The UAE banking sector: Journey to achieving Dhs1 trillion of sustainable finance

Part I

Challenges and opportunities

pwc

Foreword

The UAE has always been a beacon of ambition and innovation, continually pushing the boundaries of what is possible. The nation's commitment to mobilise Dhs1 trillion in sustainable finance by 2030 underscores this spirit, marking a pivotal step towards securing a resilient and prosperous future for generations to come.

This thought leadership paper, presented in two comprehensive parts, delves into the intricacies of the sustainable finance space. Part 1 examines the current state of sustainable finance in the UAE, highlighting both the challenges we face and the opportunities that lie ahead. It navigates the evolving regulatory landscape, offering insights into global and local market trends. It also identifies key hurdles within our ecosystem and the banking sector, proposing actionable pathways to surmount these challenges and accelerate growth.

In Part 2, the focus shifts to a sector-specific analysis, highlighting seven critical industries poised for sustainable finance. Each sector is scrutinised to identify sustainability-related risks, project future directions, and showcase major ongoing initiatives and case studies. This segment not only illustrates the progress within these sectors but also pinpoints further opportunities to expand and deepen sustainable finance across the UAE.

The UAE's ambition for sustainable finance is more than just a commitment; it is a declaration of our intent to lead by example in the global movement towards sustainability. This paper serves as a guide and a source of inspiration for all stakeholders in our journey towards a more sustainable future, with the UAE at the forefront of this global transition.

I invite you to delve into the insights and analyses presented in this paper, and to join us in shaping a sustainable future for the UAE.

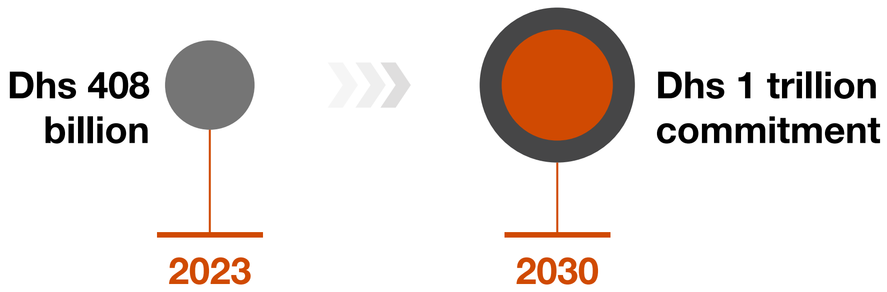
Sanjay Jain
Middle East Financial Services Consulting Leader / Middle East Insurance Leader

The Dhs 1 trillion commitment and the case for sustainable finance: Challenges and opportunities

The 28th session of the Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC) held in Dubai, UAE, in December 2023 saw the mobilisation of over Dhs 304 billion ($83 billion) of investments across climate change and nature and biodiversity[1]. In the same spirit, the Central Bank of the UAE (CBUAE), supported by the UAE Banks Federation, announced that over Dhs 1 trillion of sustainable finance will be mobilised by 2030, reflecting the collective commitment and effort of the country's banking sector to finance sustainable initiatives[2].

The commitment represents an ambition to more than double the current level of sustainable finance – representing an increase of over Dhs 600 billion from the current Dhs 400 billion over the next five years.

Sustainable finance growth target for the UAE by 2030



The global economy heavily relies on hydrocarbons across sectors and therefore requires large amounts of capital to decarbonise. Sustainable finance offers a solution to fund the transition towards a less hydrocarbon-dependent, lower-emission economy, leading to a more inclusive society that benefits from the positive impact of the change.

Public and private sector investments are essential to meet the significant sustainable finance funding requirements globally and in the UAE.

1 UN Climate Conference Secures $ 83 Billion In Climate Pledges In First Week, Outlook Planet, (2023)
2 UAE financial sector announces to mobilise AED 1 trillion in sustainable finance by 2030 as UAE hosts COP28, Central bank of the UAE, (2023)

The regulatory landscape and developments in the UAE

With the establishment of the UAE Sustainable Finance Working Group (SFWG) in 2020, the UAE has seen a number of regulatory developments and guidelines being issued to support the integration of ESG considerations within banking practices as well as build a platform for the development and growth of sustainable finance in the country. Below is a timeline of the developments in the regulatory space in the UAE and an overview of the functions of the UAE SFWG.

UAE regulatory developments

01

SCA 2021

Governance code public joint stock companies listed on the Abu Dhabi Securities Exchange or DFM must publish an annual sustainability report in compliance with GRI Standards.

02

FSRA and ADGM

Proposal for a Sustainable Finance Regulatory Framework (2022)

Consultation on proposed approach for green and climate transition funds and portfolios, green bonds and sukuks designation and mandatory disclosure.

