Supporting Private Sector Net Zero Targets

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The Coalition of Finance Ministers for Climate Action

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Summary for Policymakers

The private finance sector is critical to supporting net zero-aligned change in the real economy, contributing to meeting the global climate goals that governments and many financial institutions have committed to, and reducing climate change-related risks. Global private financial assets are estimated to be USD 407 trillion.[1] As of mid-2022, 547 private financial institutions—with holdings of USD 129 trillion, a sum equal to nearly 32 percent of global financial assets—have made commitments to reach net zero emissions by 2050.[2]

Nonetheless, **there are several gaps: financial institutions representing the remaining 68 percent of global financial assets have yet to commit to net zero by 2050; many of those who have committed have yet to set interim, short-term targets; and targets that have been set vary significantly in their credibility.**

Ministries of Finance are well-positioned to encourage private financial institutions to set credible targets and to take effective steps towards their implementation. As part of broader government action, Ministries of Finance can help to create an enabling environment to encourage commitment to net zero targets, support the implementation of those targets, and establish tools to help determine the credibility of commitments. They can promote this enabling environment through engaging with the private sector and civil society to identify barriers to setting net zero targets, establishing and enforcing standards, providing expertise and funding to build capacity, and coordinating with other government agencies to provide regulatory clarity and develop disclosure requirements (Section 3 further explains these and other possible actions). Economic and policy action along these lines is aligned with the Coalition of Finance Ministers for Climate Action Helsinki Principles (HP), particularly HP 5.[3]

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[1] Financial Stability Board, 2021. Excludes assets associated with central banks and public financial institutions.

[2] Climate Policy Initiative, 2022a. Estimates are as of May 13, 2022. We calculate this figure as the sum of assets under management for all asset managers, insurers, and asset owners, and total assets for commercial banks. When assets under management are unavailable, we use total assets. In addition to members of GFANZ-affiliated alliances, this figure includes financial entities that joined SBTi – Business Ambition for 1.5C or have made an SBTi net zero by 2050 commitment, or that made a standalone commitment to net zero by at least 2050. Therefore, both the methodology and coverage of CPI estimates differs from GFANZ's. This total does not double count entities that have committed to multiple net zero groups and intends to limit AuM double counting when both a parent company and some of its subsidiaries have committed to net zero.

[3] Coalition of Finance Ministers for Climate Action, 2022

Determining Credibility Through Voluntary Net Zero Alliances and Why Additional Action Is Needed

The evaluation presented in this report examined the membership requirements for the two Race to Zero initiatives[4] and four of the net zero alliances under the Glasgow Finance Alliance for Net Zero (GFANZ) with significant membership—the Net Zero Banking Alliance, Net Zero Asset Owner Alliance, Net Zero Asset Manager Initiative, and Net Zero Insurance Alliance—to evaluate whether net zero alliance membership can be used as a signifier of commitment credibility.[5] Our key findings are as follows:

Membership in an alliance is not a guarantee for effective climate action as each private financial alliance and initiative has a different set of requirements. While there was previously a baseline requirement for all GFANZ alliances to meet the Race to Zero Starting Line criteria, each alliance has developed additional sectoral requirements. This leads to different core targets and metrics between alliances based on membership consensus and sectoral needs. A variety of credibility levels exist across the spectrum of commitments of various members in the different alliances. Governments and other stakeholders will benefit from understanding the distinctions between the alliances (covered in Section 2.2 of this report) to accurately distinguish between the different integrity measurements. Government engagement with net zero alliances, industry associations, and individual financial institutions could potentially increase membership and lead to greater credibility and accountability.

Interim targets are extremely important but lack comparability and often do not cover all balance sheet assets or assets under management. The guidance for setting interim targets varies significantly across alliances. Moreover, the newness of interim targets within the financial sector has led to a wide spread (<1–100 percent) of portfolio emissions being covered by interim targets.[6] It is necessary to have complete information of the expectations of each alliance regarding interim targets and the financial institutions' assets under management covered by the targets to better understand both the ambition of the net zero commitment and the targets' impact on real economy emissions. Governments can play a role in supporting third parties with expertise, data, and research funding to create methodologies to verify, measure, and monitor interim targets across the financial sector.

Alliances typically do not set strong guidelines with respect to fossil fuel finance. Of the alliances evaluated, only one provides a requirement to avoid new thermal coal financing. Even the baseline Race to Zero criteria fall short of the International Energy Agency's (IEA) recommendations. There is an opportunity for governments to provide guidance on the reduction, removal, or repurposing of fossil fuel subsidies in support of Nationally Determined Contributions (NDCs), including the future of new fossil fuel investment.

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[4] GFANZ downgraded the Race to Zero Starting Line criteria from a GFANZ membership requirement to a strong recommendation shortly before publication.
[5] Additional GFANZ alliances include the Paris Aligned Asset Owners, the Net Zero Financial Service Providers Alliance, and the Net Zero Investment Consultants Initiative, but due to membership, composition, and focus they have not been included in this analysis.
[6] Climate Policy Initiative, 2022a

Levers for Supporting the Creation and Implementation of Commitments

Ministries of Finance and other government agencies can encourage the creation of new net zero commitments and support the credibility and implementation of existing commitments through a variety of soft power techniques and regulatory actions. Depending on a country's governance structure, authorities and legal regimes, and policy objectives, these actions may vary in effectiveness and may be best achieved by the engagement of other ministries or government actors with or without the Ministry of Finance.

Employing soft power techniques provides some advantages in flexibility, coverage, and ease of implementation to shape the actions and preferences of private financial institutions on climate action. Some key soft power levers to influence the private finance sector include:

- Setting climate as a government-wide priority and leading by example in government actions through mainstreaming climate into annual budgets, developing sustainable finance roadmaps, and setting net zero and interim targets for different government sectors;
- Engaging with the private financial sector (where and as appropriate) and civil society to communicate expectations and potential obstacles;
- Supporting the implementation of targets through capacity building, improving emissions data tracking, comparability, and quality, and providing voluntary tools to measure alignment; and
- Supporting the monitoring of private financial institution climate targets and interim actions, including through supporting third parties, such as auditors, financial service providers, and civil society verifiers. Support can include providing Ministry expertise, research funding, and data needed to verify and measure progress.

Regulatory powers, while often more difficult to enact, can also be more enduring and can apply to a larger number of private financial institutions. Regulatory levers that support the creation and implementation of net zero targets and ensure their credibility include:

- Coordinating with securities and regulatory agencies to develop standards and support mandatory climate disclosure, including the disclosure of transition plans; and
- Providing guidance on the reduction, removal, or repurposing of fossil fuel subsidies and the transition to subsidies for new low-carbon technologies.

Additional actions that can use either soft or regulatory power approaches to achieve objectives include:

- Adopting global or regionally focused taxonomies, labelling standards, and other alignment approaches to deter private sector greenwashing;
- Supporting the measuring and monitoring of climate risks through scenario analysis and measuring portfolio exposure to climate and policy risks, including through stress testing; and
- Developing blended finance vehicles and other financial incentives such as tax credits to catalyze private finance.

Benefits and Impact

Actions taken using soft powers, regulatory powers, or a combination of the two can not only improve the understanding of commitments, progress, risks, and opportunities domestically, but can also set expectations for best practices internationally. The potential actions outlined in this report are both incentives and guidelines to encourage private financial institutions to consider climate action and climate-friendly investments. Through developing a deeper understanding of private sector action and enabling more ambition, Ministries of Finance can achieve some of their larger goals, including taking steps to identify and manage financial risks, mobilizing private investment in climate solutions, and providing non-climate benefits through economic stability, local employment, and energy security and independence.

Gaining positive results from Ministry actions to support net zero commitments and commitment credibility can take time. As many of the alliances are still expanding membership and finalizing their requirements, Ministry recommendations to further improve the credibility of the commitments of their members would be timely. Increasing government involvement, either through using soft or regulatory powers, could support the development of transparent, comparable, and credible commitments from private financial institutions and further support the transition to a low-emission and climate resilient future.

