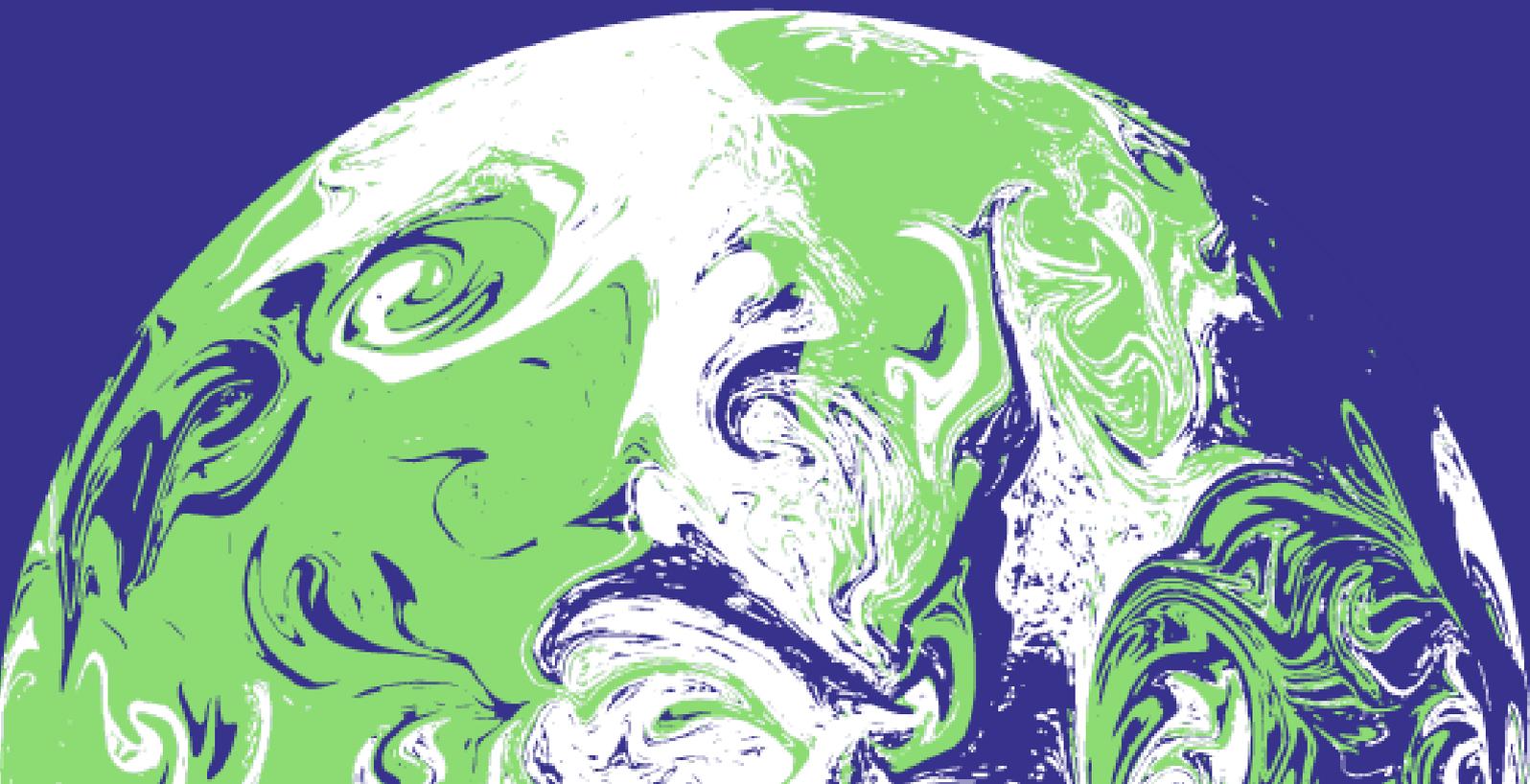


# **BUILDING A PRIVATE FINANCE SYSTEM FOR NET ZERO**

## **Priorities for private finance for COP26**

Mark Carney, UN Special Envoy for Climate Action and Finance and  
the Prime Minister's Finance Adviser for COP26



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Countries turn Paris Agreement targets into credible climate policies and legislated objectives



This sets the terms of the new economy, providing certainty for future investment



This encourages companies to develop and implement "transition plans" to adjust their businesses for a net zero world



This amplifies the effectiveness of government climate policies and accelerates the transition to net zero, minimises costs, smooths adjustment while promoting jobs and growth



Private finance will help companies realign their business models for net zero by funding the initiatives and innovations of the private sector

**EMBEDDED THROUGH A FRAMEWORK TO ENSURE EVERY FINANCIAL DECISION TAKES CLIMATE CHANGE INTO ACCOUNT**



**REPORTING**

of climate-related financial risks and opportunities by companies in line with TCFD



**RISK MANAGEMENT**

of physical and transition risks from climate change



**RETURNS**

realised from the enormous commercial opportunities in the transition to net zero



**MOBILISATION**

of private finance for investment in developing and emerging economies through new market structures and public-private partnerships

# EXECUTIVE SUMMARY

# SCOPE & OBJECTIVES

## **Achieving the objective agreed in the Paris Agreement to limit global temperature increases to below 2°C from pre-industrial levels requires a whole economy**

**transition**—every company, bank, insurer and investor will have to adjust their business models, develop credible plans for the transition and implement them. In recognition of the scale of the task, 125 countries, including half the G20, have now committed to net zero by 2050 at the latest.<sup>1</sup> There is a clear opportunity to invest in a green, resilient recovery as countries seek to recover from the pandemic.

**Achieving climate goals will require all forms of finance.** Public and blended finance, including the important commitment made by developed countries to mobilise \$100bn annually by 2020 for climate finance,<sup>2</sup> have a vital part to play in the shift to a greener more resilient economy and a fair transition for society. They will contribute to critical infrastructure development, support adaptation and resilience, and help develop new markets for private finance by de-risking investment. And mainstream private finance will help all companies realign their business models for net zero. It will fund the initiatives and innovations of the private sector and turn billions committed to climate investment through public channels into trillions of total climate investment.

