Financial Services Leadership Network

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FSLN VIEWPOINTS

Addressing challenges in financing climate transition

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Large financial institutions remain committed to achieving climate goals and mobilizing more capital to finance decarbonization efforts. However, they face political, technological, and investment barriers—many of which are outside their control—to reaching their objectives and scaling sustainable finance. Ultimately, most leaders say that policy must lead the way to enable more private investment.

On October 15 and 16 in New York and on October 29 in London, board directors and senior executives from leading financial institutions gathered to discuss how approaches to climate transition and sustainable finance are evolving, given competing pressures and priorities, and the steps needed to accelerate progress. Participants also discussed emerging AI applications and the broader oversight of tech transformation; a companion *ViewPoints* focusing on that topic is available here.

For a list of participants, please see page 10.

This *ViewPoints*[1] explores the following key topics that emerged from these meetings and related conversations:

What is impeding efforts to finance climate transition?

How can capital be mobilized at scale to transition to a low-carbon economy?

EY Building a better working world

What is impeding efforts to finance climate transition?

The formation of the Glasgow Financial Alliance for Net Zero at the 2021 UN Climate Change Conference saw financial services placed at the center of discussions about climate-transition efforts. Many financial institutions established emission-reduction targets and set goals to achieve net-zero emissions. One participant referred to this as the *"hype peak"* for sustainable finance, as *"everyone rushed to be a part of the movement."*

In the years since, progress toward shared goals across advanced economies has been limited. Many financial institutions have left these alliances frustrated by shifting mandates or nervous about legal and political challenges. Others point to exogenous factors inhibiting their ability to achieve commitments. A recent study by the European Central Bank, the Massachusetts Institute of Technology, and Columbia School of Business concluded that commercial banks' net-zero pledges have not significantly reduced their lending to carbon-intensive industries or increased financing for renewable-energy projects.[2] A participant stated, *"None of us will likely meet our targets. Is that transition risk? No, it's reputation risk."*

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—Participant

The need for financing models to support decarbonization efforts is clear, but as an executive said, *"It's always easier said than done. Everyone says 'Oh, we didn't know how hard it would be!' Of course, it's really hard and of course there will be serious roadblocks."*

Energy demand is growing, with continued dependence on fossil fuels

Despite growing support for the need for climate action, carbon emissions have continued to increase over the last decade, reaching record levels of 37.4 billion metric tons in 2023.[3] Fossil fuels still accounted for over 80% of global primary energy consumption in 2023, despite the expansion of green energy technologies.[4]

Artificial intelligence (AI) and other technology advances are driving increased energy demand: Goldman Sachs Research estimates that data-center power demand will grow 160% by 2030, potentially doubling the carbon dioxide emissions of data centers between 2022 and 2030.[5] The question, according to one participant, is *"Will AI be able to solve the problem that is AI?"* While some participants were skeptical of that, another sounded an optimistic tone: *"Historically, we tend to be better at*

controlling our energy use than we think we will be. And AI is creating a demand pull that will hasten development of clean and renewable energy."

Geopolitics and domestic politics are challenging government leadership

Climate action has become a divisive issue in global politics. Not only is a lack of proactive policy slowing transition finance but, in some cases, political forces are actively working against efforts to finance decarbonization. Donald Trump's re-election in the United States could lead to a rise in US demand for oil and gas, and the withdrawal of the US from the Paris climate treaty.[6] In Europe, the success of right-leaning political parties in elections both to the EU Parliament and within various member countries have the potential to slow the adoption of climate policies.[7] Opponents of coordinated efforts to address climate change have used state laws and threats of potential antitrust violations or breaches of fiduciary duty to challenge financial institutions in many US states, prompting further departures from groups like the Glasgow Financial Alliance for Net Zero and Climate Action 100+.[8] This is limiting financial institutions' ability to coordinate their efforts: *"We are somewhat restricted from working with our peers now,"* reported one participant, while another said, *"Antitrust issues in the US have stopped us talking to each other."*

"AI is creating a demand pull that will hasten development of clean and renewable energy."

—Executive

Government policies, whether mandates about renewable energy usage, financial incentives, or direct investments in climate transition, require significant political will. In democratic societies, shifting political winds and a lack of public consensus can be debilitating. *"Government policy and consistency of government policy is important, if not the most important factor. I'd like to see a government of any color maintain that consistency, but a lot of this is political suicide, so it won't happen,"* said one participant.

