GREEN POLICIES

Long road to net-zero

With the UK government rolling back on a number of initiatives designed to combat climate change and reduce carbon emissions, what are the long-term implications for investors? What can the FS sector do to encourage engagement with initiatives that support net-zero ambitions?

Global efforts towards tackling the growing climate crisis are ongoing. 2023 is expected to have been the planet's hottest year on record . Last year's COP28 was hailed by many as a positive step forward in relation to increasing climate finance commitments and the phasing out of fossil fuels.

But, while the role of FIs remains pivotal, regions around the world are grappling with the political weaponisation of green policies. The potential consequences of sustainably-linked finance and sustainable investing may prove cause for concern.

With both the UK and the US in an election year, what impact might these seemingly growing 'culture wars' have on the sustainability commitments of FIs? How might the reversal of some net-zero policies affect vital investment decisions? Is the green policy 'tug of war' a real threat, or, instead, political smoke without fire?

A global climate conversation in the Middle East

The most recent COP, held in Dubai in November and December, saw 192 nations gather to discuss political and economic action aimed at lowering emissions and tackling the effects of climate change. The complex web of new pledges and targets make assessing the event's overall success tricky. But reaching a global consensus around the transition away from fossil fuels is being hailed by many as seminal. When considering some of the regional political tensions around climate policy, this can be understood as a significant achievement.

"Progress has been made," says Simon Thompson, Chief Executive, Chartered Banker Institute. "Particularly in terms of including the transition away from fossil fuels in the final agreement. And while the language is not as strong as some people wanted, it is stronger than some oil-producing countries wanted. I think this COP is a significant moment.

"But of course, huge questions still exist. What is the timescale for the transition? Is it in line with the 1.5°C or 2°C objectives of the [2015] Paris Agreement? Are we going to see progress on reducing methane emissions quickly?"

Alongside these questions, very real criticism also exists around COP28. The choice to host the summit in the UAE was a concern – the country is one of the world's leading petrostates, and the COP28 president, Sultan Al Jaber, is also the head of the national oil company. Moreover, compromises within the fossil-fuel conversation were troubling for many who hoped for an agreement to 'phase out' the fuel entirely.

"There were lots of issues that came out of COP, finance being, of course, major. I think around $90bn worth of pledges were made, bringing in big investors such as BlackRock, TPG, and Brookfield. These are big names in the investment community and shouldn't be sniffed at," says Michael Wilkins, Executive Director, Centre for Climate Finance and Investment at Imperial College Business School.

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"But at the same time, it's important to step back and think about what has happened previously. Between 2013 and 2020, only 50% of pledges made at a COP have actually been implemented. That is a truly alarming statistic when you think about it."

However, despite these concerns, when it comes to the role of the COP summits in the global political conversation, there's no denying the events' prevalence. Positive analyses of the 2023 gathering praised the success of climate diplomacy, citing agreements between America and China ahead of the summit as important – while a long-sought loss and damage fund was approved by wealthy countries, committing more than $400m on the first day.

"These COP events are the political nexus for all conversation around climate change," says Charlie Kronick, Senior Programme Advisor, Greenpeace UK. "As a result, they attract the interest of nearly everybody in the world with any interest in the global economy. The signals that come out of a meeting like this are hugely important for the energy industry, for the finance industry, for pretty much everybody who's got a dog in the fight."

A cultural war on climate?

In September 2023, UK Prime Minister Rishi Sunak announced a rolling back or reversal of several climate-related policies. This included a five-year delay to the ban of new petrol and diesel cars, a watering-down of the phase-out of gas boilers, and an attack on several phantom 'green' Labour policies. Two weeks prior, Germany pushed a proposal for green home-heating rules far into the future. France has seen large protests against high fuel prices and both countries have seen a rise in far-right political parties peddling anti-green rhetoric.

And of course, in America, climate change is a key Republican/ Democratic battleground. With an election looming, Republican candidate Donald Trump has been one of the planet's most outspoken anti-climate politicians. If Trump is re-elected, it is expected he will once again pull the US out of the Paris Agreement. Research shows Democrats and Republicans have grown further apart over the past decade in their assessment of the threat posed by climate change. Nine out of 10 Democrats believe the US should prioritise developing alternative energy sources, compared with 42% of Republicans.

Back in the UK, *The Guardian* suggests that,"attempts to create divisions over the climate contrast sharply with the last general election, in December 2019, when all major parties had commitments to the target of net-zero greenhouse gas emissions by 2050. The main point of contention in their manifestos was over which could cut carbon fastest".

How much of a threat does this political backlash against climate-related policies pose on climate finance and overall progress towards net-zero?

"There is no doubt that these 'culture wars' – as a shorthand way of describing the situation – are real. Key voices within political parties – particularly notable being the Conservative Party in the UK, but the Republican Party in the US as well – are weaponising cost-of living-pressures, and instability in geopolitics," says Kronick.

