Transition of financial activities towards net zero

1. Transition investments are increasing as country-specific policies to deliver net zero commitments are starting to materialise

An industry representative stated that the transition is a techno economic transition and is accelerating. €1.1 trillion of transition investment took place in 2022. The two key vectors of decarbonisation, renewable power, and electric vehicles, both hit records. There were about 340 gigawatts of new wind and photovoltaics (PV), which is a 21% increase from 2021. Another increase to 500 gigawatts will take place in 2023. The world is getting high double-digit percentage yearly increases in the annual deployment of wind and PV. Every year is also a record on the electric vehicle (EV) side, with over 10 million new EVs on the road in worldwide sales, which is a 62% increase on 2021. The number is on track to hit about 16 million in 2023, which is another 50% to 60% increase. In the first half of 2023 16% of all new vehicle sales were electric.

Around 90% of the world has a net zero commitment either legislated or under discussion. The policy to deliver those commitments is starting to materialise, including the Inflation Reduction Act (IRA) in the US and industrial policies all around the world. The world is currently on track for around 3 degrees of warming. For 1.5 degrees, around 500 gigawatts each of wind and PV are needed to get on track in the current decade. 35 million EVs are needed each year, with the removal of around 100 gigawatts of coal each year up until 2030. The emissions trend by country is not a one size-fits-all story.

He added that banks are now setting targets for many high-risk sectors. At their institution (HSBC) policies have been put in place such as a coal phaseout policy in 2021 and an energy policy at the end of 2022. The transition requires a switch in thinking is the finance sector from risk management and compliance to building commercial strategies.

An industry representative stated that in recent years various jurisdictions presented a mix of initiatives to encourage the transition to net zero. The EU is moving from the 'stick approach' to the 'carrot approach' with its Net Zero Industry Act, following the IRA in the US and the GX Strategy in Japan. Both approaches are necessary to achieve the net zero environment

An official noted that the second element is to have the best mobilisation of public and private investment. The Spanish Recovery and Resilience Plan (RRP) has almost 40% of the envelope devoted to the green transition.

2. Ongoing swift policy efforts regarding green bond markets, sustainability labels and disclosure standards, as well as sustainability risk assessments, contribute stimulating the transition to net zero

An official stated that the objectives of fighting against climate change are valid, as record high temperatures occurred over the summer. The legal framework that the European Commission designed in 2020 has almost been completed, with the Sustainable Finance Action Plan (SFAP). The three main pillars of the whole plan are taxonomy, transparency, and tools. During the Spanish Presidency of the Council of the European Union we are working intensively in the regulation on environment, social and governance (ESG) ratings.

If there are no objections in October the new delegated acts on the four environmental objectives around the mitigation and adaptation of climate change will be introduced, so the screening criteria for the Taxonomy will be completed. The European standards of sustainability reporting of companies will hopefully be in place around November. The legal framework is very complex. The Spanish Treasury`s Sustainable finance public policy is being organised around three main elements. The first is to adapt to the European legal framework and to participate in collaboration; the second is climate risk assessment; and the third is to boost the green bond market.

3. Many jurisdictions focus on developing decision useful information for investors which avoids global duplication

An industry representative observed that the progress made on the sustainability disclosure with the publication by the International Sustainability Standards Board (ISSB) and in the EU with the Corporate Sustainability Reporting Directive (CSRD) and the European Financial Reporting Advisory Group (EFRAG) work are important milestones that contribute to realisation of the transition. Each jurisdiction needs to recognise and respect the approach in the other regions that have declared their commitment to net zero. There is no "one-size-fits-all" for transition. Recognising that there are differences among jurisdictions should be at the basis of each policy action. The administrative burden of new requirements on companies should not be excessive.

An official stated that the official sector is trying to ensure that there is genuinely decision useful information available to investors in the private sector. The official sector is able to put structures in place that allow global firms to produce that information in a way that minimises duplicative requirements. The Task Force on Climate-Related Financial Disclosures (TCFD) had been created, and the ISSB has been set up and delivered its standards, which had been endorsed by the G7, G20 and the International Organisation of Securities Commissions (IOSCO).