Even if a government can push through significant climate policy, it may not survive the next election cycle. As one director observed, *"Things may not be left the way they are by the next government unless it remains the political flavor of the day, so you need new approaches that are immune to politics or it is not sustainable. We cannot sustain things for long periods of time in democracies."* Participants contrasted these challenges with some of the progress on renewable energy emerging from centrally planned economies: *"Look at China and Saudi [Arabia]. There are some interesting green shoots there,"* noted one participant.

Another said, *"China has a 15-year head start."* The largest markets will have to lead, but cooperation remains challenged by geopolitics. *"The United States, European Union, and China will solve this; the rest of the world will then adopt what's developed by them,"* a participant said.

Green projects often require financing that is misaligned with traditional investment vehicles

Many green projects are risky, with high upfront costs and long payback periods. An executive said, *"I can see the challenges incumbents are facing with return expectations that don't match long-term requirements for investors."* Even well-intentioned financial institutions are limited by their responsibility to customers and investors. A participant observed, *"Pension funds will never say, 'I will take the discount to get it done' because they have a fiduciary duty."*

Aligning different forms of financing along the capital stack is complex for large-scale infrastructure and energy projects. At the early stages of many green projects, they rarely fit the model for traditional venture capital but have a risk profile that is too high for other forms of early-stage financing. *"Financing big green investments, like infrastructure and energy, requires alignment of risk appetite along the value chain—but it is tech and infrastructure colliding. We don't have great avenues for financing infrastructure projects with technology risk,"* explained one executive. And large financial institutions generally do not invest in early-stage clean technology companies and projects: *"There is lots of venture capital in clean tech, but we are in the pre-revenue-generating phase. There are very few opportunities for banks."* Another executive said, *"We are monitoring 14 projects across Europe; only two are bankable."*

"We are monitoring 14 projects across Europe; only two are bankable."

—Executive

How can capital be mobilized at scale to transition to a low-carbon economy?

Despite waning momentum and some real obstacles, there have been significant investments and some progress toward energy transition. *"Pessimism sounds smart, but optimism makes money,"* stated one executive. Another observed, *"There have been some positive signs. Look at the rate of renewable installations globally. It's 50% more than in 2023. There has been a slowdown in electric vehicle [EV] growth, but in Q1 of 2024, EV sales were 25% higher than the year before."* Another executive noted that *"$1.8 trillion was invested in the clean-energy transition in 2023,"* but *"that needs to double to hit emissions-reduction*

goals." According to some estimates, achieving net-zero goals by 2050 will require an estimated $300 trillion of investment, with an expected 70% financing coming from private markets.[9] Ultimately, small victories are insufficient to the task. *"Energy transformation will likely be the largest capital event the world has seen,"* said one participant.

Financial institutions are keen to take advantage of potential opportunities. One participant said, *"To financial services, it looks like an opportunity; to others, it looks like a cost. But the cost of climate change will be greater than the cost of transitioning. It is just that the costs will be borne by different people."* One executive put bluntly: *"Think about climate change as one of the world's great wealth destruction events."*

Government action is essential to driving the transition

Supportive government policies and actions are crucial to mobilizing more capital to support major energy-transition projects. As several participants noted, the *"finance-centric theory of change"* whereby financial services is viewed as the primary transition mechanism for the broader economy, is proving ineffective. *"We are just one piece of the puzzle. Government, policy, investments, and technology—if all that stuff doesn't happen, what we are doing will not work,"* an executive asserted. Another participant said, *"Governments will have to pay one way or another: either for the effects of climate change or to transition our energy sources, etcetera."*

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—Executive

Creating needed incentives

Tax incentives and related government initiatives can play an important role in attracting private investment. A participant highlighted the positive effect of the Inflation Reduction Act (IRA) in the US, noting, *"The IRA and the Infrastructure Investment and Jobs Act have collectively provided $900 billion in support over the past two years. Due to tax credits, there are more clean power projects in the pipeline waiting to be connected to the grid than power being generated in the United States."* Participants in other markets see the IRA as policy to be emulated: *"Our policies are far behind the US. We need something like the IRA,"* one executive said.

Supporting infrastructure investment

In many developed markets, *"infrastructure is dated,"* one participant said. *"It needs upgrading, but not in the ways we have done in the past.*

This will require a new way of acquiring capital. There are some projects that require tax incentives and offtake agreements because they don't create cash flows while being built. Government support can provide cash flow during the construction process, and then they're standalone and viable once construction is finished."

