third of the 2021 allocation. To strengthen their impact, both the G7 and the G20 have called for a voluntary global reallocation of \$100 billion of unused SDRs. As of mid-July 2022, countries had pledged a total of \$73 billion.¹⁵ SDRs are currently used to finance the Poverty Reduction and Growth Trust (PRGT), which can channel SDRs to low-income and other vulnerable countries on concessional terms. Further, IMF has set up a new Resilience and Sustainability Trust (RST) to channel SDRs to low-income and vulnerable middle-income countries.

34. The Resilience and Sustainability Trust will offer affordable longer-term financing (for up to 20 years) to help countries build resilience to external shocks, with an initial focus on climate change and pandemic preparedness, ensure sustainable growth and contribute to long-term balance-of-payments stability. The Trust aims at raising \$45 billion in funding through special drawing rights (with \$40 billion pledged as of May 2022) and beginning lending to pilot countries by the end of 2022.

35. A third option under discussion is to channel special drawing rights through multilateral and regional development banks that are already prescribed holders of SDRs (subject to donor countries' own regulatory, policy and institutional arrangements). For instance, developed countries could lend their SDRs through a hybrid debt instrument which would allow multilateral development banks to count them as quasi capital, further enhancing MDB capacity for long-term financing. A liquidity backstop, modelled on the PRGT/RST, would maintain reserve asset characteristics of SDRs by allowing lenders to redeem their loan in case of balance-of-payments issues.

36. Channelling of SDRs through IMF and/or multilateral development banks, while helping to mobilize additional financing for sustainable development, creates additional debt which may be difficult for some developing countries to manage. Proposals for changing the distribution formula of future allocations could limit the need for channelling SDRs and creating new debt by allocating SDRs according to countries' needs (e.g. depending on their foreign currency reserve levels) instead of their IMF quotas.

37. A greater role for special drawing rights in addressing systemic risks would require timely new issuances in times of crises. The development of a mechanism for automatic state-contingent issuance could help provide SDRs when they are most needed and avoid protracted political negotiations during those crises. Agreements could be put in place to allow for a portion to automatically support multilateral development bank countercyclical lending.

Strengthening regional financing arrangements

38. Regional financing arrangements can play an important role in strengthening the global financial safety net. Developing countries have access to six regional financing arrangements, with a combined lending power of \$1 trillion.¹⁶ Between February 2020 and October 2021, RFAs disbursed only \$5.4 billion to member

¹⁵ G20 Chair's summary of the third Meeting of G20 Finance Ministers and Central Bank Governors, 15 and 16 July 2022.

¹⁶ 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.

countries, partly in combination with IMF programmes. Despite the comparatively small amounts, the quick disbursal of RFA loans provided fast and flexible relief for those countries that accessed them. Other activities of RFAs, such as regional macroeconomic surveillance, capacity-building and technical assistance, help to strengthen macroeconomic and financial stability and resilience to shocks. RFAs also give voice and representation to their member countries, most of which are not included in other multilateral forums such as the G20.¹⁷

39. Continuing cooperation between regional financing arrangements and IMF should be balanced with sufficient autonomy to enable RFAs to best serve their member countries' needs. An expansion of their member base could help RFAs further strengthen their role in the global financial system. For instance, the Latin American Reserve Fund recently introduced the new member category "associated central banks", under which the Central Bank of Chile joined in February 2022.

