

Workshop report on financing net zero

Deliverable 4.8

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Summary

There is a growing awareness among financial actors of the risk that climate change poses to the financial sector, as well as the financial sector's role in mitigating climate change. The former includes physical (e.g. damages), transition (e.g. policy leading to devaluation of assets), and reputational risks. The key is to translate this awareness into action. While there has been a growth in finance for low-carbon activities, complex value chains and a lack of understanding of the Reinvent sectors' impact on climate change (or its mitigation) appears to inhibit the flow of 'green finance' into the Reinvent sectors. When 'green finance' does flow, the environmental impacts of these streams of finance remain little understood, and improvements in impact reporting should therefore be a key priority. However, the financing of explicit low-carbon activities is unlikely to be sufficient to achieve net zero. Rather, the financial sector will need to reorient itself and incorporate risks, especially transition risks, in all its financial decisions. Improvements in climate change scenarios are important here to enable investors, regulators, and other stakeholders to make investment decisions based on their alignment with a net zero world. Finally, while private sector actors and voluntary initiatives have played an important role to date, there is a strong need for policy makers to develop long-term policies that indicate a clear direction of travel to which investors can respond, and possibly mandate action in areas where voluntary action is not forthcoming.

Preface

Background: This workshop was one of five organised as part of the Reinvent project's activities in Work Package 4 – Cumulative Impacts and Scenarios. This Work Package creates decarbonisation pathways for the steel, plastics, paper, and meat/dairy sectors in the context of economy-wide scenarios.

This workshop set out to explore the role of actors, incentives and key trends in finance that enable or constrain decarbonisation in the Reinvent sectors (plastics, paper, steel, and meat & dairy). It complements other workshops – on electrification, biogenic carbon and the circular economy – organised as part of this work package. The workshop was organised with support from the Royal Geographical Society in London.

Context: Governments and businesses are now seriously engaging with the need to move towards a 'net zero' economy. However, a green transition will not be possible without the engagement of the financial sector. Indeed, signatories to the 2015 Paris Agreement are committed to 'Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development'. In particular, private financial investment is now widely held to be crucial to the decarbonisation of economy and society. Nonetheless, despite recent growth in so-called 'green finance', there appears to be a persistent 'investment gap' between targets and current realities of finance for a green economy.

The question of how and by whom the required level and diversity of finance will be provided is therefore fundamental to the challenge of achieving net zero. As a growing number of scenarios indicate the likely scale and nature of the investments required, there is a parallel need for insights into the ways in which investment is taking place and its consequences for society and for nature across diverse contexts, from local to global.

In this workshop expert speakers analysed the progress made on financing green innovations, the potential for greening the finance sector, and how these can contribute to a just transition towards a net zero economy. Organised through two sessions 'Financing Green' and 'Greening Finance' the ensuing discussion explored financial solutions for the decarbonisation challenge in Europe.

Objective: The workshop explored the possibilities and tensions of 'financing green' and 'greening finance' against the backdrop of the goal of reaching a net zero economy across diverse carbon-intensive sectors such as meat/dairy, paper, plastic and steel. Our aim through this event is not only to open up the debate about the ways in which academic knowledge and understandings can contribute to this important challenge, but also to develop recommendations about how financing net zero can be achieved.

