TRANSFORMING GLOBAL FINANCE FOR CLIMATE ACTION:

ADDRESSING MISALIGNED INCENTIVES AND UNLOCKING OPPORTUNITIES

GLOBAL SUSTAINABLE INVESTMENT ALLIANCE

CONTENTS

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ACKNOWLEDGEMENTS

Thank you to the following, in addition to other unnamed interviewees, for participating and sharing their insights for this project:

- **Billy Gridley**, SAIL Senior Advisor, The Investment Integration Project
- **Brian Minns**, Senior Managing Director, Responsible Investing at the University Pension Plan
- **Bryan McGannon,** Managing Director, US SIF: The Sustainable Investment Forum
- **Dave Jones**, Director, Climate Risk Initiative, Center for Law, Energy & Environment at Berkeley Law
- **Fiona Stewart**, Global Lead Insurance and Pensions, World Bank Group
- **Jon Lukomnik**, Adjunct Professor of International and Public Affairs and The Brandmeyer Fellow for Impact and Sustainable Investing, Columbia University
- **Mark Manning,** Visiting Senior Fellow, Centre for Economic Transition Expertise, London School of Economics and Political Science
- **Maria Laura Tinelli,** Director and Founder, Acrux Partners
- **Maria Lettini,** Chief Executive Officer, US SIF
- **Nathan Fabian**, Chief Sustainable Systems Officer, Principles for Responsible Investment
- **Rick Alexander**, CEO, The Shareholder Commons
- **Roger Urwin**, Global Head of Investment Content for Willis Towers Watson
- **Sandy Trust**, Head of Organisational Risk, M&G plc, and Member of Council, Institute and Faculty of Actuaries
- **Satyam Khanna**, President, Khanna Economic Strategies
- **Yuki Miyoda**, Project Researcher, Graduate School of Frontier Sciences, The University of Tokyo

HOW TO CITE

Please use the following format when citing this report:

Alexander, J., Shaw, E., Martindale, W., & Manning, M. (2024). *Transforming Global Finance for Climate Action: Addressing Misaligned Incentives and Unlocking Opportunities*. Global Sustainable Investment Alliance.

ABOUT

The Global Sustainable Investment Alliance (GSIA) is a group of the world's largest regional and national sustainable investment representative organisations who collaborate to deepen and expand the practice of sustainable, responsible and impact investment through intentional international cooperation.

The organisations in GSIA have the deepest reach into the world's largest sustainable and responsible investment markets, from retail to institutional investors.

GSIA is a recognised thought leader in responsible and sustainable investment at the global level. Since 2012, GSIA has released a global biennial study that is the most comprehensive, pre-eminent and highly cited source report on the size, growth and dynamics of the responsible and sustainable investment industry.

GSIA is comprised of the sustainable investment membership organisations in the US, Canada, Australasia, Japan, EU, Netherlands and the UK with a combined membership of many hundreds of investment organisations managing trillions of dollars of assets.

GSIA's mission is to unlock the power of the worldwide financial services industry to drive leadership, achieve a substantial impact on key global challenges, and accelerate the transition to a sustainable future.

GSIA simultaneously works to enhance the synergies between members, participate in global initiatives, and provide advice and support to local and regional sustainable investment organisations as they setup and grow. Our vision is a world where sustainable investment is integrated into financial systems and the investment chain and where all regions of the world have coverage by vigorous membership based institutions that represent and advance the sustainable investment community.

ABOUT CANBURY

Canbury is a sustainability consultancy with expertise in stewardship, climate change reporting, environmental science, sustainability, corporate finance, and policy. Canbury leverages the latest AI technologies to provide clients with a full service of sustainability support - from source data through to client reporting. Canbury takes pride in providing bespoke advice that meets clients' needs. Canbury works with companies, investors and NGOs.

FOREWORD

The global financial system stands at an inflection point. Rational investors continue to be incentivised to invest in unsustainable assets, despite widespread recognition of the climate crisis and numerous climate goals set.

While investors have a crucial role to play in addressing climate change, they alone cannot solve the crisis. A transition to net-zero needs a coordinated effort across industry sectors, and this effort needs to be underpinned by effective policy.

This report brings together experts and knowledge from across policymaker and investor spaces to identify the barriers to enacting action on climate change – the 'misaligned incentives'. In this report, we propose solutions to 'unlock' these barriers and enable capital to flow to the projects needed to facilitate the transition, offering practical insights that we believe will contribute meaningfully to discussions at the 29th Conference of the Parties (COP29).

This report recognises that solutions to address climate action barriers cannot be 'one-size-fits-all'. Different regions face distinct challenges and opportunities in driving progress towards global climate goals. With this in mind, we have outlined numerous solution sets that can be applied as seen fit, across different market conditions and regulatory environments.

We envision a future where financial flows align with climate action, where investors find clear incentives to support the transition to net-zero, and where policy frameworks enable real-world change through investment.

I would like to thank the many contributors who have shared their expertise and insights for this report. Their perspectives have been key in identifying both the barriers we face and the practical steps we can take to overcome them.

James Alexander
CEO at UKSIF | Chair of GSIA

EXECUTIVE SUMMARY

This report examines the barriers preventing capital from flowing to projects and assets that address climate change and proposes solutions for policymakers and investors to overcome these barriers.

The research identifies a 'policymaker investment dilemma' where unrealistic expectations and misaligned incentives create an impasse between investors and policymakers on climate action. In response, we've developed the 'PIVOT framework' that outlines 5 key barrier categories preventing effective flows of capital to climate solutions. In summary, these categories are:

- **P**olicy Vacuum: Lack of clear, consistent policies and national transition plans
- (self-)**I**nterest: Short-term focus and narrow performance metrics in the financial sector
- (mis-)**V**aluation: Inadequate pricing of climate risks and opportunities in financial models
- (In)active **O**wnership: Limited investor engagement on climate issues
- **T**ransition Misalignment: Conflicts between existing business models and climate goals

Addressing these barriers requires coordinated action crucially involving both policymakers and investors. Key themes across the proposed solutions include:

- Developing clear, consistent policies and national transition plans
- Aligning incentives with long-term sustainability goals
- Improving valuation methods to account for climate risks/opportunities
- Fostering collaboration between investors, policymakers, and other stakeholders
- Redefining fiduciary duties to consider long-term sustainability factors
- Enhancing corporate accountability for climate commitments

Key actions for policymakers include:

- ➢ Develop and implement comprehensive National Transition Plans, integrating climate goals with economic strategies
- ➢ Establish clear regulatory frameworks and financial incentives to drive sustainable investments and corporate accountability
- ➢ Foster collaboration through public-private partnerships and multi-stakeholder dialogues to align policy with market practices and societal needs

Key actions for investors include:

- ➢ Enhance engagement and stewardship with investee companies to drive impact within fiduciary duty boundaries
- ➢ Align investment strategies with longer time horizons and adjust incentives across the investment chain
- ➢ Redirect capital towards sustainable investments through updated valuation models and public-private partnerships

This report aims to facilitate more informed conversations among investors and policymakers at COP29 and beyond, providing a foundation for developing comprehensive strategies to align global finance with the goals of the Paris Climate Agreement.

INTRODUCING THE PROBLEM

Climate change poses severe threats throughout society, impacting various aspects of human life, ecosystems, and economies. The consequences are multifaceted and interlinked, creating a cascade of challenges that exacerbate existing vulnerabilities and create new risks across environmental, socio-political, economic, and financial spaces.

The Paris Climate Agreement was developed and adopted in 2015 to unite the world and bring together a global effort on climate change, across key actors, from national governments, to businesses, cities and civil society organisations.