C. Enhancing debt sustainability

40. The shock delivered by the COVID-19 pandemic and related debt increases have compounded debt vulnerabilities which had been building up over the last decade. Even before accounting for the impact of the war in Ukraine, about 60 per cent of least developed and other low-income countries were at high risk of or in debt distress, more than twice the share in 2015. A quarter of middle-income countries were also at high risk of experiencing a fiscal crisis. Financing conditions have deteriorated further since the outbreak of the war. Sovereign debt of a growing number of developing countries is trading at distressed levels, with Sri Lanka being the first country to default in 2022. As global interest rates continue to rise, there is a growing risk of a systemic debt crisis.¹⁸

41. To avert debt crises, the international community should, as a first step, provide short-term respite to debtors with liquidity challenges, including through a reactivation of the G20 and Paris Club Debt Service Suspension Initiative, with a further push-back of maturities. While this would help countries with liquidity needs, it would not solve solvency challenges for countries in debt distress. To help debt-distressed countries, shortcomings of the G20 Common Framework for Debt Treatments – which has not yet provided a single debt restructuring 1.5 years after its introduction – must be urgently addressed and all public and private creditors need to be engaged. Engaging private creditors, however, would require a new mechanism for providing both carrots and sticks, as without such a mechanism private creditors may have an incentive not to participate.

42. There may also be a need for a multilateral debt relief/restructuring initiative. The design of such an initiative should be guided by longer-term considerations for improving the international debt architecture.

43. For future crises, a more systematic inclusion of state-contingent lending (which incorporates automatic debt payment suspension in loan agreements in the event of predefined shocks) by official creditors would systematize debt suspension and obviate the need to negotiate a new debt service suspension initiative during a crisis. This could also be a basis for similar mechanisms in the context of market debt.

¹⁷ *Financing for Sustainable Development Report 2022* (United Nations publication, 2022).

¹⁸ For a more in-depth analysis, see report of the Secretary-General on external debt sustainability and development (forthcoming).

Swapping debt for sustainable investment

44. Countries with large but sustainable debt burdens, including middle-income countries, often lack sufficient fiscal space for sustainable investment. Swapping debt for sustainable investment can help those countries free up fiscal space to invest in the Sustainable Development Goals in line with national development priorities.

45. Although there have been examples of successful debt-for-health and debt-for-nature swaps, uptake has so far been limited owing to high transaction costs. Such transactions have also drawn criticism for their small size and for consequently failing to have a real impact on debt relief and sustainable development.

46. The sharp increase in debt burdens since 2020, together with a worsening climate crisis and growing concerns about sustainable development-related setbacks, has revived interest from both borrowers and official lenders in swapping debt for sustainable investment. Beyond increasing fiscal space for recipients, such instruments could be structured to help donors meet climate commitments.

47. To address past criticism and strengthen the impact of debt-for-sustainable investment swaps, development partners should (a) standardize term sheets to the extent possible and harmonize monitoring and verification requirements; (b) support donor coordination, e.g. through regional platforms; and (c) strengthen capacities of local officials, including for identifying potential debt swap opportunities, to enhance country ownership.¹⁹

IV. Addressing systemic financial stability risks from all sources

48. The Addis Ababa Action Agenda recognizes the importance of macroeconomic and financial stability for equitable and sustainable growth and sustainable development. Reforms introduced since the 2008 world financial and economic crisis have strengthened the regulated financial system. However, risks have been growing in other areas, particularly the less regulated non-bank financial sector (including financial technologies), as well as owing to the expanding impact of non-economic factors such as climate change.

49. Policymakers must respond to these challenges, including by expanding the regulatory umbrella and reviewing and updating existing regulations and risk assessment methodologies.

A. Managing financial risks

50. The protracted period of low interest rates since the 2008 global financial crisis incentivized financial risk taking and investor “search for yield”, contributing to the build-up of leverage in financial markets to record levels by early 2022.²⁰ Since then, monetary policy stances across the globe have become less accommodative and equity market valuations have declined. As central banks tighten monetary policy at a more aggressive pace, a sharp rise in interest rates could trigger a more disorderly deleveraging process, with potential risks to financial stability.

51. Vulnerabilities of non-bank financial intermediaries (NBFIs)²¹ could have implications for the broader financial system, as was seen during the financial turmoil

¹⁹ *Financing for Sustainable Development Report 2022* (United Nations publication, 2022).

²⁰ Based on S&P/LSTA Leveraged Loan Index.