1. Introduction and Context

As of mid-May 2022, a total of 547 private financial institutions have made net zero commitments; these institutions—commercial banks, asset managers, asset owners, and insurers— manage approximately USD 129 trillion in assets.[7] Based on an external estimate that global private finance assets have reached USD 407 trillion,[8] **approximately 32 percent of global financial assets are managed by financial institutions that have made net zero commitments.**[9]

Ministries of Finance want to contribute to driving economic growth while moderating potential risks to the climate. The Helsinki Principles that guide the Coalition of Finance Ministers for Climate Action (the Coalition) lay out how these goals align with the role of Ministries in addressing climate change. Helsinki Principle 5, "Mobilize private sources of climate finance by facilitating investments and the development of a financial sector which supports climate mitigation and adaptation", relates to the objective of developing strategies to encourage greater climate action by private financial institutions.

The private finance sector can support change in the real economy through net zero-aligned action, which will contribute to meeting the global climate goals that governments have committed to and reducing climate change-related risks. However, many financial institutions have yet to commit to net zero emissions by 2050 or to set interim, short-term targets. In addition, the credibility of targets that have been set varies significantly. Ministries of Finance can encourage private financial institutions to set credible targets and to undertake effective steps towards their implementation.

There are a few key barriers preventing Ministries of Finance and financial institutions from achieving their climate-related goals:

- The volume of current climate finance is not enough to move the financial system to where it needs to be, highlighting the need for more private financial institutions to make net zero commitments and take credible climate action.
- Commitments to reach net zero by 2050 from private financial institutions vary in credibility and coverage with respect to the share of assets under management covered by commitments, and thus lack the comparability that would make them decision useful.
- Private finance institutions need guidance from international bodies and local governments—including "carrots" for climate ambition and "sticks" for falling behind—to ensure credible net zero pathways. Each institution, actor, and country is acting under a unique set of circumstances, and therefore any guidance requires flexibility, without reducing the overall impact on real economy emissions.

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[7] Climate Policy Initiative, 2022a

[8] Financial Stability Board, 2021

[9] Financial Stability Board, 2021

- Ministries of Finance are not always the best-placed to either issue climate guidance or to encourage the announcement of net zero commitments within the private financial sector, highlighting the need for wider government cooperation.

This policy paper outlines indicators that can help assess the credibility of commitments. It provides a brief overview of the actions on key metrics by private financial sector alliances, particularly the Race to Zero criteria and the Glasgow Finance Alliance for Net Zero (GFANZ) sector-specific alliances. It will also discuss the levers available to Ministries of Finance to encourage financial institutions to make net zero commitments, support target implementation through climate action, and ensure target credibility. These levers are illustrated with several case studies from the Coalition of Finance Ministers members.

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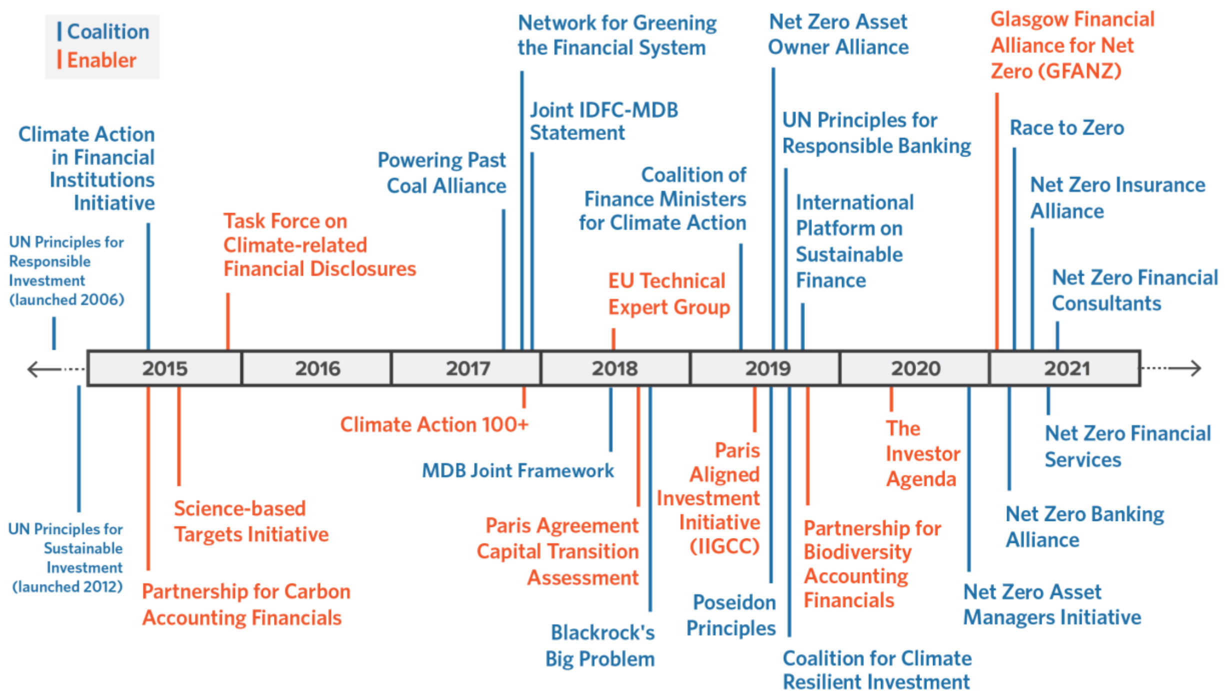
2. Assessing the Credibility of Commitments From Private Financial Institutions

Voluntary financial sector alliances have arisen to coordinate climate commitments, define the minimum requirements that help support the credibility of their members' commitments, and reduce confusion in the marketplace. These alliances are typically focused on specific financial sub-sectors, such as asset owners, asset managers, and banking, which have different roles in the financial sector and therefore require different approaches. Most, if not all, financial institutions that have made net zero commitments are members of the various net zero alliances (Figure 1). Therefore, this paper focuses on the alliances rather than individual financial institutions. However, it should be noted that some financial institutions have set commitments that go beyond alliance requirements.

Figure 1: Framework for Sustainable Finance Integrity



Source: Climate Policy Initiative, 2021

The current landscape of alliances and enabling initiatives began in 2006 with the UN Principles for Responsible Investment (UN PRI) and has continued into 2022 with the expansion of the Glasgow Finance Alliance for Net Zero (GFANZ) alliances. The UN PRI, and subsequent UN Principles for Responsible Banking, laid the fundamental groundwork for private financial sector action and cooperation on sustainable finance alignment. Enabling initiatives like the Partnership for Carbon Accounting Financials and the Task Force on Climate-related Financial Disclosures (TCFD) have also deeply impacted standards for credibility and expectations for reporting and transition planning. The Science-based Targets Initiative, a third-party emissions reduction effort that occasionally overlaps with GFANZ membership, sets clear definitions of what comprises science-based interim and long-term targets and action, as well as acts as a verification tool for members.

In total, the collective efforts of alliances and enablers have moved the conversation on sustainable finance forward and effectively highlighted the climate discussion within the private sector. The mobilization and growth of GFANZ, in particular, was realized due to significant coordination and cooperation between global governments and ministries.

In 2021, the existing major net zero financial sector alliances were brought under the umbrella of GFANZ, and additional sector-specific alliances were created to cover the full spectrum of private finance actors. The four GFANZ alliances with significant membership included in this evaluation are the:[10]

- Net Zero Asset Managers Initiative,
- Net Zero Asset Owners Alliance,
- Net Zero Banking Alliance, and
- Net Zero Insurance Alliance.

GFANZ, itself, required all alliance members to adhere to the Race to Zero Starting Line[11] criteria as a baseline until late 2022, in addition to alliance-specific membership requirements. Changes in November 2022 led to both sets of Race to Zero recommendations, Starting Line and Leadership Practices, to be voluntary for members;[12] Race to Zero updated their Starting Line and Leadership Practices criteria in June 2022 (Race to Zero 3.0), and in some instances have called for more ambition than have the sector-specific alliances. This led to tensions within GFANZ membership regarding adhering to the new Race to Zero 3.0 requirements, which members say were updated without consensus from the alliance members affected. There were concerns from U.S. members, notably banks, on being exposed to legal liability under proposed disclosure regimes and current fiduciary duty interpretations if they follow the new Race to Zero requirements to phase down fossil fuel investments.[13]

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[10] Additional GFANZ alliances include the Paris Aligned Asset Owners, the Net Zero Financial Service Providers Alliance, and the Net Zero Investment Consultants Initiative, but due to membership, composition, and focus they have not been included in this analysis.