## **The COP26 Private Finance Hub, led by Mark Carney in his capacity as UN Special**

**Envoy and Adviser to the Prime Minister, will focus on building a system that mobilises private finance to support the re-engineering of our economies for net zero.**

**The objective for the private finance work for COP26 is simple: ensure that every professional financial decision takes climate change into account.**

**This requires the right framework so that the financial sector can allocate capital to manage risks and seize opportunities in the transition to net zero. To this end, the COP26 Private Finance Hub will work with the private sector and other stakeholders to develop:**

- **Reporting:** improving the quantity, quality and comparability of climate-related disclosures by implementing a common framework built on the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations.
- **Risk management:** ensuring that the financial sector can measure and manage climate-related financial risks.
- **Returns:** helping investors identify the opportunities in the transition to net zero and report how their own portfolios are aligned for the transition.
- **Mobilisation:** increasing private financial flows to emerging and developing economies, by connecting available capital with investable projects and encouraging new market structures.

<sup>1</sup> See: <https://eciu.net/netzerotracker>

<sup>2</sup> See: <https://unfccc.int/topics/climate-finance/the-big-picture/climate-finance-in-the-negotiations>

# CONTEXT

## **COP26 will be a significant milestone for the transition to a sustainable future.**

All countries are expected to increase the ambition of their Nationally Determined Contributions (NDCs) against the temperature goals agreed in 2015.<sup>3</sup> They will do so during unprecedented tests of their health and economic systems. While the pandemic has meant that COP26 has had to be postponed, its ambition has not been scaled down. Global emissions, while lower than last year, will still deplete more of the remaining carbon budget.

## **Countries revised NDCs, long term strategies and post-COVID recovery plans need to support the whole-economy transformation required to achieve net zero.**

As countries turn Paris commitments into legislated objectives and concrete actions, they will provide certainty to the market and help crowd in private investment.

## **Finance will be critical to accelerating and smoothing this transition**

both by funding private sector initiatives and by amplifying the effectiveness of government climate policies. A transition to net zero will affect how risk is measured and managed and how assets are valued. The UK will make all forms of finance a focus of its COP26 presidency. The focus for the private finance work is to build the right framework so that the sector can allocate capital to manage climate risks and seize climate opportunities.

## **Recognising that net zero is both an imperative of climate physics and a public commitment in 125 countries, financial markets, regulators and consumers are increasingly demanding information about how companies are managing climate risks and pursuing opportunities:**

- Banks, insurers, pension funds and investors with balance sheets of \$139 trillion are demanding TCFD-aligned climate disclosure from companies.<sup>4</sup> Investors increasingly recognise that “climate risk is investment risk, and they want to know every firm’s plan for managing these risks”.<sup>5</sup>
- 75 central banks covering 60% of global emissions are now members of the NGFS, a group dedicated to improving the management of climate risk in the financial sector, and 13 central banks are in the process of stress testing their financial systems to assess individual and collective resilience to climate risks.
- Climate Action 100+, a group of over 500 institutional investors controlling over \$47 trillion of assets, are demanding that the world’s 161 highest-emitting companies (representing 80% of industrial emissions) publish strategies to reduce emissions by 45% by 2030 and to reach net zero by 2050. They have also called on these firms to

<sup>3</sup> See: <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>

<sup>4</sup> The full list of current TCFD supporters is available at: <https://www.fsb-tcfd.org/tcfd-supporters/>

<sup>5</sup> See: <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>

publish medium-term targets and disclosures in line with a new benchmark to show progress, threatening action if they don't see sufficient progress in the next 12 months.<sup>6</sup>

- In an open letter, six of the largest investor alliances, representing assets worth over \$103 trillion called on companies and auditors to fully reflect the effects of climate change in their declared results and ensure any assumptions made when preparing financial statements are compatible with the Paris Agreement.<sup>7</sup>
- Boards are increasingly under pressure to be transparent with investors, clients and colleagues about the impact of climate change. The number of climate-related resolutions tabled by investors has doubled since 2011. The percentage voting in favour has tripled over the same period.<sup>8</sup>
- A recent survey found that 70% of savers want their investments to consider the impact on people and planet alongside financial performance.<sup>9</sup> The Make My Money Matter campaign is giving people a means to ask their

pension providers to invest in line with net zero. And 9 in 10 millennials believe the success of a business should be measured by more than its bottom line.<sup>10</sup>

### **The financial sector and real economy are both increasingly focused on implementing plans to achieve net zero:**

- The Net Zero Asset Owner Alliance, whose members commit to transitioning their investment portfolios to net-zero greenhouse gas emissions by 2050, now represents \$5 trillion in assets under management. Asset owners have agreed to implement deep GHG emissions reductions in their portfolios by up to 29% by 2025. They have stated that they will work with those willing to adjust their business models, and do not wish to engage in a divestment exercise.<sup>11</sup>
- The TCFD has nearly 1,500 supporters from 55 countries, with a market capitalisation of over \$12.6 trillion.<sup>12</sup> The supply of climate disclosure is responding to the demands of investors. The International Business Council (IBC) of 140 CEOs agreed a common set of metrics that IBC members signed up to

<sup>6</sup> See: <http://www.climateaction100.org/>

<sup>7</sup> See: <https://www.iigcc.org/news/investor-groups-call-on-companies-to-reflect-climate-related-risks-in-financial-reporting/>

<sup>8</sup> See: [FT Energy Source](https://www.ft.com/content/2020-09-15/energy-source)

<sup>9</sup> See: <https://www.gov.uk/government/publications/investing-in-a-better-world-results-of-uk-survey-on-financing-the-sdgs>

<sup>10</sup> See: <https://hbr.org/2014/10/impact-investing-needs-millennials>

<sup>11</sup> See: <https://www.unepfi.org/net-zero-alliance/>

<sup>12</sup> See TCFD website Sept 2020: <https://www.fsb-tcfd.org/tcfd-supporters/>

disclose, which included TCFD. And the 3,038 signatories of the UN Principles for Responsible Investment must make TCFD disclosures or risk ejection from the group.<sup>13</sup>

- The Science-Based Targets Initiative has approved almost 500 company emissions targets as consistent with the Paris Agreement, and this number is growing rapidly.<sup>14</sup> The initiative continues to work with the over 500 more companies to increase their ambition for approval.
- The Race to Zero coalition, representing 452 cities, 22 regions, 1,101 businesses, 45 of the biggest investors, and 549 universities, is the largest ever alliance committed to achieving net zero carbon emissions by 2050. Collectively these actors now cover nearly 25% of global CO<sub>2</sub> emissions and over 50% of GDP.<sup>15</sup>
- The private sector-led Taskforce for Scaling Voluntary Carbon Markets is consulting on a blueprint of the market infrastructure required for a scalable, liquid, transparent and reliable voluntary carbon market, and a roadmap to implementation.