However, despite endorsement by 196 countries, the world is not on track to meet the goals of the Paris Climate Agreement (Politico, 2023). Countries' collective Nationally Determined Contributions (NDCs) fall short of what is needed to limit warming to 1.5°C above pre-industrial levels. While countries are legally obligated to develop NDCs, there is no binding requirement for them to achieve these self-determined targets.

In both the public and private sectors, current strategies for addressing climate change are inadequate. Like NDCs, a disparity exists between the goals set and the outcomes achieved. There is a need to critically assess our approaches, identify both successful and unsuccessful initiatives, and develop innovative strategies to drive climate action, particularly to channel finance towards climate action.

There are many reasons why we are not meeting the goals of the Paris Climate Agreement and why climate action is not where it needs to be. Attracting the necessary private capital is a key barrier. Plenty of private capital exists, but it requires concerted efforts by investors, governments and companies to drive this capital in the right way.

For this paper, our lens is the role of private capital, or simply, money. We seek to understand where institutional investors (such as pension funds or insurance funds) are investing their savers' money and why much of savers' money continues to flow towards economic activities that are exacerbating the climate crisis.

Public and private climate finance almost doubled between 2011 and 2020. However, to meet climate objectives, global investment needs to increase at least seven times by the end of this decade, aligning financial flows with the Paris Agreement objectives (Climate Policy Initiative, 2022).

At the same time, a significant shift in the direction of climate finance is necessary: the private sector's contribution in Emerging Markets and Developing Economies (EMDEs) must increase dramatically, from 40% to 90% of total climate finance by 2030 (IMF, 2023).

This is in alignment with a report commissioned for COP28 by the Independent High-Level Expert Group on Climate Finance, warning that the Paris Agreement goals are at risk without accelerated investment in developing countries (LSE, 2023). Private capital needs to flow strategically and sustainably, financing the industries of the future while supporting the transition in developing economies at the same time.

This paper examines why current capital flows remain misdirected and proposes steps for policymakers and investors to take to facilitate alignment of global capital with climate goals.

> *"The financial system is the pathway between savers and the real economy. How that system is structured impacts how investors affect the real economy, and therefore, society."*
>
> - Rick Alexander, CEO, The Shareholder Commons

BACKGROUND

THE LENS OF ANALYSIS

First, we identified the barriers, or incentive misalignments that direct capital flows away from Paris-aligned investments. To do this, we performed a review of existing literature, an assessment of policies, investor actions, and COP-related discussion points, and interviews with experts.

This exercise allowed us to group incentive barriers into 5 categories, which we have organised based on the acronym PIVOT. The PIVOT framework was corroborated with input from external experts.

We then developed a series of solution sets to address the barriers, to 're-align the incentives', and direct capital to finance the transition. Each solution should not be treated as stand-alone.

Each solution is reliant upon others, and therefore should not be read as prescription. Given that the system is complex, multiple angles should be tackled at the same time. We also recognise that solutions suitable for some countries and jurisdictions may not be applicable to others, for reasons such as their approach to sustainable finance, 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.

This report is a synthesis of these incentive barriers and potential solutions, and has undergone an external peer review to ensure it reflects best-practice.

ACCOMPANYING GUIDES

In addition to this paper, we have developed three guides and a primer that provide a greater level of detail on the topics covered here, each tailored for a specific audience: investors, policymakers, and COP negotiators. These guides serve as concise summaries of our findings, customised to address the unique challenges, needs, and interests of each group.

We decided to develop separate guides after identifying that policymakers often place unrealistic expectations on investors to facilitate the transition to net-zero without fully understanding the reasons why rational investors make investments in unsustainable activities. At the same time and at cause of this, investors claim they cannot act until policymakers do, so they end up unable to – or unwilling to – take action.

To bridge this gap, we also developed a primer to help policymakers better understand what sustainable vs. climate finance is, its potential, and its limitations in supporting climate action and the transition, in addition to providing suggested actions to take to support and facilitate its growth.

All three guides and the primer are presented as part of the upcoming COP discussions, providing insights and intending to foster more informed conversations among investors and policymakers.

SYSTEMS CHANGE

A term that's been increasingly used in responding to climate change is 'systems change', the idea and approach that seeks to address and solve a problem (in this instance, climate change) at its roots.

An investor that applies 'systems change thinking' views the 'system' (the world and its components) as interconnecting, rather than isolated parts.

Throughout this paper, we advocate for systems change thinking in understanding the complexities of climate change and in the need for a united effort across investor and policymaker spaces to address these, however, in the accompanying guides, and in our engagement with policymakers, we have not widely used the word 'system'.

In our view, 'systems change' as a theory can be overwhelming to decision-makers, too abstract for practical implementation, can lack context-specific adaptation, and can be met with resistance due to slow manifestation of outcomes.

This paper intends to address and respond to the problems of systems change thinking by providing practical steps that both policymakers and investors can take on climate action, whilst still acknowledging climate's complexity and that there are no 'quick wins'. In this way, this paper can be seen as a systemic response to a systemic problem, addressing the root causes of the issue.

THE POLICYMAKER INVESTMENT DILEMMA

Policymakers have placed significant expectations on private capital to finance the transition without fully understanding the nature of investment decisions. Simultaneously, private capital has often responded with inflated promises, and unrealistic commitments based on government policies that often fail to materialise.

The result is an impasse between investors and policymakers. This impasse, and the structures that continue to drive it, hinders effective climate action by perpetuating behaviours and decision-making that are not aligned with climate goals, leading to inadequate capital allocation towards these climate goals.

This is what we call the “policymaker investment dilemma”. At its heart, it’s an incentive issue. Capital flows like water, travelling in the easiest way and influenced by incentive structures, policy certainty and transaction availability. Where these structures create misaligned incentives through poor policy design, capital allocation ultimately exacerbates climate change rather than addresses it.

UNLOCKING CAPITAL FLOWS

While addressing misaligned incentives may be perceived as a remit unique to policymaking, we believe there is an equally important role for investors.

Policy needs to address the misaligned incentives and investors need to engage policymakers in support of addressing the misaligned incentives. Action needs to happen from both directions.

Policymakers need to take action in the real economy – to price externalities, address subsidies, and enable the roll-out of renewable and low carbon energy and industry.

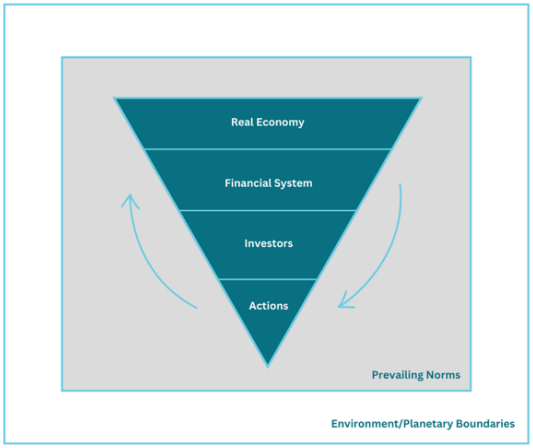
Investors need to facilitate this, and ensure they, their trade associations, and the companies in which they invest are working towards the goal of re-aligning incentives.

This includes collaborating with policymakers, investee companies, and assets through market-driven strategies. For example, investors can actively work with policymakers to highlight the types of policies that would enable money to flow and finance the transition. By committing to investments in climate solutions, investors can

build policymakers' confidence to set ambitious goals, showing market support. At the same time, investors can encourage investments (companies and assets) to act on the climate crisis, further promoting climate positive policymaking.