[11] Carney, Topping, and Muñoz, 2021

[12] Financial Times, 2022b

[13] Financial Times, 2022a

Beyond the formerly mandatory Race to Zero requirements, there is substantial variance across alliances, as each one is based both on the differing products of that financial subsector and on the consensus of member institutions. In addition, these requirements often offer a significant amount of flexibility for institutions in how commitments and emissions are measured. There is also little guidance currently provided on the consequences of non-compliance or falling short of emissions targets. This lack of standardization across and within financial sub-sectors in how commitments are made, how emissions are counted, and how to disclose, as well as the fact that many alliance members are only starting to set targets, has made it difficult to assess the impact that alliances are having on the real economy.

2.1 Framework for Sustainable Finance Integrity

To help make sense of the different financial sector alliances, their requirements, and how these might translate to credible real economy impacts, CPI developed a Framework for Sustainable Finance Integrity in 2021 as a tool to understand sustainable finance commitments (Figure 2). A set of necessary action metrics were developed to define the actions needed to align financial institutions with a 1.5˚C pathway. The Framework offers a science-based approach that can be applied across financial sub-sectors, including 10 criteria over 3 categories.

Figure 2: Framework for Sustainable Finance Integrity Necessary Action Metrics

Targets & Objectives

1. Set Paris-aligned, net zero targets

Consistent with the IPCC's no or limited 1.5˚C overshoot pathways, and in addition to 2050 targets, set 2025 target to reduce portfolio scope 1, 2, and 3 emissions by 29% on absolute level against a 2019 base year, according to fair share of reductions.

2. Set complementary SDG targets

Set context-specific complementary targets by 2025, encompassing: biodiversity; adaptation; climate equity; pollution; and direct contributions for climate investments in developing economies and hard-to-abate sectors.

3. Use credible offsets

Only use offsets where no mitigation options exist, and ensure offset credits cause no harm, prioritizing positive co-benefits where possible.

Implementation

4. Whole institution approach

Fully integrate targets and commitments into mandates, governance, executive compensation, risk management frameworks, and performance management.

5. Proactive counterparty engagement

Lead engagements with counterparties to publicly commit to 1.5˚C-aligned business strategies and publish a detailed policy for those that fail to adopt and implement credible transition plans.

6. Develop and deploy substantially more sustainable finance

Drastically increase sustainable finance volumes through new instruments and business models, including supporting developing economies in their transition.

7. Align and engage around climate policy

Proactively engage on and advocate for sustainable finance policy and regulatory measures to ensure Paris-aligned financial flows, including for mandatory global climate risk reporting for public and large private companies.

8. End fossil fuel financing

Immediately end all finance for new thermal coal projects and phase out existing coal power finance by 2030 in OECD countries and 2040 in developing economies. Eliminate finance and subsidies for all new oil and gas projects, and phase out existing oil and gas financing and subsidies where a credible transition plan does not exist.

Metrics & Transparency

9. Transparently disclose climate risks

Align with the TCFD and future TNFD disclosure frameworks, and any globally adopted disclosure regimes, ensuring disclosures, finance data, and impact are independently verified.

10. Track emissions and sustainability investments

Promote standardized and comparable approaches to defining sustainable investments and tracking emissions.

Source: Climate Policy Initiative, 2021

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2.2 Indicators of Credibility

CPI has assessed four of the net zero private sector financial alliances' membership requirements, as well as the Race to Zero's Starting Line and Leadership Practices criteria, against the Framework's necessary action metrics and observed them to be either aligned with necessary action, making progress towards necessary action, partially aligned with necessary action, or not aligned with necessary action (Table 1).[14]

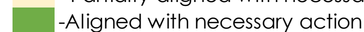
The comparison presented here is limited to private financial sector alliances. This analysis also only evaluates whether the commitment is required by the alliance, and not whether it is on track to be fulfilled by member institutions.

Table 1: Alliance requirement heatmap

This table indicates the presence of commitments in each category but does not evaluate progress made by institutions towards meeting such commitments.		Baseline Criteria	Advanced Criteria	Commercial Banks	Asset Owners	Asset Managers	Insurers
		Race to Zero - Starting Line	Race to Zero - Leadership Practices	Net Zero Banking Alliance	Net Zero Asset Owner Alliance	Net Zero Asset Managers Initiative	Net Zero Insurance Alliance
Targets and Objectives	**Setting Paris-aligned, net zero targets**						
	Setting complementary SDG targets						
	Credible offsets						
Implementation	**Whole institution approach**						
	Counterparty engagement						
	Developing and deploying sustainable finance						
	Climate policy alignment & engagement						
	Fossil fuel financing						
Metrics and Transparency	**Transparently disclosing climate risks**						
	Tracking emissions & sustainability investments						

- No commitment

- Partially aligned with necessary action

-Progress towards necessary action/in line with current leading practice

-Aligned with necessary action

[14] This analysis focuses on the current commitments, as of Sept 20, 2022, of the included private sector alliances. Sources include the new Race to Zero 3.0 requirements as well as all guidance documents, commitment statements, and announcements published by the GFANZ alliances.

Our analysis found a surprisingly large spread of alignment across the alliances, with improvements by several alliances since our first Framework analysis in 2021. Most of these are within the Net Zero Asset Owner Alliance, which is currently the most ambitious of the GFANZ alliances, particularly with the second edition of its target setting protocol released in 2022. The Net Zero Asset Owner Alliance meets the necessary action metrics on four criteria, an increase of two since the Alliance's first target setting protocol was evaluated in 2021.

The Race to Zero's more advanced criteria, Leadership Practices—which is voluntary and not the previous minimum requirement for GFANZ alliances— also meets the necessary action metrics on credible offsets and developing and deploying sustainable finance in its 3.0 guidance.

There are many more metrics where additional guidance from alliances would be beneficial. Three out of the four net zero alliances evaluated here have no criteria for fossil fuel financing, likely due to political concerns. Half the net zero alliances under review have clear requirements on tracking emissions and sustainability investments, which includes providing guidance on the standardization of emissions data. There are also gaps in guidance regarding implementing a whole-of-institution approach, as well as in setting complementary sustainable development goal (SDG) targets.

There are a variety of metrics and methods that can be used to evaluate commitment credibility and to help support and align voluntary private sector efforts. In particular, the set of metrics from the Framework (in bold in Table 1) can be combined with other credibility-focused recommendations[15] to determine private financial institution climate priorities and assess action against commitments to reach net zero emissions by 2050.

1. Setting Paris aligned net zero targets

The Framework's necessary action metric is that institutions set an interim 2025 target to reduce portfolio scope 1, 2, and 3 emissions[16] by 29 percent on an absolute level against a 2019 base year, according to a fair share of reductions, in addition to an overarching 2050 net zero target.[17] CPI considers this to be one of the most valuable indicators of credibility, as transparent and ambitious interim targets are one of the clearest signs that a financial institution is taking effective climate action and a first step toward the credible implementation of their net zero commitment. Interim targets are also scalable to financial institutions of any type, size, or geography once sufficient portfolio emissions data is collected.

Most of the initiatives evaluated, including the Race to Zero criteria, are listed as making progress towards necessary action. While these alliances and initiatives call for Paris-aligned interim targets, none of them requires an interim target date before 2030. Given the need for climate action in the short term, a 2030 interim target lacks the urgency demanded by the situation of rising global emissions.

[15] UNEP FI, 2021a

[16] See Greenhouse Gas Protocol for an explanation of portfolio scope 1,2, and 3; available at https://ghgprotocol.org/sites/default/files/standards_supporting/FAQ.pdf

[17] Climate Policy Initiative, 2021

The Net Zero Asset Owner Alliance requires members to reduce emissions by 29 percent by 2025 in the first edition of their target setting protocol. The 2022 second edition of their target setting protocol calls for a 22 to 32 percent greenhouse gas (GHG) emissions reduction by 2025, specifying that it applies to equity and debt extended to corporates, infrastructure, and real estate. The Alliance also requires a 49 to 65 percent GHG emissions reduction by 2030. Box 1 presents further details on effective interim targets.

