Transition of financial activities towards net zero

1. The financial sector has to identify the key decision points through which to deliver the fast-approaching net zero target

An official was of the opinion that the various factors the financial sector must be aware of to inform its journey towards the fast-approaching net zero target should be addressed. Market participants, regulators and central banks globally are impacted by the climate crisis, but delivery of the transition to net zero is only in the early stages. To achieve meaningful decarbonisation, there must be behavioural change and technological processes, such as innovations in hydrogen, must be harnessed. This requires capital and political will.

The EU is taking a leading role with its taxonomy to marshal the capital required and disclosure is being addressed. Gaps in the net zero regime are being filled through stress testing, supervisory practices and roadmaps, but remediation only at the EU level is not sufficient. Firms are concerned about carbon taxes, possible poor returns on sustainable investments and the longevity of transition infrastructure.

The panel will focus on what the financial sector should prioritise in transition planning in order to make a realistic contribution to greening their activities. It will also interrogate the role of public decision-making, policy formulation and capital marshalling in driving the transition to net zero.

What the non-financial information firms are asked to disclose will help the financial sector to provide a sound and efficient support to the fundamental change triggered in the economy by net zero public policies

An official stated that both upstream and downstream measures had a role to play. Upstream measures would be large and impactful changes to the economy, like the re-pricing of carbon pioneered by Sweden over 30 years ago. The EU Emissions Trading System (EU ETS) has lately taken over this dominant role, alongside policy frameworks such as the Carbon Border Adjustment Mechanism (CBAM). Some parts of Europe are also taking new perspectives on nuclear energy.

The finance sector's primary role is in downstream measures, the response to the fundamental changes in the upstream. It must take advantage of the new opportunities presented by the increased demand for investment in net zero projects. Financial intermediaries will be required to facilitate the allocation of capital, assess borrowers' credit worthiness, ensure savers a good return on investment and manage risk. Regulators must continue working as before to ensure the smooth operation of the financial sector, while being mindful not to create barriers to success when establishing new layers of regulation and reporting. The information firms are asked to disclose must be relevant, consistent and comparable.

An official summarised that upstream measures generate the business proposition that is then supported by the financial sector in the downstream.

2. Clear net zero public policies should provide clear price signals and enable firms to plan their transition. However, economic players need support, notably from the financial sector

2.1 Beyond general technology and economic directions, transition requires cooperation and support

An official noted that German corporates request a clear price signal in every case, as well as streamlined planning and approval procedures in every member state in which they wish to invest. Such alignment is essential to progress. The German Federal Ministry feels that collaboration between the financial sector, regulators, policymakers and industry is vital if the net zero target is to be achieved.

Small and medium-sized enterprises (SMEs) can sometimes find it difficult to comply with European-level regulations, reporting requirements and taxonomy. A forum must therefore be created to allow such enterprises to seek support from financial services firms and enhance their transition planning. A key cornerstone of reaching the net zero target is facilitating smaller corporates moving from the brown or yellow to the green phase.

2.2 The financial sector should demonstrate its effective commitment to net zero actual transition beyond it displaying related targets

An industry representative commented on the financial services industry's significant responsibility to take on downstream measures to capitalise on work done in the upstream. Now that the taxonomy exists, the financial sector must help corporates understand the importance of the project. The next step might be to increase the constraints placed on such enterprises. The financial sector should consider sharing milestones in liabilities, loans and bonds with investors, beyond the targets currently required. This would demonstrate that the sector is taking the challenge of the net zero transition seriously.

2.3 ESG ambitions must be translated into specific and credible objectives and embedded in companies' governance and strategy

An industry representative observed that 91% of CNP Assurances' assets are under ESG-focused scrutiny, demonstrating that decarbonisation must be addressed at every stage of asset governance. The matter must be considered first at the board level, with positive sentiment translated into specific objectives. CNP Assurances does this through membership of the UN Global Compact, commitment to achieve carbon neutrality by 2050 and significant exclusions on exploration projects. Science-based targets and KPIs are used to assess the organisation's trajectory. It also holds itself to account by publishing the carbon footprint and energy consumption of its operations.

2.4 Financial institutions must be able to understand where their customers will be on various time horizons and how they contribute to their greening

An official highlighted the value of active planning. Planners must determine the right questions to ask before establishing the complementary strategic choices to be made. Both vocabulary and broader capability must be built up. It is vital that financial firms be involved in this process, and put pressure on others to do the same, because the sector acts as an intermediary.

The financial services industry should consider where firms might be in 10 or 15 years' time and keep close watch of their exposures, rather than solely reporting on a firm's emissions today. There must be a strategy in place to ensure longevity of the net zero project and not only short-term commitment.