As investors and their investments make progress in addressing climate change, they provide the necessary support for policymakers to feel confident in implementing ambitious climate policies. The policies, in turn, incentivise further investment in climate solutions.

The goal is to align policymaking and investment, to re-work incentive structures to finance the transition. To achieve this, both investors and policymakers need to take action.



MISALIGNED INCENTIVES

The 5 ‘misaligned incentives’ or barriers that prevent capital from flowing are summarised in the framework, ‘PIVOT’, as follows:

- **P**olicy vacuum – Policies can act as structural and legislative barriers that prevent investment from flowing to projects that address the climate crisis. At the same time, there is a lack of positive policies that encourage climate-positive investments (e.g. carbon pricing, or EV sales targets).
- (self-)**I**nterest – Companies and investors may focus on quick wins for near-term financial return or sustainability, ignoring long-term goals (e.g. net-zero by 2050). They might choose easy fixes instead of tackling bigger, more complex problems. This short-term thinking stops institutions from investing in what's needed for long-lasting sustainability and meeting climate targets.
- (mis-)**V**aluation – Environmental and social factors are traditionally not accounted for in financial models. This means money continues to flow into environmentally harmful industries (e.g. fossil fuels), as these externalities, or "hidden costs" aren't considered. Company valuations are also short-term, so long-term risks like climate change, and potential revenue challenges, are overlooked.
- (In)active **O**wnership – Some institutions and investments are managed without active involvement. A hands-off approach, whether due to cultural or structural challenges, means redirecting capital is difficult, and met with resistance from the current system.
- **T**ransition misalignment – Certain business models and industries naturally conflict with the goals of the energy transition. This makes it challenging to create and put into action long-term plans that include these sectors.

The barriers we've identified in the PIVOT framework are connected and often overlap. While we've sorted them into categories to make them easier to understand, all these barriers to an extent block capital from flowing into activities that support the goals of the Paris Climate Agreement. Identifying these barriers helps us create better plans to develop policies and approaches that will direct money towards long-term climate action and sustainability goals.

"We believe that helping to shape sustainable communities, ecosystems, and capital markets is part of being a prudent long-term investor."

- Jon Lukomnik, Adjunct Professor of International and Public Affairs and The Brandmeyer Fellow for Impact and Sustainable Investing, Columbia University

IT'S TIME TO PIVOT THE SYSTEM

The following sections present a comprehensive overview of the challenges and possible solutions in aligning investment practices with climate goals. These insights are derived from studies we reviewed as part of our research, as well as interviews with industry experts, and are organised by the PIVOT framework.

Because there are dependencies in the system, it will not be effective to act on all these actions at once. Some barriers need to be acted on first, in order to then effectively address other barriers.

There is, however, no prescriptive sequencing. For example, a business can develop a transition plan, before a national transition plan, and the national transition plan can then address the dependencies identified in business transition plans, and vice versa.

POLICY VACUUM

A) BARRIERS THAT PREVENT CAPITAL FLOWING

Under-resourced and constrained governments. An under-resourced government can lead to an over-reliance on investor action, shifting the burden of climate initiatives onto the private sector without adequate policy support. This issue is compounded by the government's limited fiscal headroom and competing budgeting priorities. As a result, the ability of the government to allocate additional funding to new or expanded climate initiatives, including those required by national climate action plans and international commitments, is restricted.

Policy and regulatory challenges. Fragmented regulatory systems that fail to consider the entire financial system create inconsistencies and gaps in climate-related policies and oversight, both within individual countries and at a global level. This leads to differing expectations for investors across markets. The absence of clear and consistent policies, such as a price on carbon, reversal or delay of key climate policies, and inconsistent sustainability disclosures, hampers long-term investments in climate solutions by creating uncertainty and inconsistent market signals.

Additionally, in some contexts such as the US, legal challenges (real and perceived) arising from anti-competition and securities laws hinder collaborative investor actions, preventing coordinated efforts that could drive significant climate progress.

Short-term thinking and political barriers. Short-term views and political opposition frequently undermine long-term sustainability initiatives, as immediate economic concerns take precedence over future climate risks. This is problematic because investors need long-term confidence and certainty to make effective decisions.

Market infrastructure and investment barriers. Policy barriers and inadequate market infrastructure impede the smooth flow of capital towards climate-friendly investments and projects. For example, the lack of coordination and alignment in policies on carbon pricing can create market competitiveness concerns, rather than incentivising low-carbon projects. The lack of meaningful differentiation for green investments and bonds, coupled with a mismatch of expectations between policymakers and investors, leads to frustration and reduced effectiveness of these financial instruments in driving climate action.

A knowledge gap between policymakers and investors. Policymakers' lack of understanding of the practical requirements and constraints faced by the investment community results in a mismatch between financial structures and policy assumptions, as well as overly complex, overlapping, or burdensome market disclosure expectations. Investors may in turn not consider or prioritise policymaker engagement. This disconnect can lead to unintended consequences such as 'greenhushing', the growing trend of under-reporting of sustainability activities, in response to increasingly strict anti-greenwashing regulations.

B) POTENTIAL ACTIONS THAT WOULD MAKE CAPITAL FLOW

Implement clear and consistent policies that set clear guardrails for investors to facilitate, direct, and incentivise capital flow towards projects that support the transition to a low-carbon economy. Implementing comprehensive real-economy policies will address the barrier of policy vacuum and form the foundation to address the other barriers of self-interest, mis-valuation, inactive ownership, and transition misalignment by providing investor confidence and incentivisation.

Example actions for policymakers:

Develop whole-of-government National Transition Plans (NTPs). In developing an NTP, integrate Nationally Determined Contributions (NDCs), Long-Term Strategies (LTSs), and other existing plans to form a coherent strategic response to climate change. These NTPs should outline short- and long-term pathways and actions, ideally backed by legislation, to provide investors with confidence on the direction of travel. NTPs should include direction, funding, and incentives to steer actions across the system, offering planning certainty and setting appropriate incentives.

Communicate the NTPs' direction to net-zero actively and frequently. Governments should detail immediate, actionable steps to build public confidence in climate-related policies and other changes. Both national and sector-specific pathways should be developed, tailored to local circumstances, to then inform sectoral policies.

Issue sovereign debt instruments linked to the National Transition Plan to address fiscal headroom constraints and finance climate initiatives.

Eliminate fossil fuel subsidies to align economic incentives with climate goals, reduce contradictory messaging, and minimise policy and regulatory barriers.

Implement taxonomies and labels for green investments and bonds to provide a standardised framework, tackle greenwashing, and improve investor confidence.

Update legislation to support systemic stewardship. Where necessary, this may include clarifying competition laws to allow for collaborative investor actions. Otherwise, policymakers should ask institutional investors to disclose their systemic risk management practices.

Require both public and private companies to develop and implement meaningful transition plans with clear time horizons and conditionalities. Incorporating these requirements into COP agreements could ensure a standardised approach and align corporate actions with national and international climate objectives.

Invest in capacity building within government and public institutions. Capacity building would help to align policy with financial market requirements by helping policymakers to understand the limitations of private capital in solving climate issues. Specifically, policymakers should work to identify and address policy barriers that hold back investment and investor confidence, typically including: planning rules, lack of legally binding targets, and policy inconsistency.

International sustainable finance regulations should be harmonised, avoiding a "lowest common denominator" approach. To achieve this, policymakers can adopt a principles-based framework, underpinned by robust transparency requirements and comprehensive taxonomies. Clear guidance on acceptable sustainability claims and reporting standards should be provided, and an open dialogue with investors should be maintained to identify emerging regulatory issues.