The UK will set up a framework for its adoption of the ISSB standards by the middle of 2024. The ISSB allows for divergences in the ways that jurisdictions will do this. In the UK the divergences will be minimised by ensuring that UK firms have the building blocks for a disclosure that is compatible with an international approach to disclosure information. The aim is for a UK firm's disclosure to be compatible with ISSB standards. The Chair noted that it is also important to think about the real economy.

4. Key success factors for a swift transition

4.1 Further accelerating the transition of SMEs is a challenge, which represents critical economic, competitive and sustainability stakes for the EU

An industry representative stated that 99% of all businesses in Europe are SMEs. SMEs are responsible for 63% of the CO_2 emissions of the EU. Some companies are more advanced due to their business model or practices, but others are lagging. Managing climate issues will give them a competitive advantage.

4.2 A green sectoral plan should be envisaged to clarify the roles of the public financial and corporate sectors, foster cooperation for private financing, and reduce regulatory uncertainty

An industry representative stated that according to Banque de France 65% of large companies managed and implemented energy decarbonisation measures. A significant amount of uncertainty remains regarding a manageable regulatory framework, especially for SMEs. Clarity is needed on a clear cut role split between public authorities, industry, and banks. The public authority has to define sectoral transitory paths for each industry.

On public spending and the budgetary normalisation, it will be impossible for public spending to finance investment in member states. The solution remains in the private sector. It is important to have information that allows companies to help finance and advise its clients on their transition path. The regulatory framework should be rationalised and simplified for all companies, not only SMEs.

4.3 An effective transition requires further clarification of what needs to be done and what is deemed sustainable

An official commented that it is vital to understand what public authorities expect and what legislators require of companies. Companies, particularly on the financial sector side, need more data to clearly understand what is going on and to identify the companies that are transitioning effectively and the corporates that provide that data. Clear guidance from public authorities about expectations are needed, as well as clear orientations and definitions around what needs to be done and what is deemed sustainable.

4.4 Monitor both the availability of finance and the uncertainty hindering transition projects in order to focus public sector intervention

An official stated that there is sufficient financing capacity to finance the transition needs but there are not enough projects to finance. The real economy is not transitioning fast enough. Investments by corporates and individuals for the transition are costly in the short term, but their expected returns in the medium to long term are often too uncertain. Public utilities have already done a great deal. The EU has set up a comprehensive disclosure framework, which will provide a large volume of data to all market participants. There have also been attempted definitions of what is sustainable in the EU taxonomy.

Regarding the lack of profitability of projects that limit the decisions made by corporates and individuals, public utilities have provided a great deal of support to try to increase the profitability of the projects in specific cases. In the context of the green industry law, the French Minister has announced tax cuts to foster investments in production capacities in batteries and solar panels.

Much is being done but those actions are potentially not leading to sufficiently quick progress. Setting up disclosure frameworks takes a significant amount of time. The CSRD starts in 2024 and the first reporting will be in 2025. So, it will take several years to specify the disclosure requirements in each sector. The EU taxonomy is also not yet completed. The work should be done at the international level as much as possible. Some areas are asking for more public support but there are constraints in public finance. It is vital to ensure that public sector interventions are targeted and well justified.

4.5 Monitor and support the competitiveness of the EU

An industry representative stated that larger companies need to protect themselves as there is a significant issue of competitiveness. In the EU the industry needs to be helped to compete during the energy transition with its main external competitors. That is the purpose of the Carbon Border Adjustment Mechanism (CBAM). The size is apparently too small to ensure that a level playing field will be guaranteed. Without a CBAM at the European level it will be very difficult to manage transition in the EU without creating de industrialisation. There will be zero impact at the level of the planet itself, because there will be no industry in Europe and more industry elsewhere.

5. EU SMEs need multi form support

5.1 Addressing SMEs lack of finance, availability, and expertise

An industry representative commented that the first key challenge for SMEs is the lack of resources, as they do not have the required budget, time, employees or expertise. SMEs also cannot keep up with the new regulations as they do not know how to apply them. The situation is going to be even harder with the CSRD. Some companies have not started because they do not know how or where to start. One idea could be to implement an online toolbox where SMEs will find everything they need.