03

CBUAE

Climate Risk Stress Test Pilot (2023)

- Bottom-up analysis for high transition-risk economic sectors. Alternative approach for top-down portfolio analysis at economic sector level.
- Physical risk lending and investment exposures to acute and chronic weather hazards.

04

CBUAE

Principles of the Effective Management of Climate-Related Financial Risk (2023)

- Minimum standard expected to implement governance and risk management of climate-related financial risk aligned to the entire financial services sector.
- Aligned to Basel Committee on Banking Supervision and NGFS climate-related financial risk.

05

CBUAE and Higher Shariah Authority

Principles of Islamic Sustainable Finance (2023)

- Financial risks aligned to the entire financial services sector.
- Aligned to Basel Committee on Banking Supervision and NGFS climate-related financial risk.

06

CBUAE

Principles for Sustainability-Related Disclosures for Reporting Entities

- Financial risks aligned to the entire financial services sector.
- Aligned to Basel Committee on Banking Supervision and NGFS climate-related financial risk.

The UAE Sustainable Finance Working Group is a consortium of key ministries - the Ministry of Finance, Ministry of Economy and Ministry of Climate Change and Environment - working with financial regulators including the CBUAE, DFSA, ADGM and SCA to develop sustainable finance in the UAE:

Working Group Workstreams

01 Strengthening sustainability disclosure

02 Improving corporate governance

03 Designing the UAE's sustainable finance taxonomy

The market for sustainable finance

In the global market:

Fossil fuels continue to represent **80% of the total energy supply** globally, with oil comprising nearly 30%, followed by coal (27%) and natural gas (24%). Global emissions from fuel combustion were dominated by coal (44%), followed by oil (32%) and natural gas (22%)[3].

Approximately **$50 trillion** in incremental investments is required by 2050 to transition the global economy to net zero emissions and avert a climate catastrophe[4].

In the UAE:

Approximately 30% of the UAE's GDP is dependent on hydrocarbons. Additionally, heavy emitting segments (i.e cement, steel, aluminium, petrochemicals) are responsible for approximately 46% of total GHG emissions.[5]

The UAE is forecasted to invest **$160 billion** in the economy to reach net zero emissions by 2050[6].

The UAE will require **$681 billion (Dhs 2.5 trillion)** in investment to finance its transition to a net zero economy[7].

The UAE has invested more than **$50 billion** in renewable energy projects across **70 countries**, including 27 island nations, and plans to invest an additional $50 billion over the next decade[8].

3 Greenhouse Gas Emissions from Energy Data Explorer, International Energy Agency (IEA), (2023)
4 Making Mission Possible: Delivering a net zero Economy, Energy Transitions Commission, (2020).
5 The United Arab Emirates' First Long-Term Strategy (LTS), UAE Ministry of Climate Change and Environment, (2023)
6 Transitioning to a Green Middle East, Minister of Economy at World Economic forum, (2022)
7 Leading the charge towards a net zero transition, Standard Chartered (2023)
8 The United Arab Emirates' First Long-Term Strategy (LTS) - Demonstrating Commitment to Net Zero by 2050, UAE Ministry of Climate Change and Environment, (2023)

Navigating challenges to meet the Dhs 1 trillion target

The path to an ambitious target comes with certain challenges. As sustainable finance within the UAE grows towards the Dhs 1 trillion target, the UAE Government and banks must work together to create an enabling environment for sustainable investments, ensuring that regulatory frameworks are robust to prevent greenwashing and build investor confidence.

01.Challenges within the ecosystem

The **regulatory landscape** in the UAE has been continuously **evolving** over the past few years. Banks face the challenge in navigating a framework that is **not yet fully standardised** and lacks alignment to international standards, resulting in **uncertainty in implementation and compliance**.

The **absence of a taxonomy** to guide and enhance clarity for all stakeholders in providing a standardised definition and classification of sustainable activities, which exacerbates greenwashing risk.

The transition to a green economy has introduced the crucial requirement for banks to monitor, measure, track, and collate climate data. **Insufficient and inconsistent ESG data across the banking sector** coupled with a **lack of standardised reporting** and **classification systems** hinders accurate risk assessments, informed investment decisions, and regulatory compliance.

The **absence of supportive financial incentives**, such as **subsidies or risk mitigation measures**, hinders investment in green initiatives due to perceived higher risks, longer time horizons, and lower immediate returns compared to traditional markets.

02.Challenges within the banking sector

Only a **limited number of banks** have developed **sustainable finance strategies and frameworks** that are aligned with the UAE's national ambitions and effectively articulate priorities, commitments and resource allocation.

Concerted and coordinated efforts to **channel funds towards sustainable projects and activities**, in line with this strategy, are **not widely present across the banking sector**.

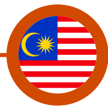
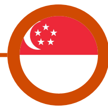
ESG risk management processes have not yet been **implemented** by a **majority of banks**. Additionally, only a few banks have set net zero targets and decarbonisation roadmaps.