Example actions for investors:

Engage with policymakers to provide insights on the implications of proposed climate policies on investment practices and highlight the barriers holding back climate investments. This engagement can occur directly or indirectly through collaborative initiatives. Consider leveraging Sustainable Investment Forums, given their influence, connections to policymakers, understanding of local investment and policy climates, and knowledge of policy frameworks.

Develop innovative financial instruments and mechanisms that align with NTPs and support long-term sustainability goals with policymakers. This collaboration extends to sharing best practices and collectively advocating for policy changes that facilitate sustainable investments.

Participate in industry and policy-backed working groups and initiatives, focusing on developing standardised financial metrics for measuring and reporting climate impact.

Develop long-term investment strategies that align with Paris Agreement goals and national transition plans to demonstrate to governments that policymaking should support long-term

investments, and encourage a shift in focus from short-term gains to sustainable growth.

Seek legal protections that allow more flexibility in investment strategies (where applicable). For example, move away from rigid annual dividend cycles by negotiating terms in investment agreements that provide greater flexibility on when returns are received.

Explore innovative financing mechanisms. Mechanisms such as blended finance and green bonds can support climate adaptation and mitigation projects, especially in emerging markets where traditional financing may be insufficient.

Example: **France's Low Carbon Strategy** (Stratégie Nationale Bas-Carbone SNBC)

France's Low Carbon Strategy is an example of a comprehensive whole-of-country roadmap approach, bringing together key actors from across society in a coherent, well-informed plan.

The plan integrates perspectives from across government bodies, including municipal and regional governments to localise and enforce national strategies, businesses, NGOs and trade unions, the scientific experts and the general public. The approach tackles the policy vacuum by creating transparent and participatory framework for decision-making.

In alignment with existing global frameworks like the Paris Agreement, the SNBC sets targets including carbon neutrality by 2050, requiring EUR 105 billion annually to meet EU emissions reduction targets. It establishes five-year carbon budgets, sector-specific targets, and intermediate carbon targets, providing clear benchmarks for emissions reductions.

SNBC sends clear signals to investors through mechanisms such as strengthened carbon pricing and incentives for reducing emissions – improving the profitability of low-carbon investments. The strategy includes financial tools like green bonds and labels for green financial products, providing assurance and encouragement for green investment. In offering the long-term view on climate policies, the strategy steers investors to direct capital towards sustainable initiatives.

Example: **Chile's Sustainable Bond Framework**

The framework is designed to facilitate investments in sustainable initiatives by issuing green, social, and sustainability-linked bonds, which are aligned international standards such as those from the International Capital Market Association (ICMA) for consistency. These bonds help investors by providing a clear and structured financial instrument that directs investments into projects supporting environmental and social goals, as part of Chile's broader climate goals (e.g. carbon neutrality by 2050, and phasing out coal by 2030).

The framework enhances investor confidence by ensuring transparency and accountability through detailed reporting and external verification (addressing mis-valuation). The framework promotes public-private cooperation and sets regional benchmarks, aligning interests across sectors.

SELF-INTEREST

A) BARRIERS THAT PREVENT CAPITAL FLOWING

A short-term and narrow investor focus. Traditionally, investors have focused on individual company success within investment portfolios. For example, historical performance metrics assess specific returns and risks associated with each investment within a portfolio, rather than considering macroeconomic indicators, despite, for many asset owners, the macroeconomic indicators being more relevant for long-term returns. The emphasis on quarterly returns for portfolios, rather than long-term sustainable growth, further exacerbates this. This has led to a short-term focus, rather than the longer-term focus needed to finance the transition.

Competitive market pressures. Market pressures hinder financial services' ability to drive long-term sustainability. Short-term executive compensation structures incentivise short-term profit maximisation and are not aligned with long-term sustainability goals. The focus on driving short-term economic growth comes at the expense of long-term economic drivers.

Risk assessment and valuation issues. An inadequate pricing of long-term risk, particularly environmental and social risks, leads to a lack of consideration or undervaluation in financial models and investment decisions.

Systemic complexity and inertia. There is a prevailing view that the financial system is too complex to warrant comprehensive action or too detached from policymakers, who often fail to understand how capital markets function.

Market power imbalances and societal representation. Existing imbalanced market power dynamics and a lack of societal voice in financial decision-making contributes to a system that may not adequately serve the broader public interest.

Fragmented engagement and accountability mechanisms. Inadequate mechanisms undermine efforts to align the financial system with long-term sustainability goals. Fragmented approaches to policymaker engagement lead to inconsistent and sometimes contradictory messages across the industry. There are limited accountability mechanisms for financial institutions regarding their broader societal and environmental impacts. For example, a lack of transparency and accountability on lobbying activities means that there can be a discrepancy between companies' public climate statements and their lobbying activities on climate.

B) POTENTIAL ACTIONS THAT WOULD MAKE CAPITAL FLOW:

Confront and realign self-interest within the financial sector to support climate action. Incentivise increased consideration of economy-wide success rather than just individual company performance and support collaborative climate initiatives to overcome competitive barriers.

Encourage financial actors to view climate action as aligned with their own interests, fostering a system where pursuing sustainability becomes a path to market leadership.

Example actions for policymakers:

Advocate for reforms in corporate law and executive compensation structures. This would enhance current incentives in the financial system to promote behaviours that address climate goals over the long term. Policymakers can also create mechanisms to address the free-rider problem in stewardship activities through cost-sharing arrangements or regulatory requirements.

Develop and implement a robust carbon pricing mechanism to internalise environmental costs and provide market clarity and confidence in carbon pricing.

Design tax incentives that encourage investments in research and development (R&D) and other longer-term projects that are finance-ready to address excessive short-termism in financial markets.

Implement disclosure-related policies aligned with long-term objectives and require financial institutions to consider and report on their systemic risks and impacts, beyond traditional financial metrics. This could be enabled by clarifying fiduciary duty definitions, for example by adopting the UK's Financial Markets Law Committee's (FMLC) interpretation. Such an approach would help channel investment into projects that mitigate systemic risk exposure, such as investments that help mitigate climate change.

Example actions for investors:

Develop and use risk models that incorporate longer-term sustainability risks and opportunities to help institutions better understand and prepare for future challenges and potential opportunities related to sustainability.

Integrate comprehensive sustainability considerations into investment decisions to embed sustainability thinking throughout the decision-making process, as core factors rather than as separate concerns.

Align compensation structures with long-term goals. Aligning executive incentives with long-term sustainability goals and systemic risk management ensures that leadership is motivated to prioritise sustainable practices and consider long-term impacts.

Engage in collaborative initiatives to address systemic sustainability challenges. This approach would allow financial institutions to work together to tackle larger, industry-wide issues more effectively, and to move beyond company-specific engagements.

(MIS)-VALUATION

A) BARRIERS THAT PREVENT CAPITAL FLOWING

Regulatory and methodological gaps. There are outdated regulatory tools that are not designed for addressing climate change or systemic risks across portfolios. ESG rating methodologies can also be conflicting or unclear, creating confusion and potential greenwashing risks that further undermine investor confidence.

Data and valuation challenges in financial models. There is a lack of comprehensive data about material financial factors and a limited notion of materiality, and this hinders the accurate valuation of sustainability factors. In particular, there is limited integration of natural capital in financial models, leading to an undervaluation of ecosystem services and biodiversity. In place of comprehensive data, there is overreliance on indicators backed by opaque data that lead to bias and a lack of critical analysis. This can perpetuate existing biases, for example towards higher-income countries, potentially diverting capital away from emerging markets and developing countries that need additional investment to finance the transition.