The total value of assets currently on a net zero trajectory is unknown, as interim targets often only cover part of an institution's portfolio. As of 2022, there are significantly more institutions with net zero commitments than with interim targets, as financial institutions still have time to develop interim targets under the GFANZ requirements. Information on the emissions covered by existing targets is also scarce, as there are no standardization or disclosure rules around interim targets to allow for flexible institution approaches. Since 2021, progress reports from the alliances themselves have provided some details on assets under management (AuM) and balance sheet assets covered by interim targets:

According to the Net Zero Asset Managers Initiative, 43 members have set interim targets, covering an average of 39 percent of those managers' assets.[18]

For asset owners in the Net Zero Asset Owners Alliance, as of May 2022, there were 29 asset owners (of the 56 members) with 2025 interim targets, and a total of 33 percent of their AuM were covered by interim targets.[19]

Commercial banks in the Net Zero Banking Alliance are only required to set interim targets for certain sectors and include on-balance sheet investment and lending. This excludes the majority of fossil fuel lending, which is usually financed through bonds issuances and equity underwriting facilitated by banks.[20,21]

Box 1 – The makeup of effective interim targets

There are several different ways that financial institutions can develop their interim targets, and an agreed upon set of factors that should be included to ensure clarity and comparability.[22]

Emissions data should be reported as CO2e (carbon dioxide equivalent), which bundles the larger set of greenhouse gases into a common unit. For any quantity and type of GHG, CO2e signifies the amount of carbon dioxide that would have the equivalent impact on global temperature.[23]

[18] The Net Zero Asset Managers initiative, 2022

[19] UNEP FI, 2021b

[20] UNEPF FI, 2021c

[21] Rainforest Action Network, 2022

[22] Agreed upon by the Institutional Investors Group on Climate Change (IIGCC), Paris Aligned Investment Initiative (PAII), Science Based Targets initiative (SBTi), and the Net Zero Asset Owners Alliance.

[23] Econometrica, 2012

Interim targets should include targets for both absolute emissions and emissions intensity.

"Absolute emissions" measures the total owned carbon emissions associated with the underlying portfolio investments. It is a well-known metric that can be applied to a range of assets. It can also be linked to the global carbon emissions budget available under a 1.5°C scenario.

"Carbon intensity" measures the volume of emissions attributed to an institution or portfolio in relation to a specific financial metric. This metric is more stable to asset additions or divestments, and is more widely comparable across portfolios and institutions.

Targets should include Scope 1, 2, and 3 emissions to cover the full breadth of institution emissions. Scope 1 and 2 emissions cover the financial institution's operational emissions, including direct emissions from activities and emissions from sourced energy. The significant majority of Scope 3 emissions for most financial firms comes from investment or lending portfolios, and refers to the emissions of counterparties in which the institution has a financial stake. For financial institutions, the majority of emissions will be in portfolios.[24]

Interim targets should be set at 5-year intervals or less, with a set baseline year.

It is also vital that interim targets be viable; there are clear credibility losses if a financial institution announces ambitious targets and makes no effort to meet them. The requirement that transition plans be disclosed to show clear action plans to reduce portfolio emissions can help mitigate some of this risk.

2. Whole institution approach

The Framework's necessary action metric is that institutions fully integrate net zero targets and SDG commitments into mandates, governance, executive compensation, risk management frameworks, and performance management, in a "whole institution" approach, similar to the Coalition of Finance Minsters guidance. Financial institutions with a credible approach to climate will ensure that climate risk is mainstreamed throughout operations and evaluated at multiple levels of the institution, with clear oversight and accountability from Board members and C-suite leadership.

The Race to Zero guidelines provide little detail on mainstreaming climate in operations, and the Net Zero Banking Alliance and Asset Managers Initiative have not yet made any commitments on this topic nor included it in their guidance.

The Net Zero Asset Owners Alliance calls for a holistic approach to managing sustainability considerations, while the Net Zero Insurance Alliance requires that a net zero and decarbonization risk criterion is integrated into the risk management frameworks that underpin decision making.

[24] CDP, 2020

3. Counterparty engagement

The Framework's necessary action metric is that institutions lead engagements with counterparties to publicly commit to 1.5°C-aligned business strategies and targets. They must also publish a detailed policy for those that fail to adopt and implement credible transition plans. Lowering counterparty emissions is the main way financial institution net zero commitments can have an impact on the real economy, as a large majority of financial institutions' emissions (Scope 3) stem from their portfolios, rather than in their operations.

The Net Zero Asset Managers Initiative was an early adopter in requiring ambitious counterparty engagement, with an engagement policy that includes escalation tactics and voting policies. The Net Zero Asset Owners Alliance updated their guidance in 2022 to align with the Net Zero Asset Managers Initiative more closely, and published a detailed voting policy for members in 2021.

The Net Zero Banking Alliance requires members to prioritize client engagement and offer products and services that support client transitions, with no examples, goals, or techniques specified. This is particularly concerning given the direct relationship between banks and counterparties and the significant influence banks can have on counterparty targets and transition plans.[25]

4. Developing and deploying sustainable finance

The Framework's necessary action metric is that institutions drastically increase sustainable finance volumes through new instruments and business models, including supporting developing economies in their transition and catalyzing the private sector. This is a first step for institutions to demonstrate that they are implementing the policies needed to reach their interim targets.

The Net Zero Banking Alliance, the Net Zero Asset Managers Initiative, and the Net Zero Insurance Alliance all call for increased investments in new technologies and safe, high-quality climate solutions, but do not provide specific guidance on what form those solutions could take or recommended volumes of finance to achieve.

The Net Zero Asset Owners Alliance has provided more detail in its new requirements, including identifying potential instruments, encouraging members to set quantitative targets, and requiring reporting on sustainability investments.

[25] Climate Safe Lending Network, 2021

5. Fossil fuel financing

The Framework's necessary action metric is that financial institutions phase out fossil fuel financing in line with the IEA recommendations,[26] including ending all financing for new thermal coal projects and phasing out existing coal power finance by 2030. While each government has different energy needs and its own approach to fossil fuel investment, it is worth highlighting the lack of alliance requirements regarding continued new fossil fuel investments.

Only the Net Zero Asset Owners Alliance has requirements on this metric, by calling for no new thermal coal financing, although further guidance on oil and gas investments is expected this year.

None of the other net zero alliances have requirements on new fossil fuel investments, outside of requiring coal to be considered a high-emitting sector and included in interim targets. The new Race to Zero requirements on fossil fuel investments, which fall short of the IEA and Framework recommendations but are more advanced than the remaining alliances, have already caused tension with financial institutions that are concerned about the risks of creating fossil fuel targets.[27]

6. Transparently report[28] climate risks

The Framework's necessary action metric is that institutions report climate risks in line with the TCFD recommendations, as well as release transition plans and provide an independent verification of emissions data. Transparent and standardized reporting of progress against robust, credible methodologies can help provide the information necessary to assess real economy emissions and the metrics mentioned above. Standardized reporting on progress also has the benefit of generating comparable data and information, which can help identify leaders and laggards within a country's financial sector.

All four of the net zero alliances evaluated here recommend TCFD-aligned reporting and standardized methodologies for emissions accounting, which is beyond the criteria in the two Race to Zero guidelines. There is, however, no mention of releasing publicly available transition plans or requiring third party verification. The alliances are generally of one mind on this issue, which may make it more difficult for governments to push for more consistent transparency in reporting.

Requiring transparent and standardized reporting could also address the need for greater clarity in the structure of how institutions report to alliances. While the Net Zero Public Data Utility (discussed further in section 2.3) may help address data collection and dissemination challenges, there is a pressing need for the membership institutions to ensure the data provided is accurate and externally verified.

