GUIDE FOR POLICYMAKERS

GLOBAL SUSTAINABLE INVESTMENT ALLIANCE

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This guide presents insights and actionable strategies to align government policies with the Paris Climate Agreement goals, addressing key barriers and unlocking opportunities to transform global finance for climate action.

INTRODUCTION

This guide was developed alongside the report, ***Transforming Global Finance for Climate Action: Addressing Misaligned Incentives and Unlocking Opportunities***. The goal of this guide is to provide policymakers with example actions to allow capital to flow to initiatives in alignment with the goals of the Paris Climate Agreement. This guide was developed in consultation with key industry experts, who were asked to provide their input on the current challenges in facilitating change in the financial system, and the steps to address these barriers.

Policymakers set the incentives and pathways, for the public-private partnership etc., for capital to flow and cascade through pathways.

Government should take a lead with a coherent, whole of government, consistent transition plan that the investor can then take on. Government needs to assess their contingencies (in the different contexts) and look at what has been stopping them from developing and/or following through with their transition plan.

Policymakers should understand where activity is not happening and be prepared for what they could or should do to change that. Policymakers need to be a good partner to investors and build investor confidence to allow capital to then flow.

HOW TO USE

This research serves as an initial exploration rather than an exhaustive study. It provides a foundation upon which we can build, guiding ongoing efforts to develop comprehensive strategies for addressing the significant challenges within financial and policy systems. Actions should be tailored to specific contexts and circumstances.

Given that the system is complex, multiple angles should be tackled at the same time. We also recognise that actions suitable for some countries and jurisdictions, may not be applicable to others, for reasons such as stage in their sustainable finance journey, or political backdrop. In this way, solutions may be thought of as ‘characteristics’ for enabling environments that will allow capital to flow at the scale and pace necessary to achieve the goals of the Paris Climate Agreement, not as a ‘one size fits all’ checklist.

The guide is paired with a supplementary introductory paper, ***Primer: How Investment Works – And How It Can Help Or Hinder The Transition***. This paper was developed in response to the identified barrier, “Policymakers’ lack of understanding of practical requirements and constraints of the investment community, leading to a mismatch between financial structures and policy assumptions”.

PIVOT refers to a framework for identifying the barriers to climate finance, developed to address the "policymaker investment dilemma". For a comprehensive explanation of these ‘misaligned incentives’, and associated solution sets, see the full report, *Transforming Global Finance for Climate Action: Addressing Misaligned Incentives and Unlocking Opportunities*.

PRIORITY ACTIONS

Example actions include the following:

Action Group	*Specific Action*	*Rationale*	*Relationship to PIVOT*
Strategic Planning and Coordination	*1. Develop National Transition Plans (NTPs) integrating NDCs, LTSs, and other existing plans*	*To provide a consistent strategic response to climate challenges*	*Policy vacuum: Addresses the lack of comprehensive national strategies for sustainable transition*
	2. Create platforms for dialogue between government, industry, and civil society	*To foster collaboration and shared understanding*	*Policy vacuum: Facilitates better-informed and more inclusive policymaking*
	3. Engage proactively in international forums on systemic risk and policy changes	*To push for coordinated global action on climate risks*	*Policy vacuum: Promotes international policy coherence on climate issues*
Financial Instruments and Incentives	*4. Issue sovereign debt instruments linked to the NTP*	*To address fiscal constraints and finance climate initiatives*	*Transition misalignment: Aligns national financing with transition goals*
	5. Implement clear and consistent policies, e.g. a global price on carbon	*To provide clear signals for long-term investments and drive behaviour changes*	*Policy vacuum: Establishes consistent market signals for sustainable practices*
	6. Eliminate fossil fuel subsidies	*To align economic incentives with climate goals, and reduce contradictory messaging*	*Transition misalignment: Addresses misalignment between climate goals and existing economic incentives*
	7. Develop blended finance solutions to de-risk sustainable investments	*To catalyse private investment in challenging sectors or markets*	*Transition misalignment: Addresses funding gaps in sustainable transition efforts*
	8. Identify opportunities for catalytic interventions to incentivise new technologies underpinning the NTP	*To encourage investment in technologies supporting transition plans*	*Transition misalignment: Bridges the gap between current technologies and those needed for the transition*
Regulatory Framework and Legislation	*9. Update legislation to support systemic stewardship and clarify competition laws*	*To address legal uncertainties hindering collaborative climate efforts*	*Policy vacuum: Removes legal barriers to collective investor action on sustainability*
	10. Create regulatory frameworks encouraging long-term value creation	*To challenge excessive short-termism in financial markets*	*(Self-)Interest: Aligns market incentives with long-term sustainability goals*
	11. Review and update regulatory tools to address systemic climate risks	*To ensure regulatory frameworks are fit for purpose in addressing climate challenges*	*Policy vacuum: Modernises regulatory approach to climate risks*