²¹ Including insurance corporations, pension funds, other financial intermediaries (particularly investment funds) and financial auxiliaries.

in March 2020 and after the collapse of the private investment firm Archegos in April 2021.²² The growing role of fintech and large technology companies in the financial sector and ongoing developments in the decentralized finance (DeFi) space also call for further regulatory and supervisory scrutiny.

Non-bank financial intermediation

52. The recent growth of non-bank financial intermediaries, which now hold almost half of global financial assets (up from 42 per cent in 2008), means that financial risks are increasingly being held outside of the regulated banking sector. While NBFIs contribute to a diversified financing landscape, their activities and structures can amplify volatility and market stress. Liquidity mismatches (when holdings of illiquid long-term investments are funded with short-term borrowings) and excessive leverage are two main risk factors associated with NBFIs which could trigger rapid deleveraging in the event of a shock.

53. Collateral (or margin) requirements for derivatives trading, introduced as part of the post-2008 reforms to reduce risks from market price changes or counterparty defaults, may have increased the procyclicality of derivatives markets as an unintended consequence. For instance, margin calls to replenish collateral in response to price changes and increased volatility were found to have increased liquidity stresses in March 2020.²³ Recent developments have already caused new stresses in financialized commodity markets when price volatility triggered large margin calls following the outbreak of war in Ukraine.

54. To address growing financial stability risks from non-bank financial intermediaries, policymakers should continue to expand the regulatory umbrella according to the principle of “same activity, same risk, same rules” while minimizing unintended consequences. Beyond the full implementation of agreed G20 reforms, proposals include (a) enhanced reporting requirements to facilitate monitoring; (b) measures to reduce leverage (e.g. through tax incentives or regulatory limits) and increase shock absorption capacity; and (c) greater coordination between national authorities and with international standard setting bodies to facilitate a better understanding of the systemic risks of NBFIs and address international spillovers.²⁴ Policymakers should also continue to explore other measures that have been suggested to rein in excess financialization, such as financial transaction taxes or ceilings for financial sector remunerations.

B. Digital finance

55. Rapid developments in digital financial technology, further accelerated by the pandemic, have transformed financial services and created a new range of digital assets including cryptoassets and so-called stablecoins. While creating new opportunities for efficiency gains and financial inclusion, the large-scale adoption of these technologies also creates new risks, including for financial stability and integrity. Many central banks are also exploring the development of central bank digital currencies (CBDCs), in part to address these risks by offering a safer alternative.

²² Bank for International Settlements, *Annual Economic Report* (Basel, Switzerland, 2022).

²³ Bank for International Settlements and International Organization of Securities Commissions, *Review of Margining Practices: Consultative Report* (Basel, Switzerland, 2021).

²⁴ *Financing for Sustainable Development Report 2022* (United Nations publication, 2022).

Harnessing digital finance

56. By reducing market frictions and lowering transaction costs, digital financial innovations can make it profitable to provide access to financial services for previously excluded or underserved individuals and micro-, small and medium-sized enterprises. Between 2017 and 2021, account ownership in developing countries increased from 63 to 71 per cent, with a decline in the gender gap from 9 to 6 percentage points. Mobile money in particular has enabled a greater level of account ownership and usage in sub-Saharan Africa, especially for women.²⁵

57. The COVID-19 pandemic accelerated the expansion of digital financial services worldwide. Yet, while big tech platforms saw rapid revenue growth during the pandemic, some smaller companies struggled to raise funding.²⁶ The growing presence of big tech in finance has increased concerns about financial stability risks, including from the growing systemic importance of actors not covered by financial regulations. In some countries, particularly in sub-Saharan Africa, mobile money platforms have become systemically important but regulatory protections vary widely between jurisdictions.

58. As the activities of such actors become more interconnected with the rest of the financial system and as they become “too big to fail”, financial regulators and supervisors need to close regulatory gaps. In addition to following the principle of same activity, same risk, same rules, they may also consider complementary regulations to address the challenges posed by big tech companies (including the risk of market dominance).