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[26] IEA, 2020a

[27] Financial Times, 2022a

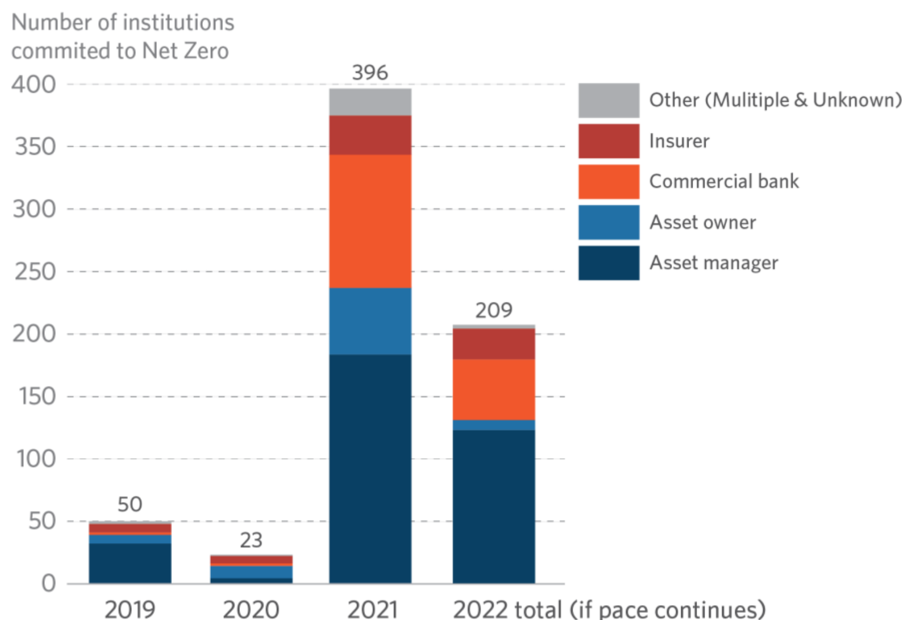
[28] We have adjusted the Framework language from "disclose" to "report" here, to avoid confusion with the ongoing discussion around regulatory disclosure requirements.

2.3 Barriers to Assessing Commitments

The growth in private sector alliances is dependent upon expanding membership across institutions and geographies. In order to ensure the membership has a positive impact on real economy emissions, it will be necessary to create procedures and mechanisms to both support and assess committments.

The rate of growth in net zero alliances is slowing. The number of new institutions announcing net zero commitments dropped by an estimated 40 percent between 2021 and 2022 (Figure 3); the estimated value of additional assets managed by institutions making commitments in 2022 has fallen by over 70 percent, relative to the amount managed by institutions that made commitments in 2021.[29] As noted in the Introduction, approximately 32 percent of global financial assets are managed by financial institutions that have made net zero commitments. Our evaluation found that the remaining 68 percent of uncommitted private AuM are held by a large number of diverse, smaller institutions across a geographically dispersed spread of varied economies.[30]

Figure 3: Net Zero Commitments by Actor Type



Source: Climate Policy Initiative, 2022a

Geography also plays a particularly dominant role in which institutions have made commitments, as an estimated 88 percent of past and current net zero pledges have come from OECD countries.[31] While there

[29] Climate Policy Initiative, 2022a

[30] Climate Policy Initiative, 2022a

[31] Climate Policy Initiative, 2022a

is an upward trend in commitments from institutions in non-OECD countries in 2022, which increased by a third to 37 total institutions, the number of institutions and the AuM are still comparatively quite small.[32] Capacity, data scarcity, and data sharing issues have created barriers for private financial institutions interested in making net zero commitments in non-OECD countries, along with concerns about making commitments that are stronger than government climate goals and Nationally Determined Contributions.[33]

There are several known barriers to ensuring the credibility of commitments that the current set of voluntary alliances does not address. These include questions about what constitutes credibility, what counts as climate action, and how institutions will report progress and obtain information needed to report such progress, which varies by country and alliance. Some of these factors can be improved by Ministry or government involvement, while others will require engagement with GFANZ and other international standard setters.

The information needed to assess credibility, such as interim targets and institutional strategies, may simply not yet be available. The time lapses between when a financial institution announces a commitment to reach net zero emissions by 2050, when it makes interim targets to guide action, and when it takes action can vary by institution and alliance membership. Based on the GFANZ guidelines, every member has 18 months to develop interim targets after announcing their net zero commitment. Given the rise of net zero commitments in the run up to COP26 in 2021, many financial institutions are scheduled to announce their interim targets in late 2022 or early 2023.

Additionally, the commitments made by different financial institutions are not standardized, even within alliances. This makes it difficult to compare the current landscape of commitments and assess the differences in expected real economy emissions reductions, as well as to assess credibility and progress in meeting commitments across the sector.

The September 2022 announcement of the Net-Zero Data Public Utility, designed to provide a central repository of key climate transition-related data open to all stakeholders, can potentially resolve questions of data availability and comparability. While still in the early stages, the Utility's Steering Committee has recommended that the repository prioritize collecting data on company and financial institution-level data for both direct and indirect emissions, covering Scopes 1, 2, and 3, as well as reported net zero targets and implementation actions, and available statistical information.[34] The effort is designed to include financial institutions as well as the real economy companies that have made net zero commitments, allowing for the evaluation of real economy impacts. To further evaluate credibility, we would recommend that the next phase of data collection focus on the monetary value of financial flows dedicated to climate solutions and sustainability investments.

[32] Climate Policy Initiative, 2022a

[33] Climate Policy Initiative, 2022b

[34] Bloomberg Philanthropies, 2022

The consequences for alliance member institutions' not meeting the relevant criterion are unclear for many alliances. While removal from the alliance is certainly a potential outcome, alliances may first attempt to engage with and support underperformers to meet requirements. As interim targets are announced, and progress is measured against those targets, GFANZ will have to determine both how to provide incentives to achieve further progress and what constitutes sufficient lack of progress to face consequences for members that fall short of their targets. The UN PRI accountability mechanism could provide potential guidance; the initiative regularly de-lists signatories that have not met the minimum requirements after a two-year engagement period to improve performance.

Alliances face a balancing act between credibility and actionability in developing their membership requirements. The Net Zero Asset Owners Alliance has the most stringent membership criteria, particularly after its target setting protocol update in early 2022, but it recently lost two pension fund members due to the funds' lack of internal capacity to meet the Alliance requirements. It is also one of the smallest in both membership numbers and AuM. This is particularly noticeable when evaluating the percentage of asset owner holdings managed by alliance members, compared to the estimated total global assets of asset owners, estimated to be 6.7 percent (Table 2). Comparatively, the Net Zero Asset Managers Initiative has the least stringent criteria on every metric but engagement and has the largest membership by both institution number (266 institutions) and percent of potential AuM held by members (42 percent).

Table 2. Net zero commitments by actor type (as of May 2022)

Actor Type	Financial Institutions Committed to Net Zero	Assets Managed by Institutions Committed to Net Zero (USD billion)	Estimated Total Assets Industry-Wide (USD billion)	Estimated % of Industry Assets Managed by Institutions Committed to Net Zero (USD billion)
Total	**547**	**129,474**	**N/A**	**N/A**
Asset manager	266	43,344	103,000[35]	42 %
Commercial	128	69,876	180,400[36]	39 %
Asset owner	74	3,772	56,575[37]	6.7 %
Insurer	54	6,493	40,260[38]	16 %
Multiple	15	4,618	N/A	N/A
Unknown	10	1,371	N/A	N/A

Source: Climate Policy Initiative, 2022a

[35] Boston Consulting Group, 2021f
[36] Financial Sustainability Board, 2021
[37] Based on an estimate of pension fund assets in 22 of the largest markets in the world. Thinking Ahead Institute, 2022
[38] Statista, 2022

There is an opportunity for governments to engage with net zero alliances, industry associations, and individual financial institutions to support efforts on membership expansion and credibility. Many of the issues regarding credibility and accountability also have the potential for further policy and regulatory development, highlighting possible complementary efforts and collaborations between governments and private sector alliances.

3. Government Levers to Support Net Zero Commitments and Credibility

Governments and, in particular, Ministries of Finance, can support private financial institutions' efforts to make credible net zero commitments and to implement effective measures to achieve them.

Governments can use soft power methods that communicate that climate is a priority or provide useful information and support, or can use techniques that exert influence through formal regulations and policies. Three main types of actions can be defined: soft power, regulatory power, and those that can be either soft or regulatory, depending on whether the action is voluntary or mandated. The following definitions are used in this paper for soft and regulatory power:

- **Soft power** – shaping the actions and preferences of private financial institutions through persuasion and incentives.
- **Regulatory power** – using laws and regulatory enforcement to require private financial institutions to take specific actions.