Wilkins adds: "It is difficult to tell exactly how much of a threat this 'culture war' really is. It is definitely right to say that climate policies are being used as political weapons. If this continues to be turned into a political football, we are in danger of continuing down the path we're on – and there will be severe climatic impacts as a result. But it is important not to be completely taken in by the big political headlines. There's often more going on under the surface."

Thompson agrees: "Of course, some of the rolling back of targets isn't helpful. But it does seem to be aimed more at short-term political gain, rather than making enormous changes. It is frustrating to see things like gas licences being awarded, when we know that the science tells us that gas reserves need to stay in the ground. But it is still a very small part of the story – even in terms of the UK emissions, let alone global emissions."

In search of certainty

One area that remains a cause for concern is the impact this policy to-ing and fro-ing may have on sustainable investment decisions.

"I do think that deterring investors is a potential problem," says Kronick. "If we compare the UK and the US for example, the US's Inflation Reduction Act is having a real stimulus impact. The EU is trying to do something similar. But the UK has basically stopped doing anything. I think this is a missed opportunity."

Wilkins agrees: "In the UK, we have a Conservative government that is sending unbelievably mixed signals to both the fossil fuel industry and to investors. It wouldn't be surprising if an investor thought, 'I'd rather just go to the US where the Inflation Reduction Act is making billions of dollars available' – and redirecting investment away from countries like the UK.

"We have a policy mess in the UK that is not going to encourage the right kind of investment at the pace that it is needed. It's hugely discouraging and it is hugely damaging – there's no question about it. This kind of flip-flopping is going to deter market investors who can go and seek out a million other opportunities in more stable environments. There's going to be more money made in the next 50 years from energy efficiency than we could possibly imagine from fossil fuels."

Thompson adds: "For a successful transition, we need policy certainty. Whether it's over dates, whether it's over subsidies, or other forms of sort of tax relief, if a government's constantly changing its mind and introducing something, then taking something away, moving dates forward or back, then it becomes very hard for businesses, individuals and FIs to plan. And one thing we know is that the transition requires substantial amounts of longer-term capital, which needs a larger degree of policy and legislative stability. When we don't have that, it gets harder to unlock the sustainable finance we need to make sure the transition happens."

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Encouraging signs

So, looking forward, what role will FIs play in the transition to renewable energy and a net-zero economy? Can the world's largest firms override the political tensions around climate policy? And what steps are necessary to continue to propel the transition forward?

"If you think about Western democracies, I think FIs individually and collectively ought to show leadership," says Thompson. "Banks have access to hundreds of thousands, if not millions, of customers, and tens of thousands of colleagues, and thousands of suppliers. This means there is a lot we can do when it comes to educating about the importance of net zero etc.

"FIs are lucky that we have access to policymakers and politicians at very senior levels. And we should be using that sort of access to make a strong case for net zero. But maybe it's less around making the scientific and the environmental case important, though, because that may not change the minds of some in the current political climate.

"Maybe it's about making the case on the basis of energy security or national security, on creating jobs and avoiding some of the long-term risks of stranded assets and being caught on the wrong side of the transition. Perhaps it is more geopolitical, economic arguments that we ought to be making."

In light of this, there are some encouraging signs. Alongside the seeming progress made by the Inflation Reduction Act, nearly a quarter of emissions are now subject to carbon pricing; China – the world's biggest emitter – is investing significantly in solar and wind; both Brazil and Australia have voted out anti-green leaders; and, according to the London School of Economics, there are many parts of the economy where clean energy is already cheaper than the damaging alternatives. However, global cooperation and political regulation remain critical.

"Big FIs, whether they're lenders or asset managers or even insurers, will follow the signals that the market is given by the regulator. Of course, they will lobby in favour of the lightest-touch regulation, but the reality is, they will adapt to whatever the market requires," says Kronick.

"What we really need, in the UK specifically, is a strong signal from both the Treasury and the regulator at the Bank of England that shows there is going to be a requirement that portfolios, whether lending portfolios or credit portfolios, are going to have to be aligned with the goals of the Paris Agreement."

Wilkins adds: "FIs are absolutely pivotal. Achieving net-zero targets depends on finance moving in the right direction. But banks, insurance companies and institutional investors need to be incentivised to finance the path to transition.

"I think banks are currently positioning themselves – largely – in the right way. There are some exceptions, but they are moving in the right direction. There is lots of behind-the-scenes work going on.

"I think the kind of changes we need are already in motion, but it is more a question of pace now. Making climate disclosure mandatory is key, and already it's being seen less as a burden and more accepted as a part of what banks need to do for their regulatory compliance commitments.

"The question used to be what more needs to be done, but now I think it is more [a case of] what needs to be done faster." CB

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