Limited internal capacity and expertise within banks to develop, scale and manage sustainable finance products and innovations. Many financial institutions are in the **early stages** of understanding how to **integrate** sustainability into their **operations** and **product offerings**.

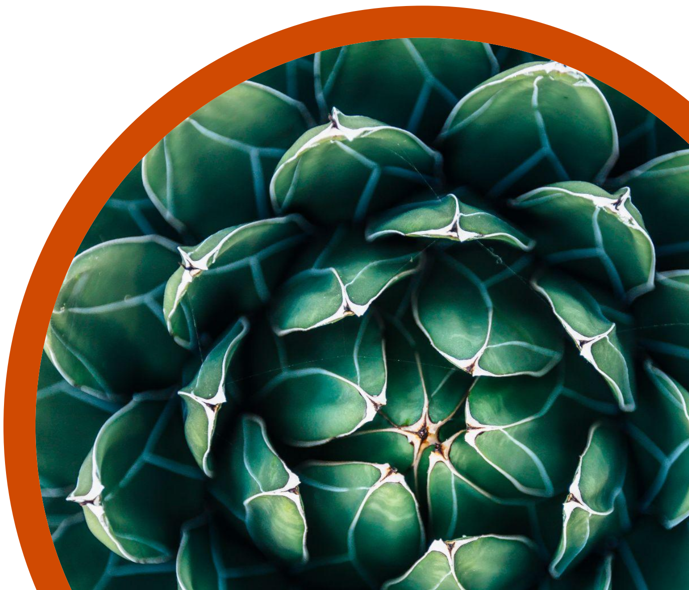
Pathways to overcome challenges in the ecosystem

Policymakers must create an enabling ecosystem through development and implementation of policies, regulations, and incentives to divert financial flows to climate mitigation and adaptation projects. Encouraging sustainable behaviours among consumers and investors is crucial to this transition. Such measures will drive a shift in public-private spending, fostering a more resilient and low-carbon economy. There are several areas that organisations and regulators can focus on to overcome the challenges and create an environment conducive to encouraging the development and growth of sustainable finance.

Overview of key global sustainable finance markets and their initiatives

Enablers						
Taxonomy[9]	●	●	●	●	●	
Disclosures	●	●	●	●	●	
Statistical indicators		●		●		
Data catalogue			●			
Data collection platform		●		●		●
Industry and educational institution collaboration				●	●	

The following pages reflect on some of the key measures that can be introduced and implemented by both the UAE Government and regulatory bodies as well as the banks themselves to foster a growing sustainable finance market in the country.



9 The UK Taxonomy due for release in Q4 2024

Pathways to overcome challenges in the ecosystem

i Building a transparent regulatory landscape

The regulatory landscape is pivotal in establishing a solid foundation for the growth of sustainable practices. With heightened investor awareness, the financial system will need to shift to ensure that investments yield not only financial returns but also environmental and social dividends.

Regulators need to formulate policies that emphasise transparency and responsible disclosure in the financial sector, while simultaneously cultivating an environment that encourages the expansion of sustainable finance.

This requires creating a **regulatory framework** that encourages banks to innovate and invest in green initiatives, strategies for mitigating climate risks, and alignment and adoption of existing international standards and frameworks to ensure international market symmetry.

This is heavily dependent on the availability of a **taxonomy** that offers financial market participants a definition qualifying what constitutes a 'sustainable' activity or transaction.

Given the urgency required for climate action and the national net-zero commitment, a voluntary approach for disclosures is not sufficient. **Mandating standardised sustainability reporting** aligned with international standards such as the ISSB* tasked with developing a comprehensive global baseline of sustainability reporting standards will strengthen credibility and investor trust in the UAE's sustainable finance market.

Taxonomy benefits

- **Enhance standardisation and comparability**
- **Building trust and credibility for global investors**
- **Strengthen and accelerate development of products**
- **Facilitate better allocation of capital**
- **Remove fragmentation and potential greenwashing**

*The International Sustainability Standards Board under the IFRS Foundation

Pathways to overcome challenges in the ecosystem

ii Creating an enabling environment

Tax incentives and subsidies can be introduced as **supervisory incentive mechanisms** to ease the cost of sustainable finance through fiscal concessions or **relaxed regulatory capital requirements**. This can be achieved through various mechanisms, such as tax credits, deductions or reduced tax rates for sustainable transactions, grants and subsidies to cover costs associated with developing and offering sustainable financial products or services. Additionally, relaxed capital reserve requirements for sustainable or green assets or refinancing facilities can be introduced, allowing banks to borrow at preferential rates for financing sustainable projects.