### **The transition to Net Zero is creating the greatest commercial opportunity of our age.**

- Globally, the benefits of shifting to a low-carbon pathway are estimated at \$26 trillion by 2030 compared to our current high-carbon pathway.<sup>16</sup> But shifting the global energy system towards a well-below 2°C pathway requires a significant redirection of global investment flows. The scale of the investment opportunity is significant, with commensurate returns for those that back the technology and infrastructure of a zero-carbon future. Over the next three decades, the total required investments in the energy sector alone will be \$3.5 trillion per year, while almost \$50-135 billion per year will need to flow to carbon capture and biofuel technology.
- Research and development of new technologies offer a prospect of high returns; doubling of investments in this area could generate returns of \$20 billion per annum.<sup>17</sup> Specific regions offer enormous opportunities: Eastern Europe, Central Asia, the Middle East, and North Africa could support up to \$1 trillion in climate-related investments by

<sup>13</sup> See <https://www.unpri.org/signatories>

<sup>14</sup> See: <https://sciencebasedtargets.org/>

<sup>15</sup> See <https://unfccc.int/climate-action/race-to-zero-campaign#eq-3>

<sup>16</sup> See [https://exponentialroadmap.org/wp-content/uploads/2020/03/ExponentialRoadmap\\_1.5.1\\_216x279\\_08\\_AW\\_Download\\_Singles\\_Small.pdf](https://exponentialroadmap.org/wp-content/uploads/2020/03/ExponentialRoadmap_1.5.1_216x279_08_AW_Download_Singles_Small.pdf)

<sup>17</sup> Stern Review: The Economics of Climate Change: [https://webarchive.nationalarchives.gov.uk/20100407172955/http://www.hm-treasury.gov.uk/d/Executive\\_Summary.pdf](https://webarchive.nationalarchives.gov.uk/20100407172955/http://www.hm-treasury.gov.uk/d/Executive_Summary.pdf)

2020.<sup>18</sup> And changes in the way we live open up more opportunities: over the next three decades, more than 6 billion people will live in urban areas and 400 million homes are expected to be built in the next decade which will require green technology and infrastructure to align with a net zero, resilient transition. This is not only a huge opportunity for investors, but also a way for countries to attract international capital and build back better and greener from COVID.

- All companies will adjust business models to align with net zero pathways. Value will be driven by identifying the leaders and laggards, as well as the most important general-purpose technologies that will overcome choke points in the transition.

**To identify these opportunities and assess the transition readiness of companies,** the financial sector needs information on scientifically feasible transition paths by sector. **This information will help expose which companies will seize the opportunities in the transition to a net zero world and which will cease to exist.**

**Despite major progress in recent years, more is required to build the right frameworks for the private sector to do what it does best: allocate capital to manage risks and seize opportunities.**

- **Ultimately, the speed with which the new sustainable financial system develops will be decided by the ambitions of governments' climate policies.** Governments can reinforce the efforts in the private sector by setting clear and credible climate policies, which will provide more certainty to the market, crowd in private investment and ensure that private financial markets pull forward adjustments from the future. This will minimise costs and smooth adjustments.
- **The significant private, voluntary momentum in recent years is welcome, but it needs global coordination to agree the core frameworks for reporting climate risks and opportunities, and for assessing transition alignment of both users and suppliers of capital.** There are multiple standards (for example there are over 1,000 ESG metrics), which can lead to confusion, indecision and greenwashing. The public sector has a clear coordinating role to harness the energy of the private sector and a set of common standards in reporting, risk management and measuring return.
- **Listed companies in countries with net zero targets will increasingly need to:**

<sup>18</sup> See [https://www.ifc.org/wps/wcm/connect/59260145-ec2e-40de-97e6-3aa78b82b3c9/3503-IFC-Climate\\_Investment\\_Opportunity-Report-Dec-FINAL.pdf?MOD=AJPERES&CVID=IBLd6Xq](https://www.ifc.org/wps/wcm/connect/59260145-ec2e-40de-97e6-3aa78b82b3c9/3503-IFC-Climate_Investment_Opportunity-Report-Dec-FINAL.pdf?MOD=AJPERES&CVID=IBLd6Xq)

- Set targets for net zero (including Scope 1,2 and 3 emissions);<sup>19</sup>
  - Publish comprehensive and credible transition plans for achieving these targets;
  - Set short-term milestones for investors to monitor progress against these plans; and
  - Detail governance of these plans, including how effective board oversight is ensured and how compensation is tied to their achievement.
- **The window for action is finite.** Sustainable financing is moving mainstream, but the world is still collectively well behind the curve. As one illustration, estimates from Japan's GPIF (the world's largest pension fund) suggests that the assets it holds shows that temperatures are on track to rise more than 3 degrees from pre-industrial levels across most asset classes.<sup>20</sup>
  - **Public expectations are running ahead of action.** In the absence of a clear, positive, targeted and coordinated agenda, demands will grow for simplistic solutions such as wholesale divestment

and protectionism that will undermine a smooth transition and fail to achieve our climate goals. As one illustration of this, in 2020, AXA calculated the emissions of its 2019 investment portfolio (corporate debt, equities and sovereign debt) and the implied contribution to global temperature increases, and found that, even post divestment of coal and oil sands, the portfolio contributed to 2.8 degrees of warming, significantly above the 2 degree target.<sup>21</sup>

**Finally, international private financial flows to emerging and developing countries are still limited but are critical to supporting the transition in these countries.**

- The benefits of improving reporting, risk management and return measures in advanced economies will also accrue to emerging and developing economies. Reporting emissions and conducting scenario analysis on a Scope 3 basis will create incentives to invest to decarbonise across the supply chain, including in developing countries. And companies will increasingly need to show how they plan to meet their net zero targets, and the role of offsets as they make the transition.