Modelling and risk assessment issues. In addition to an over-reliance on backward-looking data to assess incoming climate risks, systemic hyper-discounting of future cash flows leads to a fundamental misalignment in valuations, incentivising short-term decisioning-making. Discounted Cash Flow (DCF) models also fail to adequately account for long-term climate risks and opportunities.

Misaligned incentives and performance metrics. There are insufficient reward mechanisms for investors engaging in climate transition investments, and this stems from multiple issues, such as:

- An absence of performance evaluation horizons aligned with long-term sustainability goals.
- Limited scale in sustainable strategic asset allocation processes.
- Remuneration structures not aligned with long-term transition objectives.

Short-term focus in financial reporting and analyst expectations further undermines long-term value creation and sustainability initiatives.

Emerging market challenges. Emerging markets face significant difficulties in accessing capital, particularly for adaptation financing, which often relies on public funds; high costs of capital and perceived risks deter private investment in these regions, while lack of knowledge, data challenges, and currency hedging issues further complicate the situation.

B) POTENTIAL ACTIONS THAT WOULD MAKE CAPITAL FLOW:

Re-wire incentive structures by unlocking barriers for investors, incentivising (financially and / or non financially) capital to flow to finance the transition, and re-aligning current objectives to focus on long-term performance, addressing issues of self-interest and mis-valuation.

Example actions for policymakers:

Develop and implement standardised global frameworks for incorporating climate-related risks and opportunities into financial valuation models, including guidance on carbon pricing and physical climate risk assessment.

Invest in R&D of tools to value natural capital and ecosystem services, and integrate these tools into national accounting systems. Consider requiring the systematic valuation of sustainability impacts through impact-weighted accounting (for example, Value Balancing Alliance, International Foundation for Valuing Impacts).

Review and update regulatory tools to better address systemic climate risks, moving beyond traditional investor protection frameworks. For example, embed consideration of sustainability impacts through application of the Natural and Social Capital Protocols.

Create regulatory incentives for financial institutions to adopt long-term performance metrics that include sustainability factors.

Establish guidelines for transparent and consistent ESG data reporting, addressing current biases and promoting comparability across markets and regions.

Advocate for open-source data to ensure policymakers in emerging markets have the resources needed. This could be achieved by establishing collaborative data platforms, and enhancing local capacity through knowledge-sharing networks. For example, the NDC and LTS partnership could take up the mandate to help countries develop and implement national transition plans.

Implement a cohesive whole-of-government approach. This should include developing a compelling narrative for change and creating citizen engagement mechanisms to reconnect government, the financial sector, companies, and society to encourage a systemic mindset change towards collective action for sustainability.

Work towards national or global agreements to give value to shared commons, such as oceans and rainforests.

Example actions for investors:

Modify DCF models to include climate-related risks and opportunities, such as carbon pricing, regulatory changes, and physical climate risks. Climate-related risks may impact both revenues and costs, and this should be reflected in DCF models, especially over the longer-term. For example, the manifestation of physical risks through floods, or other extreme weather events, could result in greater costs to maintain assets or in stranded assets. Depending on the economic activities present within an investor's portfolio, regulation on climate change may impact the profit margins of constituent companies.

Collaborate with academic institutions and think tanks to develop more robust and forward-looking climate risk assessment models.

Perform critical evaluations of current data and improve data standards to facilitate the incorporation of traditional 'externalities' by:

- Encouraging transparency in methodology to improve investor confidence.
- Developing better, consistent standards for data quality.

In turn, develop and adopt valuation methodologies that incorporate these 'externalities' into investment decision-making processes, and support the development of open-source platforms for sharing sustainability data and valuation methodologies, promoting transparency and continuous improvement.

Create tools and methodologies to value natural capital, assessing and understanding current biases, to facilitate and incentivise the active stewardship of nature.

Engage with companies to promote integrated reporting that combines financial and sustainability performance metrics.

Align executive and fund manager remuneration with long-term performance and progress against climate-related objectives.

Example: **The Australian Sector Pathways Review project**

The Australian Sector Pathways project is a comprehensive initiative conducted by the Climate Change Authority to support Australia's transition to net zero emissions by 2050, considering the federal-level Climate Change Authority Act 2011 and the international-level goals of the Paris Climate Agreement.

The review worked to identify gaps and opportunities needed to address and facilitate the transition such emissions reductions, new technologies for each sector, implementation, data, and public and private finance support.

Addressing the barrier of mis-valuation specifically, Australia's Climate Change Authority has outlined a number of actions, including:

- Developing a "one stop shop" for emissions reductions financial support programs and expanding associated data collection to help better inform transition-related investment decisions, across sectors.
- Updating renewable energy employment statistics.
- Implementing a consistent cost of carbon signalling, by standardising it across the policymaker space.
- Undertaking ground-up analysis and economic modelling to evaluate net-zero pathways.
- Implementing market-based mechanisms that value greenhouse gas reductions.

Read more here.

(IN)-ACTIVE OWNERSHIP

A) BARRIERS THAT PREVENT CAPITAL FLOWING

Governance issues. Under-resourced and costly stewardship can lead to free riders and adverse lobbying and is connected to and exacerbates the issue of self-interest, whereby investors choose to focus on select sustainability issues rather systemic problems. Because stewardship is often under-resourced and costly, there is limited public policy engagement by investors, limiting investors' influence on systemic issues. Misalignment of fiduciary duties between asset owners and asset managers also results in a lack of consideration of the broader impact of investment on the economy and society, and vice versa (with managers often focusing on gathering assets rather than the end use or beneficiaries' interests). Misalignment is perpetuated by a scepticism about regulating asset managers to prioritise beneficiary outcomes, leading to resistance against potential reforms.

Systemic financial challenges. The long intermediation chain and cultural blocks within the financial system hinder the adoption of multi-stakeholder value systems. Simultaneously, passive management of index funds results in a lack of accountability for corporate management.

Responsibility and accountability. The widespread belief that sustainability issues are solely the government's responsibility results in:

- A siloed government approach (e.g., only one ministry handling investor-related issues).
- Company and investor complacency.
- A lack of accountability for corporate management.

B) POTENTIAL ACTIONS THAT WOULD MAKE CAPITAL FLOW:

Address inactive ownership by implementing regulatory frameworks and mechanisms that encourage active stewardship, address misinterpretations of fiduciary duties, and emphasise the value of long-term engagement, to foster responsible and sustainable investment practices.

Example actions for policymakers:

Develop regulatory frameworks that encourage active ownership and stewardship. This may include incentives for long-term engagement and penalties for passive approaches.

Create mechanisms to address the free-rider problem in stewardship activities. This could include mechanisms such as industry-wide cost-sharing arrangements or regulatory requirements.

Clarify fiduciary duties to explicitly include consideration of long-term sustainability factors and systemic risks.

Re-clarify, re-emphasise, or shift wording to highlight that results from engagement efforts do not have to be immediate. For example, emphasise that progress can be slow and that the timeliness of goals does not equate to the importance of an engagement.

Example actions for investors:

Leverage influence and drive systemic changes towards sustainability. For example, engage in public policy, and move beyond traditional stewardship to engage in a broader range of activities.

Recognise that all investments have an impact on the real world and adjust investment strategies accordingly by aligning voting and engagement strategies with systemic goals. For example, investors could vote or collectively engage to remove directors at companies that do not have credible plans to align with the goals of the Paris Climate Agreement.

Evolve understanding of fiduciary duties to consider the impact on the broader economy and society (e.g., the world's carrying capacity), in alignment with the interests of diversified shareholders.

Highlight the difference in incentives between asset managers and asset owners. Asset owners should ensure managers focus on the end use or beneficiaries – this should feature prominently in asset owner mandates.