3.1 Soft Power

Governments can use soft power techniques to shape the actions and preferences of private financial institutions on climate action. Soft power actions do have the advantage of typically being easier to implement, more flexible to changing conditions, and able to cover a wide range of barriers and end goals. Being voluntary in nature, soft power techniques lack an accompanying accountability aspect and success rates often rely on the ambition, capacity, and willingness of financial institutions.

Ministries' success in implementing these techniques depends in part on the strength of the relationship and the level of trust and mutual understanding between financial institutions and Ministries of Finance. Often, the first steps of soft power are general lead-by-example actions that governments can take including mainstreaming climate into annual budgets and recovery packages, developing sustainability finance roadmaps, and setting net zero and interim targets for the government sector and relevant public financial institutions.

The actions described in the table below are all examples, and the actionability and effectiveness will depend on each country's governance structure, authorities and legal regimes, and policy objectives. These examples are intended to be implemented by Ministries of Finance, but depending on the jurisdiction, other ministries or government actors may be more appropriate.

Example Action	Intended Impact
Engage with private sector, alliances, and civil society through roundtables, ongoing conversations, and publication of research.	Provides opportunity to identify barriers and communicate expectations to the private financial sector on climate investment and net zero pathways; ensures standards are clear, decision-useful, and implementable; signals the Ministry takes credibility, and credibility concerns seriously.
Support capacity building in private financial institutions through training sessions and coordinating with industry associations. Coordinated technical work, ideally internationally with companies, data providers and data users to improve the availability, quality, consistency, and comparability of data to calculate emissions.	Results in increased internal capacity, expertise, and emissions tracking within private financial institutions that can strengthen climate alignment, risk assessments, and disclosure at the institutional and financial product level.
Support monitoring of private financial institution climate commitments and interim targets to establish which AuM are covered and the real economy impacts.	Measures commitments' coverage of assets and provides a baseline for measuring emissions reduction progress over time.

Engage with the private finance sector, civil society, alliances, and standard setters

Regular engagement with the private finance sector through CEO roundtables and other visible methods is a way for Ministries to clearly communicate expectations on climate commitments, net zero pathways, and future climate investments. These efforts can generate productive conversation, provide positive publicity for participants, and may help ensure better follow through by indicating the Ministry's sustained interest. Roundtables can be particularly useful, as they allow for feedback from financial institutions on what challenges they are facing to implementing their commitments and increasing sustainable finance flows, and what barriers the Ministry can address.

Well-respected, climate-focused civil society organizations should also be included as participants in discussions; they can convey research findings, determine what constitutes credible commitments and action, and reinforce the messages regarding the importance of net zero pathways and interim targets. As an example, in mid-2022 the US Treasury Department held a listening session with civil society organizations to understand credibility concerns and how these can be addressed.[39] By including civil society, Ministries can communicate that their engagement with private financial institutions is about

[39] U.S. Department of the Treasury, 2022

ensuring credibility as much as it is about supporting financial institutions on their way to creating and implementing net zero commitments.

Governments should also engage directly with international initiatives, such as GFANZ and Race to Zero, and standard setters, such as the International Sustainability Standards Board (ISSB), as well as other enabling organizations. Direct engagement can provide perspective on the credibility of alliance requirements and potentially support alliance membership expansion. Ministries can represent both national interests and the perspective of civil society and smaller financial institutions that may not have the capacity to communicate their needs to these alliances.

Support the implementation of net zero commitments through capacity building and knowledge sharing

Many financial institutions, particularly those in emerging markets and developing economies, lack the capacity and portfolio emissions data to make net zero commitments. These factors help to explain the disparity in commitments between institutions in OECD and non-OECD countries. Ministries can help build capacity at private finance institutions through disclosure guidance, enhancing data accessibility, knowledge sharing, and financing climate-related capacity building. These tools can assist in both the definition of targets and their credibility, as well as the evaluation of counterparties' transition plans.[40] While institutions in developing economies are likely the most in need of this capacity-building, Ministries may not have the internal capacity or jurisdictional ability to offer that support, and therefore focus on institutions in their own countries. A demonstration of capacity building efforts is further described in Box 2, discussing the efforts of the Rwandan Ministry of Finance and the Rwanda Green Fund to increase knowledge sharing within the domestic private financial sector.

Ministries can also use climate tools to help support commitment implementation and portfolio alignment. This may include partnering with technical government agencies and data providers to provide up-to-date and easily accessible emissions data, where Ministries of Finance can play the role of bringing together financial institutions to make use of the data. Ministries can identify the most impactful and decision-useful datapoints to incorporate into voluntary or mandatory disclosures,[41] as discussed in Section 3.4.

Box 2 – Rwanda: Policies and practices to boost sustainable development

The Rwandan Ministry of Finance together with the Rwanda Green Fund, the nation's largest climate investment fund, have applied soft power strategies through private sector engagement and capacity building

[40] Climate Policy Initiative, 2022b

[41] RMI, 2022

to accelerate sustainable economic development and unlock the domestic and international private investment needed to reach the country's NDC targets.

One of the greatest challenges to the Ministry's program so far has been mobilizing private sector finance for climate action. The Rwanda Green Fund, more typically known by its French acronym FONERWA, was launched in 2012 as the principal financial vehicle for Rwanda's climate finance efforts. Since its establishment, FONERWA has mobilized USD 216 million in domestic and international finance, most of which has gone to mitigation. Although 20 percent of total FONERWA resources are earmarked to catalyze private action, only 4 percent was directed towards the private sector in 2021.

There are several barriers to private finance including the high cost of credit, high transportation costs as a landlocked country, investment risk, and lack of government incentives. As of late 2022, no private financial institutions in Rwanda have made commitments to reach net zero by 2050, in large part due to a lack of internal capacity and sectoral or regional climate data.

Rwanda held a series of capacity building training sessions and private sector outreach efforts in 2018 and 2020 to provide a space for ongoing dialogue and promote climate action by the Rwandan private sector. These sessions culminated in establishing Private Sector Committees led by FONERWA and the Rwanda Private Sector Federation to discuss different options for accessing climate finance and project identification and development of bankable projects. Participants were introduced to diverse modes of climate finance access and funding through the UNFCCC, African Development Bank, World Bank, and multilateral and bilateral climate funds.

Although these efforts may take time to bear fruit, Rwanda's MoF and FONERWA have laid a strong foundation to boost the credibility of the financial sector's involvement in addressing climate change.

Support monitoring of the landscape of interim targets and other implementation commitments

Current interim targets lack standardization and the amount of AuM covered by interim targets varies by institution.[42] To understand whether financial institutions are setting credible commitments, Ministries need updated and reliable data. Ministries can set an accurate baseline to evaluate credibility by assisting in the development of a methodology to enhance reporting consistency and comparability, as well as building capacity, within the Ministry and/or within alliances, to evaluate the landscape of current commitments. As the Net-Zero Data Public Utility may assist with data collection and dissemination in the future, Ministries do not necessarily need to be the entity conducting this monitoring, and it may be best for the Ministry to act as a provider of research funding and expertise to civil society organizations that are better suited to gathering and analyzing data.

Ministries can also set their own standards for credible commitments by establishing monitoring priorities. Some of the datapoints that Ministries can prioritize include the AuM covered by interim

[42] Climate Policy Initiative, 2022a

targets, potential impacts of commitments on the real economy, and progress made towards past commitments in terms of emissions reduction and implementation actions. Financial institutions, including those that have not yet set targets, can use this monitoring to identify benchmarks and best practices.

3.3 Soft or Regulatory (Mandated or Voluntary)

There are also several examples of actions that Ministries of Finance and governments can take that can be either soft or regulatory powers, depending on whether they are mandated or voluntary. As above, these are only intended as examples, and additional actions could fall into this category depending on Ministries' authority and jurisdictions.

Example Action	Impact
Adopt recognized standards for "green" labelling and other alignment tools.	Avoid greenwashing within the private finance sector by adopting or developing standards for using "green" or climate-related labels and establishing standards or best practices for other alignment tools.
Support measuring and monitoring of climate risks through stress tests.	Evaluate national climate risk, present climate risk as a priority for the government, and provide stress testing tools to financial institutions that want or need that support.
Develop blended finance vehicles and other financial incentives such as tax credits to catalyze private finance.	Creates a government vehicle to increase private financial institution involvement and can be used to direct climate finance to or within developing economies and new technologies in particular.