59. The expansion of digital financial services has also increased risks from cyberincidents, data protection and privacy breaches, digital fraud and new forms of exclusion, e.g. resulting from biases in artificial intelligence (AI) decision-making.²⁷ To address this, several jurisdictions, including developing countries, have introduced new regulations targeting market concentration, cybersecurity and consumer protection.²⁸

60. To further address risks without unduly stifling innovation, policymakers should continue to review and adapt existing regulation with the support of international standard setting bodies and enhanced peer learning.

Cryptoassets and so-called stablecoins

61. While interest in cryptoassets and so-called stablecoins had increased during most of 2021, the recent sharp drop in valuations, with total market capitalization falling from \$3.1 trillion in November 2021 to under \$1 trillion by early July 2022, was a stark reminder of the inherent volatility and risks and a wake-up call for policymakers.²⁹

²⁵ Asli Demirgüç-Kunt and others, *The Global Findex Database 2021: Financial Inclusion, Digital Payments, and Resilience in the Age of COVID-19* (Washington, D.C., World Bank, 2022).

²⁶ *Financing for Sustainable Development Report 2022* (United Nations publication, 2022); and Financial Stability Board, “FinTech and market structure in the COVID-19 pandemic: implications for financial stability” (Basel, Switzerland, 21 March 2022).

²⁷ For a more detailed discussion, see *Financing for Sustainable Development Report 2022* (United Nations publication, 2022).

²⁸ Financial Stability Board, “FinTech and market structure in the COVID-19 pandemic: implications for financial stability” (Basel, Switzerland, 2022).

²⁹ The present section is based on Cornelia Kaldewei and Shari Spiegel, “Cryptoassets and so-called ‘stablecoins’: where do we go from here?” Department of Economic and Social Affairs of the United Nations Secretariat Policy Brief, No. 135 (13 June 2022).

62. Cryptoassets such as bitcoin are privately issued virtual tokens, many of which are based on decentralized networks using distributed ledger (blockchain) technology. Their proponents tout them as democratic and decentralized substitutes for official currencies which can increase the efficiency and inclusiveness of financial transactions. However, their large swings in valuation render cryptoassets unfit to fulfil the three main functions of currencies, i.e. to serve as a store of value, as a unit of account and as a medium of exchange. Efficiency claims are countered by the lack of scalability of blockchain technology³⁰ and the concentration of a few major token holders in the cryptoecosystem belies the claim of democratization and decentralization. As an alternative, 9 out of 10 central banks are currently exploring the development of central bank digital currencies as one option among others for enhancing public payment infrastructures and settlement mechanisms.

63. As cryptoassets have become more mainstream, their correlation with global equity markets has increased, raising financial stability concerns. Other risks, especially for developing countries with high rates of adoption, include a reduced effectiveness of national monetary policy (similar to the effects of dollarization) and increased capital flow volatility. The pseudo-anonymous nature of cryptoasset transactions also raises concerns with respect to increasing the risk of illicit financial flows. The high energy consumption and large carbon footprint of some cryptoassets, including bitcoin, are worrisome as well.

64. So-called stablecoins share many of the characteristics of cryptoassets, including their pseudo-anonymous nature. However, they aim towards limiting volatility by pegging their value to assets and/or currencies. Most are currently used for trading between cryptoassets and for conversion between cryptoassets and currencies.

65. Despite their name, stablecoins can be vulnerable to runs when investors lose trust and try to redeem their holdings, possibly triggering rapid sales. This occurred in early May 2022, when a loss of trust led to the collapse of the algorithmic stablecoin TerraUSD, previously one of the top five stablecoins by market capitalization.