List of participants

First name	Last name	Organisation
Simon	Banner	National Audit Office
Christopher	Bannister	Foreign and Commonwealth Office
Fredric	Bauer	Lund University
Sofiane	Belmiloud	FAIRR
Gavin	Bridge	Durham University
Harriet	Bulkeley	Durham University
Christophe	Christiaen	Satellite Applications Catapult
Sarah	Colenbrander	New Climate Economy
Berik	Davies	Shell International
Ray	Dhirani	WWF UK
Michael	Dray	Peter Brett Associates
Will	Gould	Foreign and Commonwealth Office
Andrew	Gouldson	University of Leeds
Andries	Hof	PBL Netherlands Environmental Assessment Agency
Robert	Holden	Knight Frank
Candice	Howarth	Grantham Research Institute, LSE
William	Irwin	Grantham Research Institute, LSE
Sarah	Kemmitt	Bank of England
Sarah	Knuth	Durham University
Andrew	Kythreotis	University of Lincoln
Karen	Lai	Durham University
Paul	Langley	Durham University
Kate	Levick	E3G
Ian	McGuinness	Knight Frank
Emmet	McNamee	PRI
Hinesh	Mehta	Hammersmith & Fulham Council
Simon	Messenger	2 Degrees Investing Initiative
Priscilla	Negreiros	Climate Policy Initiative
Lars J.	Nilsson	Lund University
Sarinka	Parry-Jones	Foreign and Commonwealth Office
Jeremy	Robinson	The Green Stockbroker
Penny	Rogers	Department for Business, Energy and Industrial Strategy
Anna	Romeling	Lund University

First name	Last name	Organisation
David	Scott	Deloitte
Guy	Shires	Department for Business, Energy and Industrial Strategy
Joe	Smith	Royal Geographical Society (with IBG)
Catherine	Souch	Royal Geographical Society (with IBG)
Dewi	Spijkerman	Knight Frank
Josué	Tanaka	EBRD
Ben	Taylor	Department for Transport
Catherine	Taylor	Foreign and Commonwealth Office
Helen	Tomlinson	WWF UK
Lara	Tyrell	John Swire & Sons
Liam	Upton	Department for Environment, Food and Rural Affairs
Bregje	van Veelen	Durham University
Stephanie	Wyse	Royal Geographical Society (with IBG)

Agenda

12.00pm - Arrival and registration with a light lunch

12:30pm to 1:30pm - **Opening panel**

- Organisers' introduction: Professor Harriet Bulkeley, University of Durham/Utrecht University; Professor Lars J. Nilsson, Lund University; and Dr. Andries Hof, PBL The Netherlands Environmental Assessment Agency
- Josué Tanaka, Managing Director Operational Strategy and Planning, EBRD
- Ray Dhirani, Head: Sustainable Finance, WWF UK

1:30pm to 2:15pm - **Panel: Financing Green**

Chaired by: Dr Sarah Knuth, Durham University

What is the progress being made to finance green innovations and transitions that can help meet the UK's Net Zero target?

- Faazi Adam, FAIRR Initiative
- Bregje Van Veelen, Research Associate REINVENT, Durham University
- Sarah Colenbrander, Head of the Global Programme, Coalition For Urban Transitions, World Resources Institute

2:15pm to 3:00pm - **Roundtable discussions: Financing Green**

3:00pm to 3:30pm - Coffee break

3:30pm to 4:15pm - **Panel: Greening Finance**

Chaired by: Professor Gavin Bridge, Durham University

What is the potential for greening the finance sector, and how can such dynamics help to contribute to a just transition towards a net zero economy in the UK and beyond?

- Sarah Kemmitt, Manager, Major UK Banks Supervision, Bank of England
- Simon Messenger, France and UK Director, 2 Degrees Investing Initiative
- Will Irwin, Policy Analyst Sustainable Finance, London School of Economics

4:15pm to 5:00pm - **Roundtable discussions: Greening Finance**

5:00pm to 5:30pm - **Closing panel**

- Andy Gouldson, Leeds University
- Karen Lai Durham University
- Lars J. Nilsson, Lund University

5:30pm to 6:30pm - Networking drinks reception

Theme 1: Financing green

It is well-recognised that a “massive reallocation of capital” from ‘brown’ (high-carbon) to ‘green’ (low-carbon) investments is required to meet the UK’s net zero target (Mark Carney, 2019). The first theme of the workshop explored how finance can be redirected to flow towards ‘green’ investment.

Actors

The workshop highlighted the importance of considering the diversity of actors in the financial system, and how each can play a role in ‘financing green’. While private investors are often framed as at the heart of this, the workshop emphasised the importance of other agents of change in private finance, including stock markets and indices which can enable, inhibit or direct flows of green finance. There is an important role for the public sector as well. For example, multi-lateral development banks can be helpful to leverage private funding, while governments can issue sovereign green bonds. Furthermore, a clear policy direction and regulatory framework are essential for providing an impetus and context to which investors can respond.