Discuss the limitations of both internal and external management structures. This may include recognising the role of consolidated resources and market structures in enabling sustainable investment solutions, or recognising that even if in-sourced, asset managers still need to adapt to more complex client-specific mandates.

Example actions for asset owners:

Develop more comprehensive and long-term focused mandates for asset managers, incorporating sustainability and systemic risk considerations, and consider how to manage asset

managers on a longer-term basis rather than traditional quarter-by-quarter reporting.

Collaborate with other asset owners to pool resources for more effective stewardship activities, particularly on systemic issues.

Engage directly with policymakers and regulators to advocate for market structures that enable and incentivise sustainable investment practices.

Example actions for all stakeholders:

Foster cross-sector dialogues to address cultural blocks within the financial system that hinder the adoption of multi-stakeholder value systems.

Create platforms for sharing best practices in stewardship and active ownership, promoting continuous improvement and innovation in these areas. This may include developing and promoting case studies of successful active ownership initiatives that have led to positive systemic changes.

Invest in research and education programmes to enhance understanding of the relationship between investment decisions, corporate behaviour, and broader social and environmental outcomes.

TRANSITION MISALIGNMENT

A) BARRIERS THAT PREVENT CAPITAL FLOWING:

Political and Policy Challenges. Political challenges leading to limited public policy engagement by investors, such as anti-ESG movements. A lack of comprehensive, context-specific national transition plans that genuinely and sustainably meet net zero targets. This is exacerbated by a 'home-first' mentality, where:

- Nation-states prioritise their own interests. This poses an issue where global sustainability issues have traditionally relied upon international treaties – which has then led to a lack of actionable agreements.
- Leaders within nation-states prioritise the interests of high-emission industries due to workforce skills and cultural ties, complicating the path towards sustainability. For example, established sectors like steel and fossil fuel energy challenge the viability of renewable technologies.
- At the same time, there can be political challenges such as anti-ESG movements that leads to limited public policy engagement on systemic issues by investors.

Financial and Market Structures. Short-termism in financial markets and the failure of policy interventions to materialise (such as the carbon taxes) results in continued investment in fossil fuels. Short-termism is further exacerbated by a lack of finance-ready longer-term projects and climate solutions. Certain legal structures, such as the purpose of limited liability companies and banks, are also inherently not aligned (or perceived not to align) with broader social benefits, such as the Paris Climate Agreement.

Collaboration and Partnership Gaps. A lack of collaboration between investors, policymakers, and local stakeholders leads to inaction in addressing systemic risks. For example, insufficient coordination hinders the rapid development and scaling of fossil fuel substitutes needed to make the transition happen.

B) POTENTIAL ACTIONS THAT WOULD MAKE CAPITAL FLOW:

Address transition misalignment through a coordinated effort between policymakers, investors, and other stakeholders, by aligning interests, developing comprehensive strategies, and fostering collaboration.

Example actions for policymakers:

Build out a whole-of-government approach. To achieve this, policymakers can:

- Build context-specific transition plans through a critical evaluation of whether current strategies will genuinely and sustainably meet net zero targets.
- Develop clear national strategic ambitions with robust management, accountability, and monitoring mechanisms to guide the transition process.
- Foster collaboration between various government departments, investors, other policymakers, and local stakeholders to address systemic risks and promote sustainable development holistically by providing structured mechanisms for private-public engagement.
- Create long-term plans, trusted by investors, to require high-carbon industries to reduce their emissions, particularly in industry sectors that don't command a green premium.

- Identify opportunities for catalytic interventions (such as financial incentives, R&D support, and infrastructure development) to incentivise investment in the new technologies that underpin NTPs.

Create platforms for ongoing dialogue between government, industry, and civil society to ensure transition plans remain responsive to evolving needs and challenges.

Reevaluate and consider changes to legal structures to better align them with societal benefits and long-term sustainability goals.

Develop and implement fiscal incentives and regulatory frameworks that encourage transitions away from high-emission industries and towards sustainable alternatives.

Promote patient capital. For example, this can include incentivising asset owners to allocate a portion of investments to less liquid long-term projects.

Example actions for investors:

Adopt proactive and organised strategies similar to other industries, including engaging policymakers on transition-related policies and objectives, and developing and implementing investment strategies that align with long-term transition goals.

Explain to policymakers how market mechanisms would influence investment flows. This includes clearly communicating how subsidies and carbon markets would influence investor decision-making, particularly regarding hard-to-abate industries and emerging sectors like Carbon Capture, Usage and Storage (CCUS).

Engage actively with companies in high-emission industries to encourage and support their transition plans where credible, using both engagement and divestment strategies as appropriate.

Collaborate with other investors to amplify influence in policy discussions and industry transitions, potentially through industry bodies or coalitions, ensuring these bodies are working towards a climate positive future. Specifically, partnerships between large global pension funds and leading funds in emerging markets (with a considerable portion of local GDP and national-level influence).

Example actions for investors and policymakers:

Engage proactively in international forums such as COP, G20, and G7 to push for systemic risk recognition, coordinated policy changes, and oversight at a global level. Work to ensure that transition plans across countries and regions collectively 'add up' to meet the goals of the Paris Climate Agreement, highlighting any gaps where further help may be needed.

Encourage and facilitate public-private partnerships to drive transitions and overcome financial blockages, particularly in sectors requiring significant capital investment for sustainable transformation.

Develop blended finance solutions that leverage public funds to de-risk private investments in transition-related projects, especially in emerging markets or hard-to-abate sectors.

Jointly develop metrics and reporting standards that capture transition progress and impact, ensuring accountability and enabling effective capital allocation.

Example actions for all stakeholders:

Develop comprehensive just transition strategies that consider workforce skills, cultural ties, and local economic impacts of industry transitions to address the 'home-first' mentality.

Invest in education and reskilling programmes to prepare the workforce for the transition to a low-carbon economy, mitigating resistance to change.

Foster international collaboration and knowledge-sharing on successful transition strategies, recognising the global nature of climate challenges while respecting local contexts.

> *"Collective action is critically needed and has gone missing in action because of our value system increasingly emphasising outward success as opposed to something that is more realistic with respect to collective improvement of well-being"*
>
> - Roger Urwin, Global Head of Investment Content for Willis Towers Watson

Example: **The US Inflation Reduction Act**

The Inflation Reduction Act (2022) is a landmark piece of legislation aimed at addressing climate change, reducing healthcare costs, and promoting economic growth.