Adopt recognized standards for "green" labelling and other alignment tools to support the implementation of net zero commitments

To make credible commitments, financial institutions will need methods to measure what constitutes sustainable investment and how much is invested, what net zero pathways look like for different sectors, and appropriate levels of climate risk. Governments can adopt standards or guidelines for these definitions and work on indicators that can guide private investment and help private financial institutions avoid greenwashing. Taxonomies, labelling efforts, or sets of transparency indicators are intended to provide rules, methodologies, or guidelines around what can be considered "climate aligned", particularly regarding investment decisions. These definitions can be voluntary or tied to further regulations and disclosures. Depending on the country, Ministries of Finance may not be the appropriate implementer, but Ministries can use findings generated from engagement with financial institutions and civil society to ensure that adopted standards are both implementable and credible.

Developing new standards is time- and resource-intensive and can increase administrative costs for private financial institutions that need to navigate different standards across different jurisdictions. When possible, Ministries and governments should prioritize adopting existing standards and collaborating with standards setters to cut down on duplicate efforts. In some countries, such as in Indonesia (described in Box 3), there may be government and financial sector interest in developing a new taxonomy, although efforts should be made to ensure eventual alignment with the broader ASEAN and EU taxonomies. An example at the portfolio level is the Swiss Climate Score, which is a voluntary metric that includes indicators such as greenhouse gas emissions, global warming potential, and current exposure to fossil fuel activities, as well as future-looking indicators such as the percentage of companies with verified net zero commitments.[43]

Box 3 – Indonesia: Green taxonomy and Sustainable Finance Roadmap

To achieve its climate goals of reducing GHG emissions by up to 41 percent with international funding, Indonesia will require investment of approximately USD 250 billion through 2030. Given the limited availability of government funding, Indonesia will need increased private sector action. The Indonesian Ministry of Finance has implemented several strategies to close the climate finance gap, including raising private sector awareness and developing innovative financing mechanisms through, for example, public-private partnerships and blended finance instruments.

A central pillar of Indonesia's climate plan has been the development of the Green Taxonomy 1.0, released in January 2022. This green taxonomy not only affects the financial sector but it also influences the development of national fiscal policies to support mitigation and adaptation projects. The development of this taxonomy was an exercise in soft power as it brought together more than 47 financial service institutions including commercial and Islamic banks, capital-market actors, issuers, securities companies, and investment managers into a Sustainable Finance Task Force. This task force is intended to both jointly formulate policy and facilitate capacity building for private financial institutions.

Though the green taxonomy at this point is used mainly as voluntary guidance, the Ministry of Finance plans to make it a standard for determining activities and considerations in the formation of national initiatives including the decarbonization of state-owned enterprises. It could also be expanded into mandatory disclosures of taxonomy-relevant investment portfolios from the private sector. With that in mind, the Sustainable Finance Roadmap (SFR) will be the basis for a carbon exchange regulatory framework that Indonesia plans to develop. While there are still recommended improvements, particularly around broader integration with the regionally dominant ASEAN and EU taxonomies, Indonesia's Ministry of Finance and Financial Services Authority have set a strong foundation of institutional support for green finance through the SFR and rollout of the Green Taxonomy 1.0. As the programs mature with more clear targets, private sector involvement, and regional harmonization, they will attract an inflow of green investment at home and abroad which will help close the financing gap needed for Indonesia to meet its NDC commitments.

[43] State Secretariat for International Finance SIF, 2022

Support measuring and monitoring financial institution progress, including through scenario analysis and monitoring portfolio exposure

One way of achieving this is by governments offering or mandating stress testing for private financial institutions. Stress testing is a model simulation of the impact of potential economic disruptions due to acute climate risks on an institution's current portfolio. The results frequently show that financial institutions are not currently aligned with climate pathways and will potentially face portfolio losses under potential public policy changes needed to meet certain temperature targets. Institutions can use these results to target portions of their portfolio to diversify or transition to less exposed assets. Stress testing can drive decarbonization through less investment in high-emitting assets and thus enhance resilience to future climate change.

As an example, and as described further in Box 4, Switzerland provides a climate finance alignment assessment every two years, which allows financial institutions to voluntarily measure the climate alignment of financial institutions' equity, debt and real estate holdings against 2°C and 1.5°C scenarios. While progress on improving alignment has been mixed, there is some evidence that the voluntary use of the assessment tool results in more climate-friendly investments.

Box 4 – Switzerland: Voluntary climate alignment assessment

Switzerland has run an ongoing climate alignment assessment for its private financial institutions since 2017; three iterations of the program occurred or are currently taking place.

In 2017, the Swiss Government conducted the first-ever voluntary assessment of private financial institutions' climate alignment, compared to a scenario with a mean global temperature increase of 2°C. Using the Paris Agreement Capital Transition Assessment (PACTA) methodology, the Swiss Government solicited data from pension funds and insurers on debt and equity holdings, which accounted for between 20 percent and 40 percent of insurers' and pension funds' portfolios, respectively; 79 institutions participated in the pilot program.

In 2020, the exercise was repeated, this time expanding to asset managers and commercial banks, and 179 institutions participated, representing approximately 80 percent of pension funds, banks, and insurers in Switzerland (market coverage for asset managers was unavailable). About 75 percent of the participants in 2017 participated again in 2020.

The content of the 2020 assessment was expanded from the 2017 pilot to include the following:

- A qualitative survey, covering topics such as the extent of internal climate goals and strategies, distribution of asset classes and which are self-managed, and reflections on previous PACTA climate tests.
- Real estate and mortgage portfolios.
- Exposure to more high-emitting sectors – now including oil, gas, coal mining, electricity, transport, aviation, shipping, and industry (e.g., steel and cement).

- New climate scenarios, including a scenario with a global mean temperature increase of 1.5°C.
- An optional stress test, where companies could be evaluated on how their holdings would perform under a policy shock to achieve rapid emissions reductions.

In 2022, the assessment is again being run in a similar format, and the Swiss Government has committed to continuing it regularly moving forward. The Swiss Government expects to have more financial institutions participating in 2022 than in 2020, although the rate of growth in participation is slowing.

The program has been well-received by the financial industry but in terms of driving change the results are mixed. Overall, not a single institution is fully aligned with Switzerland's climate goals, although some are aligned in specific sectors, particularly with respect to the production of electric vehicles, as well as limiting gas production and electricity generation from gas. Financial institutions are still falling behind their stated climate goals and strategies; for example, a majority of investors with coal divestment policies still have equity and bond exposure to coal power. These climate assessments may nonetheless be having an impact: more than half the institutions that participated in the 2017 pilot decreased their exposure share with respect to coal power generation and increased their share in renewable power generation relative to their overall exposure to the power sector. The 2017 pilot results incentivized climate action, as some institutions noted that they took measures because of the 2017 results.

The stress tests run in 2020 provided a similarly diverse distribution of results. The Government analyzed how each institution's portfolio would perform given a transition policy shock in 2030, assuming business-as-usual. In that scenario, almost all the institutions would have experienced negative financial impacts. These risks can be mitigated by taking earlier action to align portfolios with net zero pathways and indicate that early government intervention may have a positive impact on most institutions' portfolios. It is unclear what the results of the stress test will be in 2022 given the continuing effects of the COVID-19 pandemic, as well as the European energy crunch and associated rising gas and electricity prices.

The PACTA methodology and tools used to undertake this analysis are available online. While undertaking an alignment assessment or stress test does require internal capacity from within government and private financial institutions, it can be replicated in other countries and, as of October 2022, climate alignment assessments have been completed in 14 countries and sub-national governments including some US states.[44]

Support financing of climate solutions through blended finance vehicles.

Governments can help crowd-in private financing for renewable energy and other climate-friendly investments through public investment vehicles, including blended finance and other de-risked investments. While this does not guarantee higher domestic financial flows, it does incentivize financial institutions to realign portfolios around climate-friendly investments and can potentially address barriers including lack of project pipeline and risk concerns. This can also be used as a major means of directing private finance to developing economies, and to catalyze domestic finance within developing economies,

[44] 2 Degrees Investing Initiative, 2021

as seen in Luxembourg's joint efforts with the European Investment Bank (Box 5). While the setting of clear, public goals is a form of soft power, the level of bonds, grants, and tax incentives created to incentivize climate finance is a form of regulatory power.