Improving consistency and harmonization of regulation and reporting

By one estimate, there are now 54 different sustainable finance taxonomies globally.[10] Regulation is equally uneven and inconsistent. *"Regulation and reporting taxonomies in the UK are different from what you have in the US, which is different from what you have in Singapore."*

A participant said that *"disclosures and taxonomy are now an important driver of change"* and suggested there was room for additional clarity regarding the definition of *"sustainable finance"* to avoid greenwashing. The European Union has arguably taken the lead on regulatory policy through the EU Taxonomy for Sustainable Activities, the European Green Deal, and the Corporate Sustainability Reporting Directive (CSRD). The CSRD introduced a mandatory framework for sustainability reporting that requires companies to disclose financial risks from climate change as well as environmental and societal impacts, thereby providing transparency and trust in sustainability data that can help inform sustainable financing activities. One participant described the CSRD as *a "game changer,"* emphasizing that *"it is different from past voluntary disclosures."*

Progress will require innovative financing solutions to attract capital and de-risk investment

Governments can help derisk these investments if they can provide first-loss capital. A participant noted, *"We are not just talking about risk capital—we need loss capital. It's capital that we have to assume will not come back."* This initial funding has come from philanthropic investment in some cases but will necessarily come from governments if the scale required is to be achieved.

> *"We are not just talking about risk capital—we need loss capital."*
>
> —Director

The private sector will also need to be creative in order to build financing structures for transition finance. A director said, *"We are trying to solve a problem with tools that aren't up to the task. To change the outcome, we need to change the cost of capital."* Another executive said, *"Regulators have asked me to list the new financial products*

needed to finance the transition, and my answer is zero. We have all the financial products we need; what we need are new financial structures."

One participant emphasized the need for *"collaborative finance"*—not just *"blended finance"*—to *"create the right type of capital mix and transition between different types of capital providers as companies grow and evolve."* Even within the confines of existing structures, one participant encouraged new thinking: *"It is difficult when things operate outside the bank's risk tolerance or risk frameworks, but even within these, there is so much more we can do: new ways to look at risks, new ways to underwrite, new business models."* This participant continued, *"Legislation has created the opportunity for pools of capital to enter and allowed us to create more innovative capital stacks. You have philanthropic funds that come in first; then you get into the family office space, which is mission and purpose driven; third layer is federal loans and grants; then some of the tax credits leads you into the venture climate space, then private equity; and then large joint ventures that can then access traditional capital models and raise equity. Being able to stitch these together with the overlay of government incentives can be powerful."*

"We have all the financial products we need; what we need are new financial structures."

—Executive

Still, some participants see a long road ahead. When one participant asked, *"How long before these kinds of investments are self-sustaining, where they no longer rely on green incentives?"* participants estimated most were still five to 10 years away.

Financial institutions should maintain focus on addressing client needs

A bank executive observed, *"If we look at where progress is being made, it comes down to what the banks are good at: engaging with clients. It would be easy to decarbonize the bank—we would just have to shrink the balance sheet by not doing business with some clients—but that would not solve the problem."* Another said, *"We have to solve problems for our clients, take the signals from them."*

One participant highlighted four things financial institutions need:

- **Insights.** *"Do we know what's really going on in the space, where decarbonization is happening?"*
- **Talent.** *"You need the right people doing the right things."*
- **Risk frameworks and tolerances.** *"We need new asset classes,*

new ways to look at risk, and do things we've never done before."

- **Products.** *"We need to develop the right products to align with market needs."*

Changes outside the financial system will continue to shape opportunities for sustainable investments

In addition to innovative financial structures and supportive government actions, participants noted that there are a range of developments in the real economy that can drive demand for transition finance and create investment opportunities for large financial institutions. One participant observed, *"You don't have projects sitting on sidelines waiting for capital. There isn't enough demand."*

Participants identified a series of exogenous developments that will affect green investment opportunities:

- **Advancements in renewable energy.** While significant advancements have been made in wind and solar energy, further technological advancements are required to enable a more reliable energy supply. A participant acknowledged, *"We can't get to our goal with renewables the way they stand today. We have to look at new projects."* Developments like smart grids and improved battery energy storage systems are crucial.
- **Expansion of nuclear energy.** The use of nuclear energy is likely to expand, at least in the near term. *"Small modular nuclear—lots of people think that's the answer,"* predicted one participant. Google and Microsoft have both recently made significant commitments to long-term renewable-energy sourcing.[11] At New York Climate Week, 14 financial institutions, including Bank of America, Morgan Stanley and Goldman Sachs, demonstrated support for a COP28 initiative to triple global nuclear energy capacity by 2050.[12] One executive reported, *"Demand for things like nuclear is going to grow. The question is, How orderly can we make it and how much are we able to lean into the opportunity?"* While nuclear energy has started to gain support, one executive advised, *"Let's remember that nuclear is not clean, just low carbon. I don't see a future where it pushes all renewables to the side, but we're getting better at using nuclear more efficiently."* Despite the renewed focus on nuclear, a participant noted, *"There is nothing happening today in terms of private financing for nuclear energy."*

"We can't get to our goal with renewables the way they stand today. We have to look at new projects."