Finally, transnational initiatives also have an important role to play in awareness raising and mobilising financial actors. They can play an especially important role in relation to redirecting finance in relation to the Reinvent sectors. The nature of these sectors, as well as their complex value chains means the climate impacts of investments are not always as well-understood as in relation to the energy sector, something which intermediaries such as the Climate Bonds Initiative are seeking to address.

Approaches and mechanisms

One of the most visible approaches to finance green is through the use of explicit green financial instruments; Green Bonds are a particularly visible and high-profile examples. Such instruments seek to ensure that investments are directed towards projects that are earmarked as ‘green’. The European Bank for Reconstruction and Development adopts a different approach: it applies an internal carbon price against which they test projects when making investment decisions.

In addition to financing ‘green’, mechanisms are also required to move finance out of ‘brown’ (high-carbon) economic activities, which is likely to be more difficult to achieve. Three potential approaches to encourage investors to shift their investments were identified: (1) through making the climate risk of such investments more visible (for example through mandatory climate risk disclosure); (2) through increased and improved reporting of the impact of investments on climate change; (3) through policy measures which would discourage or prohibit the financing of (some) high-carbon activities. These approaches may also require additional policy measures, such as carbon pricing, to reduce demand for high-carbon investments. In all three cases, however, policies should take into account their place-based socio-economic impacts and what a transition from a brown to a green economy means for places and people currently reliant on high-carbon activities.

Impact

The majority of explicitly green investments continue to be directed towards a relatively small number of 'green' activities: renewable energy, buildings & energy efficiency, and transport. However, evidence from the Green Bonds segment shows that their issuance is becoming increasingly diverse, with a small number of companies related to the Reinvent sectors now having issued such bonds. This is further stimulated by the development of taxonomies and other instruments which seek to determine and standardise what counts as 'green' in these sectors.

Nonetheless, there are two caveats that are worth emphasising. The first is that despite an increase in flows of financial streams that are labelled 'green', the (environmental, social and economic) impact of these streams remains little understood. There is an identified need to shift focus from quantifying flows of finance to understanding their impact. However, impact reporting, especially the inclusion of quantifiable environmental impacts, is currently not always practiced, and fundamental rules regarding how impacts are to be measured, or what reference point to use, are currently lacking. This is especially relevant for the Reinvent sectors, where investors do not always understand their upstream impact, or how 'greenness' should be measured, due to the complexity of/unfamiliarity with their value chains. The development of common, international standards is particularly important in this respect, as is the allocation of (human) resources by institutional investors to assess the social and environmental impacts of their assessments. The second caveat is that despite the many positive stats around the growth of green finance, it is important to acknowledge the relative small volumes of this form of finance compared to volumes of finance that are not labelled green, indicating there is still a significant way to go before financing green becomes mainstream.

Theme 2: Greening finance

The financing of explicit low-carbon activities is unlikely to be sufficient to meet net zero. Workshop participants emphasised that in order to meet net zero, not only should we focus on the greenest and brownest (high-carbon) activities, but also on all the economic activities that are situated in between. This is particularly relevant for the Reinvent sectors, which many investors currently do not consider to be explicitly low or high-carbon. To address the climate impact of all economic activities requires financial actors to consider climate change risks in all financial decision making.

Actors

Such a transformation of the financial system also requires the participation of a variety of actors. The discussion at the workshop indicated the importance of the role central banks can play. The leading role that the Bank of England has started to take was seen as especially promising, not least because it is becoming internationally recognised as an example of good practice. In short, the Bank of England's approach is one of risk management, where it seeks to make the heart of the global financial system more responsive to climate change. It seeks to do this through managing exposure to climate transition risk by disclosing how it integrates climate-related financial risks across its balance sheet and processes; the establishment of supervisory guidelines and requirements; and stress testing banks against diverse climate scenarios. It is too soon to tell whether such practices will be rolled out to an extent, and at a sufficient speed to meet net zero targets. Nonetheless, transnational initiatives such as the Central Banks and Supervisors *Network for Greening the Financial System* seek to foster action and the sharing of best practices between central banks in this area.