It is important to adapt the policies to SMEs, involve SMEs in the regulation process, and set up communication tools to explain regulation to SMEs. A helpline could be created with subject matter experts that answer questions that SMEs have.

5.2 Focus and simplify SME reporting obligations

An industry representative noted that the priority for SMEs should be action, not reporting adaptability to CSRD reporting. SME actions need KPIs, which need to be understandable by SME managers.

6. Proportionate and practical transition plans are needed to clarify companies' approach to the transition to net zero, including the consistency with public policies

6.1 Transition plan disclosure standards for corporates and explicit sectoral transition pathways are necessary

An official sympathised with some of the comments about the challenge of keeping up with regulation. In the UK the view has increasingly been that the core of the challenge is trying to get firms to explain what their plan and approach is to the net zero transition in a proportional and practical way that is useful for investors and in line with public policy. It will also help support a dialogue and feedback loop between the private and public sector.

The public sector in different jurisdictions is in various stages of development about what sectoral transition pathways look like. The key is getting to a point where there is practical information available that supports cross border capital flows. A genuine debate is needed between the public sector, the industry, academia, and non-governmental organisations (NGOs). In 2022 the UK set up a Transition Plan Taskforce (TPT), that included the representatives from these areas. The Taskforce is going to publish its final guidance and recommendations in the next few weeks. The aim is to build on the platform of the ISSB, and to give firms practical guidance to support the transition plans that are genuinely useful in a global marketplace.

6.2 National, regional, and global public policies must clarify the technologies and timeframe for decarbonising high emitting sectors and the consequences on investments and emissions of other sectors and their pace of transition

An industry representative stated that the key challenge is to ensure that sufficient capital is deployed towards "transition finance". In order to achieve net zero, the financing should go where the emissions are. It is the responsibility of finance to reduce the transition risk, but policy makers and public need to understand that reducing transition risk may temporarily lead to an increase of the "financed emissions" on banks' balance sheet, because they are supporting hard to abate sectors to decarbonize. There is a need to first decarbonising higher emitting sectors such as energy and power.

In Japan and other Asian countries decarbonisation of the energy generation sector is a key priority, because it accounts for roughly 50% of the total CO_2 emissions. Policymakers, society, and the private sector need to agree on the methodology and potential new technologies that allow the achievement of net zero. Ahead of COP28 will take place in the next few weeks and the industry representative's MUFG will present its Transition Whitepaper 2.0 that focuses on the decarbonisation pathways for the hard to abate sectors and discuss how best to deploy public and private capital to support the transition to a carbon neutral state in Japan for the energy and power sectors.

6.3 Adequate energy public policies will reduce cost uncertainty, spark investment, and enable private finance support

An industry representative observed that finance is ready to go, particularly in the global north, but there are too few a lack of bankable projects. The important thing for the policymaking community is to shift its attention away from the fossil fuel supply side to focus on the end-use demand side. EVs need to be brought into the market in order to decrease emissions from the oil sector. That is done by setting policies, building supply chains, dealing with battery metals, and dealing with charging infrastructure. The current amount of EV penetrations is already reducing oil consumption by around 1.5 million barrels per day. In cold-climate countries heat pumps need to go into buildings to decrease emissions from burning natural gas emissions. That is done by building the supply chain, skilling up the workforce and creating the incentives. The finance will be there to support it, but it has to have the right price signals and the right environment.

6.4 Ongoing coordination is necessary to work out and adapt national transition plans and subsequent legal frameworks

An official stated that achieving the long-term objective requires planning and a clear coordination of efforts between the public sector, the private sector, banks, and companies. In France, the Minister has recently created a committee for the financing of the environmental transitions, which gathers top level representatives of the industry, the banking sector, and public authorities to find solutions.

An industry representative highlighted that the transition is continuous work for the public and private sector. Some fine tuning of the technical aspects of the legal framework need to take place. Sustainable finance is a big topic for the private sector and for the financial industry, and a key priority for the public sector.

The Chair thanked all panellists and noted that there is a consensus on the objective. The transition is accelerating, but much still needs to be done to reach the target. Consistency in terms of regulatory frameworks at national, European, and global level would be helpful, but also terms of communication. The frameworks also need to be proportionate.