Strengthening regulation and supervision of cryptoassets and so-called stablecoins

66. Policymakers and international standard setting bodies have made progress in designing policy responses. Forty-two (mostly developing) countries implicitly banned cryptoassets in 2021 (e.g. by prohibiting financial institutions from dealing or offering services in cryptoassets), up from 15 in 2018, and 9 countries had an absolute ban (8 in 2018). There was also an increase between 2018 and 2021 in the number of countries applying tax laws and anti-money-laundering and countering the financing of terrorism regulations from 33 to 103.³¹

67. In June 2022, the European Union approved a joint regulatory framework, which will require all stablecoins to have full asset backing with adequate minimum liquidity to ensure full and timely redemption of all claims. All cryptoasset service providers will be subject to strong consumer protection (including liability) rules and will be required to declare information on their environmental and climate impact.³²

³⁰ The estimated maximum processing capacity of the bitcoin blockchain is 3.3–7 transactions per second.

³¹ Law Library of Congress, *Regulation of Cryptocurrency Around the World: November 2021 Update* (Washington, D.C., 2021).

³² Council of the European Union, “Digital finance: agreement reached on European crypto-assets regulation (MiCA)”, press release, 30 June 2022.

68. Other major jurisdictions, including the United Kingdom of Great Britain and Northern Ireland and the United States of America, are in the process of designing national legislations, though they are expected to be less far-reaching than that of the European Union. Yet, compliance of multinational companies with European Union-wide standards can sometimes turn them into de facto international standards.

69. To address financial stability-related and other risks from cryptoassets and stablecoins, while remaining innovation-friendly, policymakers should take action along four broad lines. They should (a) hold stablecoins to the same regulatory standards as similar instruments such as bank accounts, money market funds and electronic money; (b) review and update regulations to cover cryptoassets, safeguard financial stability and integrity in line with agreed international standards and address energy consumption; (c) strengthen cooperation across sectors and jurisdictions to create a comprehensive coordinated regulatory framework; and (d) address underlying domestic issues, such as weak macroeconomic performance and high inflation expectations, which may be triggering large-scale adoption of cryptoassets and stablecoins.

Central bank digital currencies

70. Central banks worldwide are exploring alternative, safer ways to address some of the issues highlighted by the interest in cryptoassets. Options include retail fast payment systems that offer around-the-clock payments processing and final settlement, and central bank digital currencies.

71. A recent survey found that 90 per cent of central banks were engaged in CBDC-related work, with 68 per cent considering it likely or possible that they would issue a retail central bank digital currency within the next six years.³³ This follows the launch of the first retail CBDCs in the Bahamas in 2020 and Nigeria in 2021, and the launch of pilot retail CBDCs in the eastern Caribbean and China. For developing countries, the main motivating factor for exploring retail CBDCs is financial inclusion, while for developed countries the main considerations are domestic payments efficiency, payments safety and financial stability.³⁴

72. Interoperability between central bank digital currencies in different jurisdictions could help to enhance cross-border payments. However, this could also create new risks similar to those associated with cryptoassets and stablecoins, involving possible currency substitution and capital flow volatility if nationals of one country were to adopt CBDCs from another, although design choices could help to mitigate some of those risks.

73. International standard setting bodies, such as the Bank for International Settlements, can provide support by developing proofs of concepts and prototypes and fostering broad dialogue and peer learning. Developing countries should be included in these dialogues, including those most likely to be affected by unintended consequences and cross-border spillovers from other countries' CBDCs.

C. Climate change

74. Increasing climate-related risks can impact asset values and threaten financial stability. While individual financial institutions are increasingly recognizing those risks, additional efforts are required to fully incorporate them into decision-making

³³ A retail central bank digital currency is meant for use by the general public; a wholesale CBDC is used for transactions between financial institutions.

³⁴ Anneke Kosse and Ilaria Mattei, "Gaining momentum: results of the 2021 BIS survey on central bank digital currencies", *BIS Papers*, No. 125 (Bank for International Settlements, May 2022).

and risk management frameworks. Monetary policy is also increasingly addressing climate-related risks as part of central banks' mandates on price and financial stability.