Greening finance could also be facilitated in different ways. For example, stock exchanges could commit to a net zero target, which would require companies listed on these exchanges to be aligned with this target. For such an approach to be successful, it would require a critical mass among stock exchanges, to prevent companies from moving their listings to other stock exchanges with less rigorous requirements.

Approaches and mechanisms

Greening the financial system likely requires a variety of changes, including the eradication of fossil fuel subsidies, the establishment & alignment of carbon markets with the net zero goal, and the alignment of public finances with this goal. Such shifts will require a shift in thinking about risk and impact that not only recognises the impact of investments on the climate, but also the impacts of climate change (and associated risks, if left unaddressed) on the financial system. There are a variety of ways in which such a shift in thinking, and associated practices, can be achieved. These include the mainstreaming of climate risk disclosures (enabling investors to make informed decisions), transformation of risk management practices, and the mainstreaming on climate considerations in financial decision making.

Mainstreaming of climate considerations, however, relies on advancement in climate related tools and metrics. While early metrics relied on carbon footprinting approaches, significant progress has been made in recent years in developing metrics and approaches that enable such data to be incorporated into meaningful decisions. This includes the incorporation of forward-looking data that indicates the direction of travel of companies included in investment portfolios, as well as comparing that data to scenarios and policy directions.

Finally, while dominant approaches to greening finance focus on enhancing the financial sector's ability to accurately determine and price climate risk, if such attempts to green finance prove insufficient, perhaps policy action is required to cut off finance to the most polluting companies.

Impact

In many ways, we are still in the early days of the process of 'greening finance'. Although it is therefore perhaps too early to assess the impact of some of the aforementioned developments, the workshop did highlight a number of potential impacts that require attention in the years to come. While much attention to date – in particular in relation to 'financing green' – has been on the quantities of finance available, the processes of greening finance should ideally result in a change to the *quality* of finance available: finance that takes into account long-term climate risks and enables long-term planning to address these risks, and that integrates social and environmental factors in all financial decision making.

While participants at the workshop agreed there is a clear need to 'green finance', in a manner that takes into account both the impact of investment on the climate and the impact of climate change on investments, they also stressed the importance of the remaining sensitive to the impacts that such changes will have in society. In particular, the incorporation of climate risk in financial decision making could potentially have negative consequences for people and companies in places that are most vulnerable to climate change, by making financial products more difficult or impossible to obtain. Other questions remain around the consequences for those parts of the financial system that do not sufficiently or accurately incorporate climate risk in their decision making. Finally, 'greening finance' can only take place if stricter climate policies are enacted: finance can respond to, but not substitute for, policies that seek to fix the climate problem.

Next steps

- We will write a briefing note together with the British Royal Geographical Society about the changes needed for the finance sector and where the challenges might lie. It will identify key issues that arose in the workshop and their implications for the way in which questions of financing net zero will need to be addressed in the run up to the COP26 in Glasgow, and for the UK's climate strategy going forwards. This briefing note will be published in early 2020.
- A follow-up workshop with policy makers in Scotland is scheduled for January 2020. It will seek to address the question of how and by whom finance can be provided for Scotland to meet its net zero target, and the role the Scottish Government can play in enabling this.
- The insights gained will also feed into our work in WP6 ('Realising Decarbonisation Pathways'). In particular, the opportunities and challenges that finance poses for the Reinvent sectors will be incorporated in our analyses of how momentum for decarbonisation and decarbonisation at scale can be achieved (task 6.1 & 6.2). We will also assess its implications for modelling decarbonisation pathways in task 6.5.

References

Carney, Mark (2019) Open letter on climate-related financial risks. Bank of England.
<https://www.bankofengland.co.uk/news/2019/april/open-letter-on-climate-related-financial-risks>