<sup>19</sup> Scope 1 covers direct emissions from owned or controlled sources. Scope 2 covers indirect emissions from the generation of purchased electricity, steam, heating and cooling consumed by the reporting company. Scope 3 includes all other indirect emissions that occur in a company's value chain. See: <https://www.carbontrust.com/resources/briefing-what-are-scope-3-emissions>

<sup>20</sup> See: [https://www.gpif.go.jp/en/investment/GPIF\\_CLIMATE\\_REPORT\\_FY2019\\_2.pdf](https://www.gpif.go.jp/en/investment/GPIF_CLIMATE_REPORT_FY2019_2.pdf)

<sup>21</sup> See: [https://www-axa-com.cdn.axa-contento-118412.eu/www-axa-com%2F667045c2-cc3c-4f65-a888-18753c463d9c\\_axa2019\\_ra\\_en\\_climate\\_report\\_2.pdf](https://www-axa-com.cdn.axa-contento-118412.eu/www-axa-com%2F667045c2-cc3c-4f65-a888-18753c463d9c_axa2019_ra_en_climate_report_2.pdf)

- This will increase demand for offsets, the most cost-effective of which tend to be in emerging and developing economies.
- Better management of physical risks – including better data, analytical tools, and the increased provision of insurance – will also be helpful for the countries most exposed to the physical impacts of climate change.
- But to unlock private financial flows, we need bespoke solutions for these countries: we need public private partnerships, pipelines of bankable projects, and new market structures, to facilitate commercially viable opportunities for sustainable investment.

# COP 26 PRIVATE FINANCE WORK: DESIRED DELIVERABLES AND CALLS TO ACTION FOR THE FINANCIAL SECTOR

	REPORTING	RISK MANAGEMENT	RETURNS	MOBILISATION
<b>Goal</b>	<ul style="list-style-type: none"> <li>Improve the quality and quantity of climate-related financial disclosures.</li> <li>Promote alignment of disclosure globally around TCFD framework.</li> <li>Establish pathways to mandatory disclosure.</li> </ul>	<ul style="list-style-type: none"> <li>Assess the resilience of companies and financial sector to climate risks.</li> <li>Ensure financial sector develops tools and products to manage climate-related financial risks.</li> </ul>	<p>Ensure financial institutions have the frameworks to:</p> <ul style="list-style-type: none"> <li>Assess the credibility of net zero transition plans.</li> <li>Measure alignment of their portfolios with the transition to net zero.</li> <li>Make their own commitments to net zero.</li> </ul>	<p>Increase private financial flows to emerging and developing economies to finance the transition to net zero by:</p> <ul style="list-style-type: none"> <li>Developing pipeline of investable projects.</li> <li>Aligning development bank funding with climate goals.</li> <li>Encouraging new market structures and products.</li> </ul>
<b>Deliverables</b>	<p>Publish stocktake of compliance with TCFD recommendation, best practice examples, and refined TCFD recommendations around scenario analysis.</p> <p><b>Action: TCFD</b></p>	<p>Conduct climate stress tests of banks and insurers and issue guidance to financial firms on climate risk management.</p> <p><b>Action: central banks; supervisors</b></p>	<p>Review approaches and establish best practice/standards for financial institutions to assess the credibility of companies' transition plans to net zero.</p> <p><b>Action: banks; asset managers; asset owners; academic and NGO communities</b></p>	<p>Develop a pipeline of investable projects by connecting available capital to projects that meet pre-defined investment principles, such as the CFLI's investment readiness guidelines.</p> <p><b>Action: private sector investor coalitions; countries</b></p>
	<p>Issue guidance for financial firms and corporates on climate-related reporting and implementing the TCFD recommendations.</p> <p><b>Action: central banks; regulators; governments</b></p>	<p>Embed use of scenario analysis in the financial sector using the NGFS reference scenarios.</p> <p><b>Action: central banks; supervisors; financial firms; credit rating agencies</b></p>	<p>Review approaches and create a framework for measuring the alignment of investment portfolios with climate targets.</p> <p><b>Action: investors; asset managers; portfolio alignment analysis providers</b></p>	<p>Close the protection gap and improve resilience in climate-vulnerable countries.</p> <p><b>Action: insurance sector</b></p>
	<p>Develop TCFD-compliant listing guidance.</p> <p><b>Action: stock exchanges and standard setters</b></p>	<p>Promote scenario analysis in the real economy through development of sector-specific scenarios and guidance.</p> <p><b>Action: companies</b></p>	<p>Develop consumer-friendly metrics that reflect investment alignment with net zero.</p> <p><b>Action: conduct regulators; investors</b></p>	<p>Development banks to align investment with climate goals and report alignment of their own lending portfolio; facilitate access to markets, de-risk investment and provide technical assistance.</p> <p><b>Action: MDBs; NDBs; RDBs; DFIs; countries</b></p>
	<p>Publish pathways to making climate-related financial reporting, based on TCFD recommendations, mandatory.</p> <p><b>Action: countries</b></p>	<p>Capture climate risks in central bank mandates, including in monetary policy, financial stability and market operations where applicable. Central banks in turn to disclose in line with TCFD, including on alignment of their investment portfolios.</p> <p><b>Action: finance ministries; central banks</b></p>	<p>Commit to align portfolios and lending with net zero, disclose accordingly, and publish credible transition plans.</p> <p><b>Action: banks; asset managers; asset owners</b></p>	<p>Encourage the development of the infrastructure for scaling up high-quality voluntary carbon markets.</p> <p><b>Action: financial market infrastructure providers; banks; companies</b></p>
	<p>Establish pathways to globally consistent mandatory reporting.</p> <p><b>Action: international standard setters</b></p>	<p>Establish centre(s) of excellence for central banks and supervisors to share knowledge and build capacity around climate risk measurement and practices.</p> <p><b>Action: NGFS; central banks; supervisors</b></p>	<p>Incorporate data that helps measure transition-readiness of firms and portfolio alignment of investors into list of recommended disclosures.</p> <p><b>Action: TCFD; standard setters; countries</b></p>	
	<p>Climate-related risks and assumptions to be considered during assurance of company reports and accounts.</p> <p><b>Action: auditors</b></p>	<p>Integrate climate risks into IMF FSAPs and Article IV reviews.</p> <p><b>Action: IMF</b></p>		
	<p>Commit to voluntary TCFD disclosures.</p> <p><b>Action: companies</b></p>	<p>International standards to review approach to climate risk measurement and management.</p> <p><b>Action: FSB, BCBS, IAIS</b></p>		
		<p>Develop the insurance products needed to de-risk the transition and improve physical risk modelling to increase coverage.</p> <p><b>Action: insurance sector</b></p>		

# DELIVERABLES IN DETAIL

# REPORTING

**Markets require information to operate effectively – what gets measured gets managed.** Investors need to understand how extreme weather events (i.e. physical risks) and the move to net zero (i.e. transition risks) affect business models and the associated financial impact. This requires an improvement in the quantity, quality and comparability of disclosure.