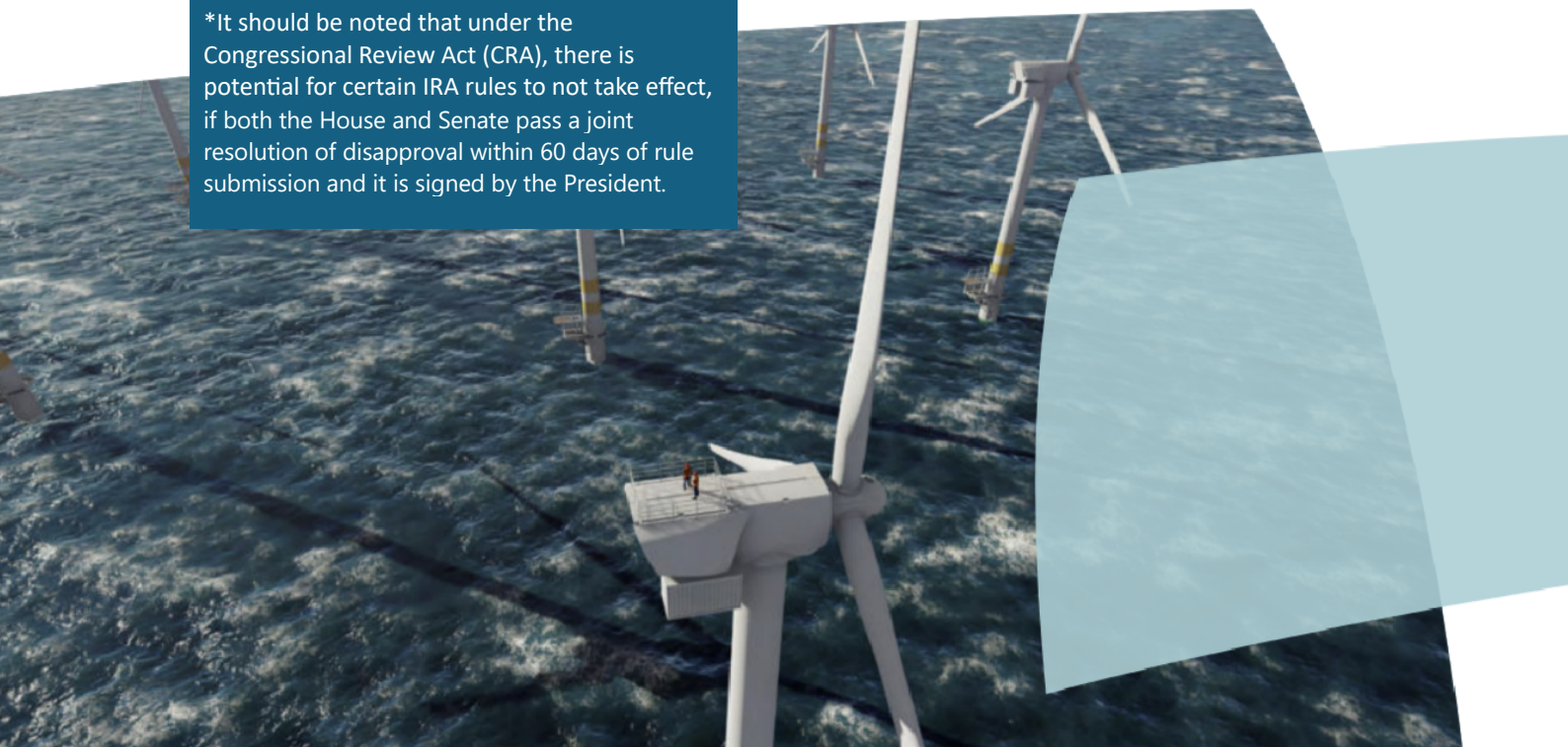
The Act significantly aids investors in directing capital towards sustainable initiatives by providing a comprehensive framework of financial incentives and tax credits. With nearly $400 billion (USD) allocated for clean energy development, the IRA offers substantial tax credits which support both established and emerging clean energy technologies like wind, solar, hydrogen, and carbon capture. These incentives lower the cost of renewable energy projects, making them attractive to investors, and reduce the challenge of creating new industries such as green hydrogen by providing financial support during the early stages when lack of supply and demand can hinder growth.

In the current context*, IRA promotes a stable and predictable environment for sustainable investment, important particularly the context of the anti-securities laws and ESG pushback. The IRA has encouraged significant private sector investment with an increase in clean energy projects and electric vehicle infrastructures since introduction.

The framework provides clear guidelines and incentives and enhances investor confidence by aligning financial returns with sustainability goals.

Read more here.

*It should be noted that under the Congressional Review Act (CRA), there is potential for certain IRA rules to not take effect, if both the House and Senate pass a joint resolution of disapproval within 60 days of rule submission and it is signed by the President.



SUMMARY

This guide identifies the barriers preventing capital from flowing to projects that address climate change and proposes solutions for policymakers and investors to overcome these barriers.

Key points include:

1. There is a 'policymaker investment dilemma' where unrealistic expectations and 'misaligned incentives' create an impasse between investors and policymakers on climate action.

2. The PIVOT framework outlines 5 key barrier categories:
    a. Policy Vacuum
    b. (self-)Interest
    c. (mis-)Valuation
    d. (In)active Ownership
    e. Transition Misalignment

3. Key themes across the solutions include:
    a. Developing clear, consistent policies and national transition plans.
    b. Aligning incentives with long-term sustainability goals (i.e. the goals of the Paris Climate Agreement).
    c. Improving valuation methods to account for climate risks/opportunities.
    d. Fostering collaboration between investors, policymakers, and other stakeholders.

NEXT STEPS

Next steps and further areas of exploration may include:

1. To distribute the report and accompanying guides to relevant policymakers, investors and COP attendees.
2. To organise workshops or seminars to discuss the PIVOT framework and develop implementation strategies for proposed solutions.
3. To engage ongoing dialogue platforms between investors, policymakers, and other stakeholders to collaborate on addressing systemic climate risks.
4. To review and update the guide periodically to reflect evolving climate policies, market conditions, and stakeholder feedback.
5. To create tailored action plans for different types of investors (e.g. asset owners, asset managers) and policymakers at various levels of government.
6. To monitor and report on progress in addressing the identified barriers and implementing solutions across different regions and sectors.

FURTHER READING

Climate Policy Initiative. (2023). *Global Landscape of Climate Finance 2023*. https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2023/

Glasgow Financial Alliance for Net Zero. (2022). *Financial Institution Net-zero Transition Plans: Fundamentals, Recommendations, and Guidance.* https://assets.bbhub.io/company/sites/63/2022/09/Recommendations-and-Guidance-on-Financial-Institution-Net-zero-Transition-Plans-November-2022.pdf

Principles for Responsible Investment. *The Inevitable Policy Response: Climate change and the transition to a low-carbon economy*. https://www.unpri.org/sustainability-issues/climate-change/inevitable-policy-response

Manning et al. (2024). *Taking the lead on climate action and sustainable development: Recommendations for strategic national transition planning at the centre of a whole-of-system climate response.* https://www.lse.ac.uk/cetex/publications/taking-the-lead-on-climate-action-and-sustainable-development/

Manning et al. (2024). *Rewiring for Success: Our values based economy.* https://www.rewired.earth/_files/ugd/d9db7d_52e220cd7a934e09b4784ea218e57a52.pdf

GUIDE FOR INVESTORS

GLOBAL SUSTAINABLE INVESTMENT ALLIANCE

GUIDE FOR INVESTORS

This guide offers investors insights and actionable strategies to align capital flows with the Paris Climate Agreement goals, addressing key barriers and unlocking opportunities in climate finance.

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 investors with example actions to facilitate the capital flows needed to align 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.

While we recognise that investors' ability to take action vary as they are subject to local jurisdictions, we have prepared a number of key actions (that may need adaptation to fit in local contexts).

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. 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.

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

Investors have two main ways (or levers) by which they can drive impact in the current set of 'norms' that they have:

1. Driving investee companies – 'the deployment of capital'
2. Engagement – 'the connections they have'

Investors can use both levers within the boundaries of fiduciary duty.

Asset owners specifically can incentivise asset managers to drive impact using these levers through mandate allocation. However, to be effective, asset owners need to:

1. Understand the time horizons of their asset managers and how these impact investment activities
2. Consider how this understanding influences the instructions they give to their asset managers

At the same time, filling the investment gap requires a combination of public and private money, involving:

1. Redirection of capital
2. Targeted reallocation
3. Revised valuation models
4. Realigned incentives throughout the intermediation chain

By incorporating these elements, investors can more effectively leverage their capital and influence to drive meaningful impact while fulfilling their fiduciary responsibilities.

The section that follows expands on the two levers and establishes priority actions.