3. The financial sector, however, must remain wary of financial stability and investor protection with the backdrop of new and emerging stakes and risks

An official stated that the financial sector should also be wary of the potential conflict between fiduciary duty and investor protection. Investors are keen to receive information about firms' sustainability initiatives, but the simple dichotomy between green and not green might not be the end of the issue. Debates can also be had about whether 'green' is green enough. Those firms with the potential to become green in future, with the right investment, must not be dismissed out of hand.

From a regulatory perspective, the financial sector is of systemic importance. Regulators must ensure that such firms are abreast of the new risks associated with the net zero transition and dealing with them appropriately. As aforementioned, what is disclosed and how is of utmost importance. The International Organisation of Securities Commissions (IOSCO) is currently working on these issues, investor protection and regulation, with close involvement from the Swedish Financial Standards Authority (FSA). An official agreed that intra-operability of regulation and political policy is a key consideration.

An industry representative stated that a collective approach is vital, with all committing to pursue the goal of carbon neutrality by 2050. CNP Assurances has a strong and proactive shareholder base, interested in these issues. The firm has intervened in 103 general industry meetings on climate change.

The impact of climate change on biodiversity, conservation and ecosystems is also significant. CNP Assurances is taking practical steps in this regard and is the first private sector owner of a forest in France. It manages 57,000 hectares of land. Recent measurement has also indicated that 26% of the firm's investment activity is dependent on just one ecosystem. The right choices have to be made other prevent unnecessary pressure on ecosystems, the environment and microhabitats.

An industry representative noted that Mizuho in December 2022 announced its policy on net zero and publicly committed to financing whatever activities necessary to facilitate the transition, while influencing the industry as a whole on decarbonisation. The bank is focused on evaluating new technologies to assess their long-term impact. The government also has a key role to play in setting the direction of the industry. Dialogue with government had aided Mizuho in alleviating the uncertainty inherent in the newly created market on decarbonisation.

An industry representative observed that Société Générale has already commenced the transition of its financing activities and has joined the Net Zero Banking Alliance (NZBA). It is important to determine a universal approach on transition. This requires cross-jurisdiction cooperation, particularly for global financial institutions impacted by differing laws and concepts. Geopolitical factors and extra-territorial effects must therefore also be a consideration in discussion of the financial sector's role. EU-designed rules might prevent the financing of transition projects outside Europe, a particular concern when there are already a small number of projects available fitting these strict criteria.

Transition planning should also include objectives beyond the strict bounds of climate, such as energy sufficiency and social acceptance of transition measures. Financial firms on the whole feel that alignment of interests between companies, banks, investors, and public authorities, informed by easily accessible and comparable data, is a more productive path forward than transition based on penalisation.

An official added that public decision-makers can help financial institutions attain the information they need from corporates as to their transition progress. The Corporate Sustainability Reporting Directive (CSRD) and European Sustainability Reporting Standards (ESRS) are important components of this, with corporates also held to account by the International Sustainability Standards Board (ISSB). It is vital that policymakers find coherence in the various pieces of legislation, difficult for the real economy to manage, to deliver comparable data to the financial sector.

An industry representative said that it is essential for financial institutions and regulators to work together on the net zero transition as part of an integrated, long-term strategy for both firms themselves and the planet. A focus on net zero must come from senior management at corporates, who are financially incentivised to pursue the matter. Plans might also be voted on by stakeholders, meaning that targets and delivery will be of great importance.

In terms of whether decarbonisation targets are effective, an official noted that the debate is taking place at the national and supranational level, with the EU considering firming up its targets to encompass all financial firms. As the negotiations continue it is clear that relevant parties have differing views. Financial firms should take note that the relevant Corporate Sustainability Due Diligence Directive (CSDDD) was prepared by a climate ministry, not one with a finance focus.

The most useful targets are likely to be interim, to facilitate benchmarking, but these must be aligned to science-based, long-term objectives. Most effective is consideration of a range of targets. The operation of financial firms should also be considered. It is significantly easier for a car manufacturer or steel plant, for example, to comply with the EU's requirements on climate and the net zero transition. Asking financial intermediaries to do the same requires some creative thinking and stretching of definitions. Such firms should do more with the regulatory perimeter and consider that regulations likely would not be uniformly imposed across the sector.

An official stated that collective action is needed and that global standards must be defined to facilitate this. The intersection of policymaking and firm-level strategies should be carefully considered to marshal the capital required to drive the net zero transition. While interim objectives are necessary to assess progress, there must ultimately be system-wide alignment on investment strategies.