**The Taskforce for Climate-related Financial Disclosures (TCFD) has become the go-to framework for such climate-related financial reporting.**<sup>22</sup> The demand for TCFD disclosure is now enormous, growing 85% since 2019, with more than 1,500 supporters from 55 countries, with a market capitalisation of \$12.8tn. The supply of disclosure is responding, with four fifths of the top 1100 global companies now disclosing climate-related financial risks in line with some of the TCFD recommendations.<sup>23</sup>

**This momentum is creating a virtuous circle.** As companies apply the TCFD recommendations and investors increasingly differentiate between firms based on this information, adoption is spreading, disclosure is improving, and the process is becoming more efficient.

**We must build on this foundation to enhance both the quantity and quality of disclosures so TCFD standards become as comparable, efficient and decision-useful as possible.** The latest TCFD report found that while support is increasing, *full* alignment with all 11 recommendations is still rare. Disclosure of the potential financial impact of climate change on companies' businesses and strategies remains low, and progress among sectors remains patchy, with energy companies leading but technology companies lagging.<sup>24</sup>

**Support for voluntary implementation for TCFD disclosure is abundant and can help increase the rate of disclosure.** Through multi-sector TCFD summits and more focused TCFD industry preparer forums, companies can share knowledge on how, what and where they disclose information. The TCFD recently published additional guidance on how to conduct scenario analysis and integrating climate risk management and disclosures into business practices.<sup>25</sup>

**Voluntary reporting guidance is helping further increase the quantity and quality of reporting.** Financial regulators have played an important role in embedding climate-related financial reporting. Nine

<sup>22</sup> The 2017 recommendations report is available at <https://www.fsb-tcfd.org/publications/final-recommendations-report/>

<sup>23</sup> The full list of current TCFD supporters is available at: <https://www.fsb-tcfd.org/tcfd-supporters>

<sup>24</sup> See: [https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD\\_Status-Report.pdf](https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Status-Report.pdf)

<sup>25</sup> See: [https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD\\_Status-Report.pdf](https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Status-Report.pdf) and [https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD\\_Guidance-Risk-Management-Integration-and-Disclosure.pdf](https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Guidance-Risk-Management-Integration-and-Disclosure.pdf)

authorities have issued guidance or started a consultation on climate financial disclosures in line with TCFD. With this information, financial firms across the value chain – and ultimately, their customers – can eventually report the climate risk and opportunity on their own balance sheets and in their portfolios. And voluntary sustainability standard-setters are aligning to facilitate interoperability between their own standards. SASB, GRI, CDP, CDSB and IIRC are collaborating to construct a comprehensive architecture of standards. The initiative will publish an illustrative draft of a climate standard based on TCFD.

**But there is a limit to how far the private sector and voluntary initiatives can push the development of public goods, such as disclosure. The public sector will need to step in to coordinate efforts and ensure consistency.**<sup>26</sup> 110 regulators and government organisations now support the TCFD, but they need to turn that support into implementation.

**To truly make this disclosure comprehensive and comparable, reporting based on the TCFD framework will need to be made mandatory.** New Zealand recently became the first country in the world to make TCFD reporting mandatory, with others, such as the EU, working toward incorporating TCFD into mandatory climate-related

reporting standards. International standard setters are also taking action to improve climate-related financial disclosures. The IFRS Foundation published a consultation paper to assess demand for global sustainability standards and how the Foundation might contribute to the development of such standards.<sup>27</sup>

**We need to build on this momentum and support countries and international standard setters to ensure that any approach to climate-related reporting is decision-useful for investors, comparable across jurisdictions and minimises the reporting burden on companies.** To that end, the COP26 Private Finance Hub will work with countries and international standard setters to align the approach to mandatory reporting and call on countries to publish their own pathways to making TCFD disclosure mandatory.

<sup>26</sup> See for example: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2019/ss319> and <https://www.fca.org.uk/publications/consultation-papers/cp20-3-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing>

<sup>27</sup> See <https://cdn.ifrs.org/-/media/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf?la=en>

## Reporting deliverables

**Goal:** Improve the quantity and quality of climate-related financial disclosures

- **TCFD to publish 2020 Status Report and refined guidance** to take stock of the quantity and quality of disclosures in the market, including a consolidated list of the most decision-useful disclosures, best practice examples and guidance on how to overcome common hurdles.
- **Companies to voluntarily disclose in line with full set of TCFD recommendations.**
- **Auditors to ensure every audit comprehensively assesses climate risk and the adequacy of climate-related disclosure.**

**Goal:** Establish pathways to mandatory disclosure

- **Countries to publish pathways to making TCFD-aligned disclosures mandatory,** setting out a clear timetable and action for authorities in their respective jurisdictions.
- **International standard setters to consider how to incorporate TCFD recommendations into core reporting guidance.**

**Goal:** Promote alignment of disclosure globally around TCFD framework

- **Financial regulators/central banks to issue guidance to financial firms on climate-related reporting.**
- **Stock exchanges to develop TCFD compliant listing guidance.**
- **International standard setters to ensure global consistency between approaches to climate-related reporting, using the TCFD as a basis where appropriate.**

# RISK MANAGEMENT

**Climate change creates both physical and transition risks.** Physical risks arise from the increased frequency and severity of climate and weather-related events that damage property and disrupt trade. **Transition risks** arise from changes in climate policy, technology and market sentiment as we adjust to a net-zero economy. Changes in climate policies, new technologies, changing consumer and employee preferences and growing physical risks will prompt reassessments of the value of virtually every financial asset.

**Climate risks are different from conventional risks. Climate risks are:**

- **Far-reaching** in breadth and magnitude. They will affect every customer, in every sector, in every country.
- **Foreseeable** in the sense that we know some combination of physical and transition risk will occur.
- **Spread over long time horizons:** actions taken today determine the severity of risks decades in the future, therefore **early action is needed to minimise future financial risks.**
- **Unprecedented by definition:** past data is not a good future indicator.

- **Risks (and responses) are complex:** they need to be sized bottom up; it is not enough to have a top-down macro model.

**These characteristics make it challenging to assess financial risks in the normal way. For the market to understand and price these risks, disclosures need to go beyond the static (what a company's emissions are today) and onto the strategic (what their plans are for their emissions tomorrow and the associated financial impact).** That means assessing the resilience of firms' strategies to the transition to net zero across a range of scenarios.