Financial regulation in a changing climate

75. Despite recent efforts to identify climate-related exposure in their portfolios, many financial institutions still lack the framework for translating this into quantifiable financial risk. Institutions have so far focused mainly on near-term transition risks, based on the alignment of different sectors' carbon intensity with national climate targets. Some banks integrate the results of such assessments into their risk-management practices, which typically cover two-to-five-year planning horizons. Climate-related risks lie mostly outside banks' conventional planning horizons.

76. To strengthen their climate risk assessments, financial institutions can develop enhanced scenario analyses and adopt climate stress testing practices, building on the framework provided by international bodies such as the Network for Greening the Financial System (NGFS). Efforts of the Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD) to encourage publicly listed companies to disclose their climate-related exposures are also promising, although the reporting of only 28 per cent of banks was aligned with these voluntary guidelines in 2020.³⁵

77. Several jurisdictions have begun to enforce mandatory climate-related risk disclosures in line with or based on the TCFD recommendations.³⁶ Other financial supervisors have increasingly introduced scenario analyses and climate stress tests for microprudential supervision.³⁷ Such disclosures and exercises could be used to determine the climate-resilience of banks' portfolios and form the basis for additional regulatory action, for example, regarding liquidity and capital requirements.

78. Increased coordination between national authorities, with support from international standard setting bodies, can help establish consistent and comparable data sets and reporting standards for the evaluation of vulnerabilities. The Financial Stability Board Roadmap for Addressing Climate-Related Financial Risks aims towards bringing together initiatives for identifying gaps, limiting overlap and promoting synergies to support policy discussions at the international level.³⁸

Monetary policy considerations

79. Climate-related risks impact key macroeconomic variables, including productivity, employment, economic growth and price stability, which brings these risks squarely within the purview of central banks' policy mandates. Moreover, central banks are increasingly incorporating climate-risk considerations in their monetary policy decisions to protect their own balance sheets.

80. To assess the riskiness of assets used in their monetary policy operations, central banks typically rely on the credit ratings of issuers. Since credit ratings work over horizons that are typically shorter than those considered relevant for the implications

³⁵ Task Force on Climate-related Financial Disclosures, *2021 Status Report* (Basel, October 2021).

³⁶ Including Brazil, the European Union Hong Kong Special Administrative Region, Japan, New Zealand, Singapore, Switzerland and the United Kingdom (TCFD *2021 Status Report*), p. 5.

³⁷ Following similar exercises by the Bank of France and the Bank of England, the European Central Bank published the results of its first climate risk stress test in July 2022, finding a combined \$71 billion loss risk for the 41 banks in the sample (see European Central Bank, *2022 Climate Risk Stress Test* (Frankfurt am Main, Germany, 2022)).

³⁸ Financial Stability Board, "FSB Roadmap for Addressing Climate-Related Financial Risks" (Basel, 7 July 2021).

of climate change,³⁹ the European Central Bank has committed to assessing rating agencies' disclosures and understanding how they incorporate climate change risk in ratings by mid-2022 and to introducing requirements into the Eurosystem Credit Assessment Framework by the end of 2024, if needed.⁴⁰

81. The Bank for International Settlements, which manages some \$3.5 billion in green bonds, can also support central banks' sustainable reserve management. By publicly disclosing their own climate-related risks and mitigating strategies, central banks can set a good example for other financial institutions.⁴¹

82. The Network for Greening the Financial System has developed a menu of policy options for central banks, including for protective and more proactive monetary policies, similar to strategies considered by private asset managers.⁴² While most central bank mandates do not explicitly refer to sustainability, close to half of central banks worldwide have an indirect mandate to support the policy objectives of their respective Governments and have announced more proactive policy measures to support the green transition.⁴³

V. Strengthening global governance and policy coherence

A. Making governance more inclusive

83. Despite repeated commitments and some improvement between 2005 and 2015, the representation of developing countries in financial institutions, regional development banks and standard setting bodies has remained largely unchanged in recent years. Major advanced economies continue to hold de facto veto powers in these institutions' decision-making bodies.⁴⁴

84. The current juncture presents a challenge and an opportunity. Governance reform is central for re-establishing trust in the multilateral system by adapting it to changes in the global economy as called for in the Addis Ababa Action Agenda. Not only are capital increases in international financial institutions and regional development banks needed to strengthen their resource envelope but they offer an opportunity to revisit the allocation of voting rights.