Box 5 – Luxembourg: Green Financial Center

Luxembourg ranks among the world's top green financial centers, thanks to a combination of factors such as its position in cross-border financial services and the collaboration between the public, private, and civil society sectors. Furthermore, Luxembourg is home to the European Investment Bank (EIB), the world's largest green lender and an expert in public-private investment projects, and is a member of the European Union, which is spearheading the regulatory push for sustainability.

Luxembourg's combination of political and economic capability and access to willing partners means it can be at the forefront of implementing measures to crowd-in private finance. This strategy is laid out in part through "The Luxembourg Sustainable Finance Roadmap" developed in 2018 together with the UN Environment Programme Finance Initiative (UNEP FI). The Luxembourg Sustainable Finance Initiative, launched in 2020, is now building on the past work and implementing the national Roadmap's objectives.

The Luxembourg government partners with the EIB) to provide blended finance through the Luxembourg-EIB Climate Finance Platform (LCFP). The LCFP aims to mobilize investment for projects which will have a high impact in the fight against climate change. The Luxembourg government contributes a first-loss guarantee to mitigate the risk for the private sector when co-investing in funds dedicated to climate change mitigation and adaptation. These other funds are focused on energy efficiency, renewable energy access, and resiliency projects. By taking on subordinated tranches, the Luxembourg government allows private investors to take on less risk in their own investments, thereby crowding in private capital.

With EUR 40 million of approved first-loss investments from Luxembourg, and follow-up investments from the EIB, the platform has mobilized more than EUR 18 billion in climate project financing to date.

Luxembourg also has a series of other success stories that incorporate some of the recommended levers discussed throughout this report:

- **Sustainability bond framework:** In September 2020, Luxembourg became the first EU country to launch a sustainability bond framework and the first country in the EU and the first triple-A country in the world to issue a sustainability bond. The sustainable sovereign bond finances or refinances investments worth EUR 1.5 billion, covering at least 65 projects in seven different sectors with positive environmental and social environmental and social impacts.

- **Labels to support implementation:** LuxFLAG is an investment labelling system developed in Luxembourg to reassure investors that a product invests in the given sector in a sustainable and transparent manner. As of end-December 2021, LuxFLAG had issued labels for 365 investment products from 9 jurisdictions, including 282 ESG labels.

- **Stress testing:** The Luxembourg Sustainable Finance Initiative helped organize the first national Paris Agreement Capital Transition Assessment (PACTA) in 2021/2022.

3.4 Regulatory Power

Regulatory power is the use of legislation and regulations to require action from private financial institutions and other actors. Ministries of Finance may not only have their own regulatory power over national financial matters but can also coordinate regulation with other ministries and agencies. Unlike soft power actions, however, regulations can be more difficult to implement, especially in the short term, and may not be as flexible to real-world changes or as applicable to different types of financial institutions. However, these actions can have meaningful real economy impacts, as detailed in the results of an empirical study to measure the effects of climate-related financial policies on carbon emissions in G20 countries from 2000 to 2017.45 Overall, the results suggest that countries that adopt climate-related financial policies see a statistically significant impact on carbon emission reductions in both the short- and long-term.46

Depending on the country, however, these regulatory actions may not always be in the remit of Ministries of Finance. The following table does not represent the entire range of regulatory actions but presents a sample of possible actions.

Example Action	Impact
Provide guidance on the reduction, removal or repurposing of fossil fuel subsidies and the direction of subsidies for new technologies.	Provide clear expectations around the future of fossil fuel investments and the rate of transition to low-carbon energy to align with NDCs and sector-specific pathways.
Work with securities and regulatory agencies to coordinate the development of climate disclosures and / or climate transition plans.	Create standardized, comparable climate disclosures in line with a global framework, such as TCFD and improve access and availability of climate data.

Provide guidance on phasing out fossil fuel subsidies to support implementation of NDCs. Governments can create regulatory guidance on reduction, removal or repurposing of fossil fuel subsidies[47] and can partner with other agencies to identify what fuels and energy sources may be impacted by environmental or emissions regulations. In the status quo, financial institutions may get mixed messages because governments are communicating through soft power channels that they should phase down their fossil

[45] D'Orazio and Dirks, 2021

[46] D'Orazio and Dirks, 2021

[47] IEA, 2020b

fuel holdings but are also providing financial subsidies to new and existing fossil fuel projects. Without this information, financial institutions are unsure of which existing energy holdings should be phased out or retired—and over what timelines—to avoid the risk of becoming stranded assets. Ministries of Finance can also provide guidance on subsidies for new low-carbon technologies when they are introduced.

Governments can support mandatory, standardized climate reporting. While most Ministries of Finance do not have direct control over disclosure requirements, which are usually in the hands of securities agencies or other branches of government, Ministries of Finance can be supportive of more robust disclosure requirements. Many governments already require climate disclosures from publicly traded private finance institutions, usually in line with the TCFD recommendations, and the ISSB is developing a set of global baseline sustainability standards for jurisdictions to adopt or implement. Mandatory disclosure guidelines can also include a requirement for an interim GHG target and climate transition plan, as the UK, Switzerland, and others are requiring for their largest institutions.[48]

Ministries of Finance could also work with other relevant regulatory agencies and international private sector initiatives to establish common and consistent disclosure practices across all sectors of the economy, generating the group-up data needed by many financial institutions to calculate their portfolio emissions. As an example, Ministries can work with the Net-Zero Data Public Utility's Climate Data (as discussed previously) Steering Committee, which is designed to include data on emissions and net-zero targets.[49]

[48] Transition Task Force, 2022

[49] Bloomberg Philanthropies, 2022

4. Conclusion

The landscape of private sector financial commitments is broad, lacks standardization, and is deeply impacted by the climate efforts taken—or not taken—by national governments. The key metrics discussed as indicators of credibility in Section 2 have the potential to unlock further action; government policy and regulatory development could set standards for credibility and accuracy across the private financial sector. It would also help align and support the current voluntary efforts being undertaken by private finance institutions to make and implement net zero commitments.

We have several recommendations for Ministries to take as a first step in supporting the creation and implementation of private sector net zero commitments and ensuring their credibility.

- Coordinate across government agencies to determine the appetite for focused efforts on the private financial sector, including determining which soft or regulatory powers are most implementable and useful within the country context.
- Engage with international initiatives, such as GFANZ, and actors engaged in supporting the broader climate information architecture, to help ensure that alliances' requirements and information available to report progress are implementable, clear, and decision useful.
- Support standardized, short-term interim targets to create the clear and comparable targets needed to assess credibility.
- Use a combination of soft and regulatory powers to increase the number of private financial institutions with commitments to net zero goals and the credibility of those commitments, in addition to leading by example through government action on climate. This can ensure the government and the private sector are working towards complementary goals.

Increasing government involvement could support the development of transparent, comparable, and credible commitments from private financial institutions and further support the transition to a low-emission and climate-resilient future.

This paper has discussed various soft and regulatory power methods to improve the understanding of commitments, progress, risks, and opportunities domestically, which can also be used to set expectations for best practices internationally. The potential government actions outlined function as both an incentive and as guidelines to encourage private financial institutions to consider climate action and climate-friendly investments. This enables Ministries to evaluate progress towards climate goals, support sustainable economic development, and monitor climate-related risks. Outside of the climate benefits of these actions, Ministries can also achieve some of their non-climate goals, including identifying and managing financial risks, mobilizing private investment through effective use of public finance, and providing economic stability, jobs, and energy security and independence.

This is a particularly relevant time for Ministries to engage with GFANZ and GFANZ members, non-members, and supporting institutions, such as industry associations, as these groups are engaged in outreach and data collection and are establishing their internal expectations around transition plans, sectoral pathways, and fossil fuel phaseouts. As seen in the case studies, achieving positive results from Ministry action to support net zero commitments and commitment credibility can take time. Ministries can represent both national interests and the perspectives of civil society and smaller financial institutions that may not have the capacity to communicate their needs to these alliances.

The Coalition of Finance Ministers for Climate Action

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