**Support and guidance for conducting scenario analysis to test strategic resilience is available, but there is a collective need to upskill and embed its use.** The TCFD recently issued guidance which provides practical, process-oriented ways for companies to use climate-related scenario analysis and ideas for disclosing the resilience of their strategies to different climate-related scenarios.<sup>28</sup> And the Network for Greening the Financial System (NGFS) has published open source reference scenarios that are publicly available, so that any company, in any sector, can use them to assess their strategic resilience to three different climate outcomes and pathways.<sup>29</sup> Coalescing around these scenarios will help promote consistency across the financial and

<sup>28</sup> See: [https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD\\_Guidance-Scenario-Analysis-Guidance.pdf](https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Guidance-Scenario-Analysis-Guidance.pdf)

<sup>29</sup> See: <https://www.ngfs.net/en/publications/ngfs-climate-scenarios>

corporate sector in how to evaluate climate resilience.

**Stress testing can complement individual firms' scenario analysis. It will show how major financial firms expect to adjust their business models, and what the collective impact of these responses could be on the wider economy.** It will reveal the financial firms – and by extension companies – that are preparing for the transition to net zero as well as those who have not yet developed strategies consistent with legislated commitments to net zero. Currently, 13 central banks have committed to conducting climate stress tests.

**As climate change becomes an increasing macroeconomic and financial stability risk, governments should consider how central bank remits need to be adapted to incorporate climate change in support of their policy objectives.** Central banks have made notable progress in thinking about how climate change could impact financial stability. This needs to be further embedded and will be progressed through stress testing exercises. Climate change is however increasingly becoming a more immediate macroeconomic issue as physical risks, such as from extreme weather, and transition risks, as seen from so-called 'stranded assets' in fossil fuel extraction and utilisation, crystallise causing disruption to economic activity and losses for the financial sector. This could affect economic forecasts and the risk profile of assets, which in turn may

impact the approach to, and market operations to implement, monetary policy. Integrating climate risk considerations in the activities of central banks, for example via their asset purchase programmes and counterparty operations has a broader benefit: it can influence both the financial system and real economy to more systematically consider climate-related financial risks. For example, central banks could require TCFD disclosures from eligible counterparties as a minimum.

**This work in central banks would fit an international programme to evaluate and manage climate risks:**

- The Financial Stability Board (FSB) has undertaken a stocktake of approaches to measuring climate-related financial stability risks at the macro-prudential level and is considering the implications of climate change for financial stability.
- The International Monetary Fund (IMF) is increasingly embedding climate-related aspects into their surveillance, including assessing the adequacy of climate disclosure and risk management as part of FSAPs/Article IVs.
- The Basel Committee on Banking Supervision (BCBS) has set up a working group on climate-related financial risks, with the aim of tackling issues pertaining to risk measurement and to

serve as a platform for different supervisory approaches to be shared.

- The International Association of Insurance Supervisors (IAIS) and Sustainable Insurance Forum is considering the risks to the insurance sector, monitoring implementation of risk management recommendations and publishing guidance on supervising climate risks.
- The Coalition of Finance Ministers for Climate Action have committed to taking collective and domestic action to achieve the Paris Agreement Objectives.<sup>30</sup>
- Voluntary coalitions in the private insurance market, such as the Insurance Development Forum (IDF), are looking at how to manage climate risk by improving data sharing and developing products to de-risk the transition.

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<sup>30</sup> See: <https://www.financeministersforclimate.org/>

## Risk management deliverables

**Goal:** Assess the resilience of companies and financial sector to climate risks

- **In line with the NGFS handbooks<sup>31</sup>, central banks and/or supervisors to commit to:**
  - **Stress test** banks and insurers against climate scenarios including (i) a catastrophic ‘no additional policy action’ scenario, (ii) a transition to net zero by 2050 scenario in line with government policy, and (iii) a late and disorderly transition to net zero scenario where action to address climate change is delayed.
  - **Issue supervisory expectations** for banks and insurers’ climate risk management.
  - **Consider climate risks in monetary policy implementation**, both from a policy and operational (i.e. collateral frameworks) perspective.
  - **Integrate climate risk considerations into portfolio management.**
  - **Publish their own TCFD disclosures, ideally with portfolio alignment metrics**
- **IMF to embed climate risk management into the Financial Sector Assessment Programme (FSAPs), Article IV reviews and macro-surveillance activity.**
- **International prudential standards setters to review their approaches to include climate risks:** BCBS and IAIS to look at supervisory approaches and develop guidance on supervision of climate risks.
- **FSB to assess implications of climate change on financial stability**, including a mapping of risk transmission channels on short- to medium-term.
- **Finance ministries** to consider how to incorporate climate reporting, risk management and returns agenda across all functions in central bank remits, including market operations, in order to fulfil their policy objectives.

**Goal:** Ensure financial sector develops tools and products to manage climate-related financial risks

- **Authorities to establish a centre of excellence** to share knowledge and build capacity around climate risk measurement and practices across central banks and supervisors.

<sup>31</sup> See: <https://www.ngfs.net/en/liste-chronologique/ngfs-publications>

- **Promote a consistent approach to scenario analysis across the financial sector using the NGFS's open source reference scenarios.**
- **Promote a consistent approach to scenario analysis in the real economy through development of sector-specific reference scenarios for high-carbon sectors.**
- **Regulators, government, and the private sector to identify and address climate risk data gaps** to improve the quality, granularity, consistency and availability of data needed for financial firms' scenario analysis and high-quality TCFD disclosures.
- **Insurance industry to use their expertise to de-risk the transition and improve physical risk modelling across the financial sector.**

# RETURNS

**As countries turn the Paris Agreement goals into nationally legislated objectives, companies and financial firms will need to adapt their business models and reallocate capital accordingly. This transition to Net Zero will create enormous commercial opportunities for those well placed to take advantage of this structural shift.**

**The Race to Zero and broader COP campaign, through the UK and the Italian governments, will work to secure net zero commitments from countries and companies. These commitments need to be backed by credible transition plans.** The development of these plans is being supported by the Race to Zero campaign,<sup>32</sup> the Science Based Targets initiative (SBTi),<sup>33</sup> the Mission Possible platform<sup>34</sup> and the Exponential Roadmap's 1.5C Business Playbook.<sup>35</sup>

**The success of company transition plans will be a key determinant of value creation across all sectors of the economy. Financial institutions will increasingly use plans to identify the leaders and laggards in the transition and use engagement, rather than wholesale divestment, to decarbonise their portfolios.** This engagement is evolving quickly, with investor coalitions such as Climate Action 100+<sup>36</sup> and

the Institutional Investors Group on Climate Change (IIGCC)<sup>37</sup> clarifying their expectations for company transition plans. They have built on material by experts such as the Transition Pathway Initiative<sup>38</sup> and SBTi to inform their view.