Action Group	*Specific Action*	*Rationale*	*Relationship to PIVOT*
	12. Update fiduciary duty definitions to include long-term sustainability factors	*To broaden the scope of investor responsibilities*	*(Self-)Interest: Aligns fiduciary duties with long-term societal interests*
Corporate Accountability	*13. Reevaluate legal structures to better align with societal benefits*	*To address fundamental misalignments between corporate structures and societal benefits*	*(Self-)Interest: Ensures legal frameworks support broader societal interests*
	14. Require companies to develop and implement meaningful transition plans	*To tackle the lack of concrete action plans and accountability in climate commitments*	*Transition misalignment: Ensures corporate strategies align with national and global climate goals*
	15. Ask institutional investors to disclose systemic risk management practices	*To encourage transparency and accountability in how large investors manage systemic risks*	*(In)active Ownership: Promotes more responsible investor behaviour*
Capital Flow and Investment	*16. Establish guidelines for transparent and consistent ESG data reporting*	*To improve the quality and comparability of sustainability data*	*(Mis-)Valuation: Enhances the accuracy and reliability of ESG assessments*
	17. Develop policies setting clear guardrails for sustainable capital flow	*To address the misallocation of capital and channel investments into sustainable projects*	*(Mis-)Valuation: Guides capital allocation towards sustainable initiatives*
	18. Create regulatory incentives for long-term sustainability performance metrics	*To promote the adoption of sustainability-focused performance measures*	*(Mis-)Valuation: Encourages more comprehensive valuation of corporate performance*
	19. Encourage public-private partnerships to drive transitions	*To overcome financial blockages and leverage private sector expertise*	*Transition misalignment: Facilitates collaborative approaches to sustainable transition*
Capacity Building and Research	*20. Invest in capacity building within government and public institutions*	*To tackle the knowledge gap between policymakers and financial markets*	*Policy vacuum: Enhances policymakers' understanding of financial market dynamics*
	21. Invest in R&D for natural capital valuation tools	*To better account for ecosystem services in economic decisions*	*(Mis-)Valuation: Improves the integration of natural capital in financial assessments*
	22. Create forums for regular dialogue between investors and policymakers	*To ensure ongoing alignment between policy and investment practices*	*Policy vacuum: Facilitates continuous feedback between policymakers and investors*
Stakeholder Engagement	*23. Establish mechanisms for greater societal representation in financial decision-making*	*To ensure broader stakeholder interests are considered*	*(Self-)Interest: Broadens the scope of interests considered in financial decisions*

Action Group	*Specific Action*	*Rationale*	*Relationship to PIVOT*
	24. Create mechanisms to address the free-rider problem in stewardship activities	*To encourage more active and widespread investor engagement*	*(In)active Ownership: Promotes more effective collective action in stewardship*
	25. Re-emphasise that engagement results don't have to be immediate	*To encourage patience and persistence in sustainability engagements*	*(In)active Ownership: Supports long-term approach to investor engagement*
Standardisation and Metrics	*26. Develop standardised frameworks for climate-related risks in financial models*	*To improve the accuracy of climate risk assessments in financial decisions*	*(Mis-)Valuation: Enhances the integration of climate factors in financial valuations*
	27. Jointly develop metrics for transition progress and impact	*To ensure accountability and effective capital allocation in the transition*	*(Mis-)Valuation: Improves measurement and valuation of transition efforts*

PRIMER: HOW INVESTMENT WORKS – AND HOW IT CAN HELP OR HINDER THE TRANSITION

This guide is intended to serve as a brief introduction to responsible investment for policymakers who are new to or unfamiliar with the topic.

"[T]he private sector has the ability to find solutions to climate change by funding the trillions needed for a global transition to clean energy" said US climate envoy John Kerry (CNBC, 2021)

– why then, is that not happening?

This short primer is intended to support policymakers in understanding what responsible investment is, its potential, and its limitations.

INTRODUCTION

Responsible or sustainable investment is a generic term that has a range of interpretations.

For those new to responsible investment, responsible investment is typically understood as 'impact investment' – talking trivially, "investing in wind turbines". Impact investing can be defined as "Investing with the intention to generate positive, measurable social and/or environmental impact alongside a financial return" (CFA Institute, GSIA, and PRI, 2023).