Example actions include the following:

Action Group	*Example Actions*	*Rationale*	*Relationship to PIVOT*
Policy Engagement	*1. Engage with policy frameworks to develop systemic responses to sustainability goals*	*To address the lack of investor input in policy development that can lead to misaligned regulations and ineffective sustainability initiatives*	*Policy vacuum: Helps fill the gap in policy development by providing investor perspective*
	2. Engage with policymakers on practical implications of proposed climate policies	*Ensures policies are grounded in practical realities of investment practices*	*Policy vacuum: Bridges the knowledge gap between policymakers and investors*
	3. Participate in industry and policy-backed working groups on standardised metrics	*Promotes consistency and comparability in sustainability reporting*	*Policy vacuum: Contributes to the development of coherent policy frameworks*
Long-term Strategy Alignment	*4. Develop long-term investment strategies aligned with Paris Agreement and national transition plans*	*Aligns investment practices with global climate goals*	*Transition misalignment: Ensures investment strategies support broader transition goals*
	5. Implement compensation structures aligning executive incentives with long-term sustainability goals	*Counters short-termism in investment decision-making*	*(Self-)Interest: Aligns individual incentives with long-term sustainability objectives*
	6. Shift towards active stewardship of nature	*Recognises the value of natural capital in investment decisions*	*(Mis-)Valuation: Incorporates often-overlooked natural capital into investment considerations*
Risk Assessment and Valuation	*7. Modify DCF models to include climate-related risks and opportunities*	*Improves accuracy of financial projections in a changing climate*	*(Mis-)Valuation: Enhances accuracy of asset valuation by including climate factors*
	8. Develop and use risk models incorporating longer-term sustainability risks	*Enhances long-term risk management*	*(Mis-)Valuation: Improves risk assessment by considering long-term sustainability factors*
	9. Develop valuation methodologies incorporating 'externalities'	*Accounts for broader impacts of investments*	*(Mis-)Valuation: Addresses the undervaluation of environmental and social impacts*

Action Group	*Example Actions*	*Rationale*	*Relationship to PIVOT*
	10. Perform critical evaluations of current data and improve data standards	*Enhances quality and reliability of sustainability data*	*(Mis-)Valuation: Improves the accuracy and reliability of sustainability-related valuations*
Active Ownership and Engagement	*11. Move beyond traditional stewardship to broader activities, including policy engagement*	*Expands scope of investor influence*	*(In)active Ownership: Promotes more comprehensive and impactful investor engagement*
	12. Engage actively with high-emission companies on transition plans	*Promotes corporate sustainability transitions*	*(In)active Ownership: Encourages direct investor involvement in corporate sustainability efforts*
	13. Recognise all investments' real-world impacts and adjust strategies accordingly	*Promotes responsible investing*	*(In)active Ownership: Fosters a more holistic approach to investment impact*
Collaboration and Innovation	*14. Collaborate with other investors on climate initiatives and best practices*	*Amplifies investor influence and promotes knowledge sharing*	*(In)active Ownership: Enhances collective investor action for greater impact*
	15. Explore innovative financing mechanisms (e.g., blended finance, green bonds)	*Facilitates capital flow to critical areas, especially in emerging markets*	*Transition misalignment: Addresses funding gaps in sustainable transition efforts*
	16. Support development of open-source platforms for sustainability data	*Promotes transparency and accessibility of sustainability information*	*(Mis-)Valuation: Improves access to data needed for accurate sustainability assessments*
Fiduciary Duty and Governance	*17. Evolve understanding of fiduciary duties to consider broader impacts*	*Expands scope of investor responsibility*	*(Self-)Interest: Redefines investor interests to include broader societal concerns*
	18. Highlight differences in incentives between asset managers and owners	*Promotes alignment of interests across the investment chain*	*(Self-)Interest: Addresses misalignments in the investment chain that can hinder sustainability efforts*
	19. Discuss limitations of internal and external management structures	*Promotes more effective governance structures*	*(In)active Ownership: Improves governance to enable more effective sustainable investing*

Action Group	*Example Actions*	*Rationale*	*Relationship to PIVOT*
Capacity Building and Research	*20. Collaborate with academic institutions on climate risk assessment models*	*Enhances credibility of risk assessment tools*	*(Mis-)Valuation: Improves tools for accurate assessment of climate-related risks*
	21. Seek legal protections for more flexible investment strategies	*Allows for more innovative, long-term focused investing*	*Policy vacuum: Addresses legal barriers to sustainable investment strategies*

GUIDE FOR POLICYMAKERS

GLOBAL SUSTAINABLE INVESTMENT ALLIANCE

GUIDE FOR POLICYMAKERS

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*
	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*
Corporate Accountability	*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*
	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*
Capital Flow and Investment	*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/

GUIDE FOR COP 29 NEGOTIATORS

GLOBAL SUSTAINABLE INVESTMENT ALLIANCE

GUIDE FOR COP 29 NEGOTIATORS

As negotiators gather for COP29 in Baku, Azerbaijan, this guide provides critical insights and actionable strategies to align global finance with the Paris Climate Agreement objectives, addressing key barriers and unlocking opportunities to drive transformative climate action.

INTRODUCTION

This guide was developed alongside the report, ***Transforming Global Finance for Climate Action: Addressing Misaligned Incentives and Unlocking Opportunities***, in advance of COP 29, in Baku, Azerbaijan. The goal of this guide is to provide key actors with example steps needed to align global finance 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.

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.

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*, (2024).

PRIORITY ACTIONS

Example actions include the following:

Action	***Rationale***	***PIVOT Connection***
1. Launch a "Systemic Risk Pledge" for financial institutions	*To encourage the incorporation of climate-related systemic risks into core business and investment strategies*	*(Mis-)Valuation: Promotes accurate pricing of climate risks in financial decision-making*
2. Host an Investor-Led Climate Policy Forum, showcasing investors' systems change programmes	*To amplify investor voices in shaping effective climate policies, addressing issues raised in this report*	*Policy vacuum: Bridges the gap between investor needs and policy formulation*
3. Establish a Global Transition Plan Evaluation Framework	*To create a standardised approach for assessing the credibility and impact of transition plans, both governments and companies*	*(In)active Ownership: Enhances investor ability to evaluate and engage with corporate transition efforts*
4. Establish commitments for investors to engage policymakers on a global carbon price	*To work towards a globally recognised carbon pricing mechanism*	*(Mis-)Valuation: Addresses inconsistencies in defining and valuing sustainable investments*
5. Initiate a "Long-termism in Finance" commitment	*To commit signatories to restructuring incentives and metrics around long-term value creation*	*(Self-)Interest: Challenges short-term biases in the financial system*
6. Launch a blended finance marketplace	*To increase accessibility of new financial instruments that de-risk sustainable investments in emerging markets*	*Transition misalignment: Addresses funding gaps for climate solutions in developing economies*
7. Showcase investor stewardship excellence	*To share and elevate effective approaches to climate-related corporate engagement and pushback on anti-trust issues*	*(In)active Ownership: Promotes more impactful stewardship practices*
8. Establish portfolio nature assessments	*To guide the integration of nature, biodiversity and ecosystem services into investment decisions*	*(Mis-)Valuation: Enhances the recognition and valuation of natural capital in finance*
9. Develop a climate risk governance scorecard for financial institutions	*To assess and improve climate risk management at the board and executive levels of financial institutions*	*(Self-)Interest: Encourages stronger climate governance in financial institutions*
10. Launch a systemic climate solutions fund based on, or as part of an existing vertical climate funds' mandates	*To pool resources for investing in cross-cutting climate solutions that address system-wide challenges*	*Transition misalignment: Targets solutions that can drive broader system change*

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