**Emerging best practice from this work suggests that for investors and lenders to identify the opportunities in the transition, they need to know:**

- Whether a company has a net zero target that covers scopes 1, 2 and 3 emissions, along with short- and medium-term milestones to monitor progress.
- The sophistication of its plan including the appropriate balance of emissions reductions and offsets for its sector; robust and evolving internal carbon pricing; and Paris-aligned investment and capital expenditure.
- The governance of the plan, including whether the board has effective oversight and how success is linked to executive remuneration.
- How the company supports development of climate policy, both

<sup>32</sup> See: <https://unfccc.int/climate-action/race-to-zero-campaign>

<sup>33</sup> See: <https://sciencebasedtargets.org/>

<sup>34</sup> See: <https://www.weforum.org/mission-possible>

<sup>35</sup> See: <https://exponentialroadmap.org/1-5c-business-playbook/>

<sup>36</sup> See: <http://www.climateaction100.org/>

<sup>37</sup> See: <https://www.iigcc.org/>

<sup>38</sup> See: <https://www.transitionpathwayinitiative.org/>

directly and indirectly (e.g. through trade association membership).

- Whether its climate reporting and risk assessment is consistent with TCFD recommendations.
- The position of a company on the transition path relative to its peers.

**These developments show great promise. But there is further scope to improve financial institutions' engagement on transition plans.** This will help raise ambition across the global economy, clarify the financial community's ask of companies and support the whole economy transition that is needed to reach our climate goals.

**In turn, financial institutions will increasingly be expected to disclose their own alignment to net zero and show how clients' money is invested.** Any measure that seeks to express how investments are aligned with the transition to net zero needs to be: forward looking (giving credit to efforts by companies to decarbonise); anchored in real-world climate targets; and dynamic, to show progress towards the targets. Without effective and comparable methodologies for measuring and articulating progress on the transition, divestment strategies will become more prevalent as consumers demand climate action.

**Existing climate metrics, while valuable and serving a purpose, do not adequately measure climate transition:**

- ESG metrics lack consistency and transparency – there are over 1,000 approaches to calculating scores – and combine a multitude of E, S and G factors. The E is not explicitly linked to achieving net zero and tend to capture single point in time measures that focus on inputs (e.g. targets) as opposed to outcomes (e.g. achievement of targets).
- Green investment labels suffer from a lack of consistent standards, definitions and metrics, increasing the risk of “greenwashing”.
- Carbon footprints and corresponding CO2/\$ invested measures only capture current emissions and fail to give credit for plans to reduce them.
- Taxonomies capture a proportion, not all, of business activity and as criteria are administratively set, may not be sufficiently dynamic to accommodate rapid changes in the market needed for measuring portfolio alignment
- Pure “green” investment is still small scale – despite rapid growth, green bond issuance makes up less than four per cent of global bond issuance – and inadequate to either fund a whole economy transition or meet increasing

investor demand to align with the transition.

**More comprehensive approaches to measuring portfolio alignment are starting to emerge.** These include, for example, calculating the percentage of portfolio companies with a net zero target, through to more sophisticated measures which calculate the current and projected emissions by companies in a portfolio and their contribution to global temperature rises. Some investors, such as AXA, Aviva, GPIF and CalPers are already calculating and disclosing so called “portfolio warming” metrics and committing to reducing their portfolios in line with global temperate goals of 2 and 1.5 degrees.

**A critical assessment of the strengths and trade-offs of these options is important.** The most sophisticated and potentially most useful of these metrics – the portfolio warming metric – can be calculated in a number of ways, relies on a series of judgements and requires greater disclosure from underlying portfolio companies. Exposing these issues will help focus on the action needed to improve the accuracy and therefore the utility of these metrics. These issues are discussed in a the [Measuring Portfolio Alignment report](#), which will serve as a useful basis for discussion in the industry on the approaches to measurement.

**The financial sector will need to agree the preferred measurement approaches as consumers increasingly call for information on how their money is invested.** With climate activism moving to the mainstream and headlines still focusing on fossil fuel investments, the financial sector will face increasing scrutiny on their role in the transition to net zero. They will need to provide answers to these questions, including those from clients on how their money is invested as campaigns such as Make My Money Matter gather pace.

**Ultimately, if providers of finance can assess the position of companies and portfolios on the path to net zero, compare peers and track progress, they will be better able to identify opportunities in transition, assess vulnerability to transition risks, and guide their engagement with companies.** Metrics of portfolio alignment will also allow providers of capital to track their own progress on the path to net zero, signal to governments where the economy is on the transition and show year-on-year progress to limit temperature increases.

## Returns deliverables

**Goal:** ensure financial institutions have the frameworks to:

- **Assess the credibility of transition plans**
  - Financial sector to work with academic and NGO communities to review and establish best practice/standards for financial institutions to assess the credibility of companies' transition plans to net zero.
  - Ancillary service providers, such as credit rating agencies and ESG score providers, to consider company transition plans in their analysis/reviews/ratings.
- **Measure alignment of their portfolios with the transition to net zero**
  - Private financial sector to review approaches to measuring portfolio alignment, expose further work needed, and discuss next steps for developing a reliable metric.
  - Industry to develop consumer-friendly metrics to express how their investments align with their values on climate change, drawing on existing work by industry bodies such as the Investment Association.
  - Standard setters to incorporate data requirements into core reporting frameworks to improve the measurement of portfolio alignment.
- **Make their own commitments to net zero**
  - Financial institutions to work with initiatives including SBTi, Race to Zero, Net Zero Asset Owner Alliance<sup>39</sup>, Climate Action 100+ (and its regional partners such as IIGCC), Investor Agenda<sup>40</sup>, Principles for Responsible Banking<sup>41</sup>, Partnership for Carbon Accounting Financials (PCAF)<sup>42</sup> and CDP<sup>43</sup> to commit to align their activity with net zero, disclose accordingly, and publish credible transition plans.