While impact investment is an important part of responsible investment, it is but a subset of investable capital. For impact investors, the objective is to invest in projects, assets and companies that provide demonstrable real-world impact.

However, most institutional investors (this includes pension funds, insurance funds and mutual funds) are subject to a range of constraints that limit the impact of their investment. This may include 'fiduciary duty', a set of legal and ethical obligations in which institutional investors must act in the best interests of their beneficiaries (depending upon interpretation).

These investors – managing trillions of dollars in total – invest in listed assets (the day-to-day brands we're familiar with as consumers, such as Apple or Coca Cola) as well as government debt.

THE INTERMEDIATION CHAIN

To understand responsible and sustainable investment, it's important to first understand the intermediation chain – the chain of 'actors' that connect providers of capital (savers, insurance policy holders, in short, us as individuals) with users of capital (companies and governments). There are a number of ways in which individuals interact with the capital markets (often, without even knowing about it), such as through:

- Pension funds
- Insurance funds
- Mutual funds
- Banks, private wealth

In aggregate, these investors are called asset owners. In some markets, they are well resourced, for example, the Dutch, Australian or Californian pension markets are characterised as large, well-resourced pension funds. In some markets, they are more fragmented, such as the UK (although this is changing through auto-enrolment).

In turn, asset owners invest via asset managers. Asset managers take many forms – the largest, such as Blackrock, Vanguard or State Street, invest trillions of dollars on behalf of their clients. Smaller asset managers may invest a few billion, or even few hundred million dollars.

ASSET CLASSES

Companies are typically financed through equity (the company's ownership) and debt. Equity can be private or public; where public, the company is listed on a stock exchange, and anyone (in theory) can purchase the company's shares.

Investors assume a certain amount of risk (that the company is unsuccessful). In return, the shares may increase in value (if the company is successful), and the company may pay its shareholders a dividend.

Debt tends to be structured as a bond, an investment with a fixed coupon, over a fixed time period.

Public equity, public debt, private equity, private debt, and potentially, infrastructure and property may all form part of an investor's portfolio.

LEVERS OF INFLUENCE

There are two main approaches that investors can take to achieve their sustainability goals:

1. They can invest (choose not to invest, reduce their investment, or divest entirely).
2. They can engage (as a (part) owner of a company, the investor has certain engagement rights, such as participation in the company's annual general meeting (AGM)) and can use their influence with other stakeholders, for example, policymakers, NGOs and civil society.

Key term: Stewardship – "The use of investor rights and influence to protect and enhance overall long-term value for clients and beneficiaries, including the common economic, social and environmental assets on which their interests depend." (CFA Institute, GSIA, and PRI, 2023).

Companies will respond in different ways, depending on the company's position, the 'ask', and the type of investor.

As such, investors' contribution to net-zero GHG emissions (net-zero meaning amount of GHGs emitted to the atmosphere equals GHGs removed) may involve direct investments in sustainability solutions, but more likely, it will involve investing and engaging companies on their own corporate decision-making.

OPPORTUNITIES IN INVESTMENT

Runaway climate change is not in investors' best interests.

As such, investors have both the motivation and the means to take action to address climate change. However, the route to doing so is often indirect, more complex than is typically understood, and subject to barriers that can be technical, and multi-departmental.

Barriers include:

- Lack of policy progress in the real economy (investors' portfolios will often mirror that of the economy).
- Lack of investable environmental solutions (at market rates of return).
- Misinterpretation of legal frameworks, such as fiduciary duties and acting in concert.
- Inadequate disclosures of companies' sustainability activities.
- Inadequate expertise and resourcing.
- Short-termism and short-term reporting requirements.

Lifting these barriers will enable capital to flow (both investor capital, and capital within companies' own balance sheets, subject to investor oversight) to sustainability solutions at pace and scale, accelerating the transition.

This is why a 'systems' and 'whole-of-government' approach is needed to ensure – as John Kerry set

out in 2021 – that the private sector funds the trillions needed for a global transition to clean energy.

FURTHER READING

Global Sustainable Investment Alliance, CFA Institute, & Principles for Responsible Investment. (2023). *Definitions for Responsible Investment Approaches*. https://www.gsi-alliance.org/members-resources/definitions-for-responsible-investment-approaches/

Global Sustainable Investment Alliance. (2022). *Global Sustainable Investment Review*. https://www.gsi-alliance.org/members-resources/gsir2022/

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