85. The ongoing IMF sixteenth general review of quotas (to be concluded no later than 15 December 2023) can help IMF governance reform move forward. The review is expected to result in an increase in the quota share of emerging market and developing countries, while protecting the voice and representation of the poorest members.⁴⁵ Within the World Bank Group, there was a major revision of voting rights in the International Development Association in 2021, for the first time in over 50 years, aimed at enhancing the voice of recipient members and incentivizing future

³⁹ Network for Greening the Financial System (NGFS), "Credit ratings and climate change: challenges for central bank operations" (May 2022).

⁴⁰ European Central Bank, "Annex to the European Central Bank climate action plan, entitled 'Detailed roadmap of climate change-related actions'", 8 July 2021. Available at www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210708_1_annex~f84ab35968.en.pdf.

⁴¹ *Financing for Sustainable Development Report 2022* (United Nations publication, 2022).

⁴² Network for Greening the Financial System (NGFS), *Adapting Central Bank Operations to a Hotter World: Reviewing Some Options* (March 2021).

⁴³ Lena Boneva, Gianluigi Ferrucci and Francesco Paolo Mongelli, "Monetary policy and the green transition", SUERF Policy Brief, No. 268 (Vienna, European Money and Finance Forum, February 2022).

⁴⁴ See *Financing for Sustainable Development Report 2022* (United Nations publication, 2022).

⁴⁵ IMF, IMF quotas, factsheet, 4 March 2021. Available at www.imf.org/en/About/Factsheets/Sheets/2016/07/14/12/21/IMF-Quotas.

contributions. The new framework, with a two-tier membership structure, sees the voting power for non-recipient members gradually aligning to their level of contributions to IDA while the voting power of recipients will be boosted and protected from dilution. The next World Bank shareholding review is set to take place in 2025.

86. Heads of the main international financial institutions' should be selected through an open and transparent, gender-balanced and merit-based process and the diversity of their staff increased, as committed to by Member States in the Addis Ababa Action Agenda.

87. International standard setting bodies have made no significant progress in strengthening the voice and participation of developing countries. Developed countries remain predominant, as most of those bodies were set up by developed countries' national regulatory and supervisory authorities.

B. Policy alignment with the international system, including tax norms

88. The Addis Ababa Action Agenda broadened long-standing calls for increased coherence of the international financial, monetary and trading systems to cover a wider range of policy areas across all three dimensions of sustainable development. It also called on development finance institutions to align their business practices with the 2030 Agenda for Sustainable Development.⁴⁶ Since then, IMF, the World Bank and other multilateral development banks have continued efforts to coordinate and better align their activities with the Sustainable Development Goals and the Paris Agreement⁴⁷ adopted under the United Nations Framework Convention on Climate Change.⁴⁸

89. Despite such efforts, there is still a lack of global policy coherence in support of sustainable development. Greater international cooperation is needed to update tax policies; capital market rules; development cooperation, trade, debt and financial sector regulations; and competition policies to ensure that they are in line with the new realities, including a changed economic landscape, growing systemic risks and an increasingly digitalized economy.

90. In particular, the international community needs tax norms for addressing the digitalization and globalization of the economy that are tailored to the needs and capacities of developing countries. Improved tax norms and international cooperation can reduce tax avoidance and evasion and increase domestic revenue mobilization and thereby make more resources available for public investment in the Sustainable Development Goals.⁴⁹

91. Enhancing coherence will require strengthened multilateralism and new forms of global cooperation which bring together different policy communities and give voice to the most vulnerable. The United Nations continues to provide an inclusive forum for addressing global challenges. Most recently, the Secretary-General set up a Global Crisis Response Group on Food, Energy and Finance which brings together the United Nations system, international financial institutions and other stakeholders

⁴⁶ Resolution 70/1.