<sup>39</sup> See: <https://www.unepfi.org/net-zero-alliance/>

<sup>40</sup> See: <https://theinvestoragenda.org/>

<sup>41</sup> See: <https://www.unepfi.org/banking/bankingprinciples/>

<sup>42</sup> See: <https://carbonaccountingfinancials.com/>

<sup>43</sup> See: <https://www.cdp.net/en>

# MOBILISATION

**The OECD estimates that 70% of the \$3.5trn of investment required for the energy transition will need to be in developing countries. Yet the flow of international capital to emerging and developing economies is limited and reducing in scale as the COVID crisis continues. This indicates the importance of unlocking domestic capital resources in coordination with international flows.** The recent rise of clean energy investment is highly concentrated in high-income countries, China, and a select group of fast-growing economies. Despite rapidly increasing energy demand, other emerging markets have struggled to attract capital for clean energy projects – even in cases where wind and solar may be more competitive than fossil fuels.<sup>44</sup>

**While public finance will play an important supporting role, to turn “billions into trillions”, private financial flows will need to increase.** Putting in place the framework to reorient financial flows with achieving Net Zero and the Paris Agreement can have potentially major ancillary benefits in emerging and developing economies. Corporates will need to invest to reduce emissions in their supply chain to meet Scope 3 net zero targets and invest in decarbonisation activities to offset emissions elsewhere: both these activities are more likely to occur in developing and emerging

economies, helping private investment to flow to greening activities.

**But financial firms still face several barriers to investing in developing and emerging economies that are unique to their context. To scale up investment, they need:**

- Strong institutions, governance and reliable macroeconomic management.** Investors need broad assurance of the financial sustainability of their investments. They also require reliable data on the macroeconomic state of the economy to support their own assessment of risk and return and reporting requirements.
- Policy stability, commitment to low-carbon solutions and contract enforceability.** Low-carbon projects are particularly vulnerable to policy risk, such as the ability to predict and rely on stable tariffs, due to declining input costs and a reliance on government subsidies. The risk of policy reversals or renegotiations is often the single biggest concern of most investors in developing countries. Strong public policy commitments to low-carbon solutions, such as energy targets, NDCs, tax incentives also help create a favourable business – and therefore

<sup>44</sup> See Climate Finance Leadership Initiative report: [https://data.bloomberglp.com/company/sites/55/2019/09/Financing-the-Low-Carbon-Future\\_CFLI-Full-Report\\_September-2019.pdf](https://data.bloomberglp.com/company/sites/55/2019/09/Financing-the-Low-Carbon-Future_CFLI-Full-Report_September-2019.pdf)

investment – environment. Businesses require predictable local legal frameworks to have confidence that contracts will be enforced promptly in local courts. Effective dispute resolution mechanisms are also essential to giving business confidence to enter into relationships with new businesses and partners in foreign markets.

- **Increased market access, a viable commercial partner and ability to scale.** A lack of awareness of bankable projects can be an issue. Technical skills to engage with investors and execute commercial agreements are important. Criteria for investments must be met. The mutual benefits are often not articulated clearly. Smaller markets generally offer fewer opportunities for financial institutions to reach economies of scale. Regional integration and coalitions may help address these issues, if the credit, structural and legal complexities can be overcome.
- **Depth in local financial markets.** Local bank markets that can provide financial services, such as currency, interest rate swaps, access to listed markets, and even support for a robust green bond markets are important for international investors.
- **Currency stability.** Mismatches between the currency denomination of a project's costs and the denomination of its revenues presents extra costs and

risks where instruments needed to hedge those risks are lacking. Structures that are available to partially hedge local currencies tend to be inefficient and expensive.

**The international community must work together to help overcome these barriers. For the private finance agenda for COP26, however, there are four specific areas of contribution:**

- **Supporting the development of a pipeline of investable projects,** including development platforms for blended finance based on clear standards for sustainable infrastructure projects in developing economies, supported by technical expertise, investment protections and appropriate risk mitigation by MDBs and DFIs, and connected to a dedicated pool of “capital in principle” from private investors for proposals that meet these criteria.
- **De-risk investment** by developing new risk management tools, supporting public-private partnerships to provide access to markets and increasing blended finance options.
- **Align MDB/NDB and DFI activity with the Paris Goals.** These institutions have a unique ability to enable countries to create private markets for low-carbon and resilient investment. From an investor point of view, the commitments

the MDBs and DFIs have made to Paris Alignment could help investors seeking to align portfolios with Net Zero, help reduce exposure of investments to transition risk, and provide leverage to offer a commercial incentive to investors for Paris-aligned investments.

- **Encourage the development of the infrastructure for scaling up high-quality voluntary carbon markets.**

Companies will increasingly need to show how they plan to meet their net zero targets, and the role of offsets as they make the transition. The reality is that the most cost-effective offsets, with the biggest emission reduction potential, are typically in developing and emerging economies. This can generate large flows of private capital from advanced to developing economies. For finance to flow from companies to these emissions reduction projects however, there needs to be a functioning voluntary carbon market. A scalable, high-quality, transparent and credible market structure could turn the current \$300 million spent on these projects through the voluntary market into tens of billions of dollars every year.

## Mobilisation deliverables

**Goal:** supporting development of pipeline of investment grade projects

- Increase availability of and access to bankable projects, using the private sector to build capacity in developing countries, building on existing initiatives and alliances. This would include working with CFLI on their next steps following their report *Financing the Low Carbon Future*. For example:
  - Support development of enabling policy environments that attract private finance, as outlined in the CFLI/EDFI/GIF consultation document *Private Sector Considerations for Policymakers*, potentially expanding into pilots for implementation in select countries.
  - Address barriers in financing sustainable infrastructure, such as data availability, by building from existing initiatives such as the work of the G20 and Global Infrastructure Hub, the work of the OECD, and Fast Infra.
  - Connecting pipeline of investable projects to pools of capital that have committed to invest in principle to progress investment discussions.

**Goal:** Align MDB/NDB/DFI activity with Paris goals

- Seek progress from MDBs, DFIs and other institutions on enhanced commitments; aligning their investments with climate goals and green, resilient recovery; and reporting alignment of their own lending portfolios; facilitate access to markets, de-risk investment and provide technical assistance.
- MDBs and DFIs should aim to go from being the first investor/lender for low-carbon and resilient investments in many developing countries now to using their finance more efficiently by de-risking and enabling private sector investment to 2030.

**Goal:** encourage the development of new market structures and products

- Encourage a transparent, credible market structure that is required for scaling liquid, transparent and reliable voluntary carbon markets, alongside parallel initiatives ensuring that these markets have the highest level of environmental integrity.
- Create new products and markets by building on the work of the Insurance Development Forum, the Coalition for Climate Resilient Investment and other key initiatives to scale up resilient infrastructure spending and insurance coverage to close the insurance protection gap.