—Executive

"Demand for things like nuclear is going to grow. The question is, How orderly can we make it and how much are we able to lean into the opportunity?"

—Executive

- **Developing needed skills and capabilities.** An EY executive said, *"[There is a need for] knowledge and skills. We need 2,300 electrical engineers to invest in energy transition. We have a fundamental problem of a talent and skills gap, so how do you invest in and build talent? You can invest and have the financing, but if the talent isn't there, that is an issue."* More broadly, developed economies, where the manufacturing base has eroded over the last several decades, will require the development of new capabilities. *"It's been a long time since we financed industrialization in the US, and we have lost practice. Putting steel and cement in the ground isn't something we are that great at anymore,"* observed one participant.

"It's been a long time since we financed industrialization in the US, and we have lost practice."

—Executive

- **Encouraging systemic shifts in consumer behavior.** An executive suggested, *"If demand for oil remains high, there will be continued reliance on fossil fuels. A big part of achieving this goal is changing consumer preferences."* Another executive agreed, *"How can we shift consumer behavior? If it doesn't shift, none of this is going to work."* Recent extreme weather events—hurricanes in the US, extreme heat and flooding in Europe, wildfires in Canada—could help to shift public sentiment.
- **Addressing supply-chain risks from geopolitical tensions.** One participant observed, *"China is really taking off. We need to develop our own tech so we can export it."* Diversifying supply chains and international cooperation is essential to tackle the global crisis of climate change, especially given China's dominance in certain raw materials needed for sustainable energy technologies. *"You can't avoid relying on China to be a significant part of the transition,"* a participant said.

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Many experts say the most recent climate finance agreements emerging from the 2024 UN Climate Change Conference in Baku, Azerbaijan, are too little, too late. One group of researchers insists it is "necessary to mobilize climate finance now—starting at full scale in 2025—not 'by 2035.'"[13] One summit participant suggested that even as government action is required, a leadership role remains for financial institutions in driving this investment: *"Ideally, climate finance should be blessed by government but led by financial institutions so that they can work at that nexus between public and private. We have the expertise."*

Meeting participants

The following individuals participated in the meetings or related conversations:

Participants

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The Financial Services Leadership Network (FSLN) is a group of financial services board members, executives, and stakeholders, together with other subject matter experts committed to addressing pressing problems and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive ViewPoints are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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Endnotes

[1] *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby comments are not attributed to individuals or corporations. Quotations in italics are drawn from conversations with participants in connection with the meeting.

[2] Anita Hawser, "EBRD's Climate Head Questions Utility of Net Zero Bank Targets," *Banker*, May 17, 2024.

[3] "Emissions Grew in 2023, but Clean Energy Is Limiting the Growth," IEA, accessed Dec. 9, 2024.

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[5] "AI Is Poised to Drive 160% Increase in Data Center Power Demand," Goldman Sachs, May 14, 2024.

[6] Rebecca Elliott, "Exxon Chief to Trump: Don't Withdraw from Paris Climate Deal," *New York Times*, November 12, 2024.

[7] Kate Abnett, "EU Climate Policies Could Be Slowed in Future after Rightward shift in Election," *Reuters*, June 10, 2024.

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[9] Kristen McDuffy, Vikas Agrawal, and Christian Schaefer, "Private Credit: Funding the Climate Transition," Goldman Sachs Asset Management, October 21, 2024.

[10] Joshua Joseph Pangelinan and Adriana Bazán Fuster, "The Next Wave: Global Trends in Sustainable Finance Taxonomies," CCAP Blog, September 9, 2024.

[11] Rafael Mariano Grossi, "Meeting Global Climate Goals Requires a Step Change in Nuclear Investment," World Economic Forum, November 8, 2024.

[12] Lee Harris and Malcolm Moore, "World's Biggest Banks Pledge Support for Nuclear Power," *Financial Times*, September 22, 2024.

[13] Martin Wolf, "Climate Change Is a Global Problem—it Requires a Global Solution," *Financial Times*, November 26, 2024.