Measures can be taken to enable a **supportive market and financial infrastructure** and availability of **consistent and quality data** across the banking sector. This includes introducing a green labelling and accreditation mechanism for sustainable products, projects or services, and developing a sustainability data directory and collection platform to enable the collection and maintenance of centralised data accessible to market participants. Such measures will help with transparency in the sustainable finance market, increase consumer confidence through green labelling and accreditation, and prevent greenwashing.

Capacity building is key in the growth of new markets, given the knowledge, skills and expertise required to ensure institutional awareness and action across the banking ecosystem. Regulators can support this by building knowledge hubs and networks to facilitate knowledge sharing and collaboration.

Initiatives outlined above are not new globally and many jurisdictions have taken steps in each of the areas to foster a collaborative, transparent and supportive environment to grow sustainable finance within their economies.

Global best practices of key sustainable finance markets

The initiatives outlined are not new globally and many jurisdictions have taken steps in each of these areas to foster a collaborative, transparent and supportive environment to grow sustainable finance within their economies.

Examples of such initiatives from markets globally are summarised in the table below:

Area of focus	Examples from other markets
Harmonised regulatory frameworks	**Green Finance Institute** Brings together the UK government, finance sector, communities, land managers, academia, business and environmental NGOs to collectively identify barriers to the flow of private sector capital into high-integrity nature projects. Participants work together to design solutions, which may include policy changes, knowledge exchange, data platforms or financial products.
Developing a taxonomy	**Taxonomy design principles** Association Southeast Asian Nations (ASEAN) taxonomy allows a qualitative assessment to qualify and benchmark eligible green activities and investments. The adopted criteria aim to achieve sustainability objectives such as climate change and adaptation, protection of healthy natural ecosystems and biodiversity, and promotion of resource resilience and transition to a circular economy.
Incentives	**Tax incentives** To achieve Singapore's ambitious climate goals and improve sustainability in the country, the government provides a suite of funding and incentive schemes[10]. These relate to energy efficiency, environmental initiatives, food production, green buildings, sustainable finance, sustainable transport, urban solutions, waste management, water technology, emissions trading, and workforce and business development.

10 | Singapore Green Plan 2030, Government of Singapore, (2024)

Pathways to overcome the challenges in the banking sector

i Establishing robust sustainable finance strategies and a framework for banking

By seeking out and capitalising on sustainable finance opportunities in the market, banks can develop **individual financial strategies** for sustainable targets, in alignment with national and global sustainability goals. This will help realise both the national sustainability objectives as well as meet the collective sustainable finance targets of the country's banking sector, such as the Dhs1 trillion target by 2030[11].

Banks should consider developing their **sustainable finance frameworks** setting out the methodology and criteria for eligible products and services, ensuring alignment with the UAE's national strategies and commitments.

ii Product development and innovation

Decarbonisation of portfolios is critical to the transition to a green and sustainable economy. By **innovating their product range**, banks can finance sustainable opportunities in the material and high-emitting sectors to achieve sustainable outcomes.

11 | UAE financial sector announces to mobilise AED 1 trillion in sustainable finance by 2030 as UAE hosts COP28, Central bank of the UAE, (2023)

Pathways to overcome the challenges in the banking sector

The following table lists a set of products that banks could introduce in addition to their existing range to capitalise on the growing demand for sustainable finance:

Innovating the sustainable finance product range

Existing product range

Corporate and investment banking

- Green loan ●
- Social loan
- Sustainability-linked loan ●
- Sustainable trade finance
- Sustainable project finance
- Sustainability linked guarantees
- Export letters of credit and LC discounting

Retail banking

- Green auto / car loan ●
- Green mortgage loan ●
- Green personal loan
- Green credit card

Treasury and financial markets

- Sustainability-linked derivatives
- Corporate finance advisory services
- Supply chain financing

Innovative product range

Transition finance

- Transition loans
- Sustainability-linked loans

Blended finance

- Public and private partnership instruments

Nature and biodiversity finance

- Climate loans
- Blue loans

Impact investment

- Green & social impact investments
- Socially responsible investments (SRIs)

Sustainable fintech solutions

Legend

● Commonly offered products by the UAE banks

Two-pronged approach for banks

1 Continue the growth momentum with existing products

2 Innovate and develop new products to capitalise on the available opportunities within the key sectors

Two levers are key in delivering a successful sustainable finance product strategy:

1) **Engagement with customers** is essential to help them see the value in sustainable finance products and services and transitioning their businesses to net zero.

2) A strong, competent team is necessary to deliver a successful sustainable finance strategy and therefore banks need to **build internal capacity** by dedicating resources and assigning responsibilities to individuals and teams to drive the growth of sustainable lending and investment portfolios.

Authored by:

Anand Balasubramanian
Partner, FS Consulting ESG and Climate Risk Leader

Adil Hunain
Senior Manager

Mahasweta Mitra
Senior Manager

Henna Sakia
Manager