⁴⁷ See [FCCC/CP/2015/10/Add.1](#), decision 1/CP.21. annex.

⁴⁸ United Nations, *Treaty Series*, vol. 1771, No. 30822.

⁴⁹ For more in-depth analysis, see the reports of the Secretary-General entitled "Follow-up to and implementation of the outcomes of the International Conferences on Financing for Development" ([A/77/223](#)) and "International coordination and cooperation to combat illicit financial flows" (forthcoming).

to address the impacts of the war in Ukraine. Since 2016, the Inter-Agency Task Force on Financing for Development convened by the Secretary-General has been bringing together the views of over 60 institutional members and helping to shape joint analysis and recommendations for its annual *Financing for Sustainable Development Report*.

92. The United Nations should continue to guide reform of the international system through its universal platform and intergovernmental processes. In particular, the financing for development process could further explore proposals for global governance reform.

C. Women's leadership in the economy

93. The COVID-19 pandemic disproportionately affected women-led businesses. According to a recent survey, women were 20 per cent more likely than men to report a business closure due to the pandemic (41.9 per cent versus 35.5 per cent).⁵⁰ The pandemic did not, however, interrupt the (slow) improvement in the representation of women in company leadership. In 2021, the representation of women on boards increased to 22.7 per cent (from 21.1 per cent in 2020), while the proportion of director seats held by women reached 22.6 per cent (21.1 per cent in 2020). Based on the current four-year trend, it would take until 2042 for gender parity to be reached, three years less than the previous estimate.⁵¹

VI. Conclusions

94. **The combined effects of the COVID-19 pandemic, the war in Ukraine and the worsening climate crisis have resulted in a dramatic setback to sustainable development and curtailed investment in the Sustainable Development Goals. These cascading crises have laid bare the gaps, inefficiencies and inconsistencies of the international financial system. The pandemic highlighted a great finance divide, that is, a situation where developed countries were able to finance record fiscal response packages, while developing countries' responses were constrained by their lack of access to affordable funding. The short-term, high-cost nature of international finance also means that many developing countries are unable to finance long-term productive investments in the Sustainable Development Goals.**

95. **Returning to a sustainable development path will require a transformation of the international financial system to facilitate the allocation of resources towards financing the Sustainable Development Goals and the channelling of long-term investment to developing countries. Necessary reforms include providing access to affordable long-term sovereign funding for investment in the Goals; strengthening the global financial safety net; addressing gaps in the debt architecture; accounting for the opportunities and risks arising from technological change; and moving ahead on governance reform.**

96. **Public development banks have an important role to play in providing long-term financing and countercyclical lending in times of crisis. Their capacity for concessional lending should be increased, including through capital replenishments, channelling of special drawing rights and making optimal use of their balance sheets. Credit rating agencies and improved sustainability analysis**

⁵⁰ Global Entrepreneurship Monitor (GEM), *Women's Entrepreneurship 2020/21: Thriving through Crisis* (London, Global Entrepreneurship Research Association, 2021).

⁵¹ Christina Milhomem, "Women on boards: 2021 progress report" (MSCI, November 2021).

can support the allocation of private resources for productive and sustainable investment, including through longer-term ratings and enhanced transparency.

97. The global financial safety net should be strengthened and made fit for purpose for new and emerging challenges. The channelling of unused special drawing rights to countries in need must be stepped up and state-contingent issuance of SDRs could be explored. Making the financial safety net fit for purpose also includes better representation of developing countries. The financing for development process is an inclusive platform which could further explore proposals for global governance reform.

98. The United Nations provides a unique platform for bringing all stakeholders together – the official sector, including international financial institutions and standard setting bodies; government; the private sector; and civil society – across the three dimensions of sustainable development to work towards making the international financial system fit for purpose.
