Principles for Responsible Investment

# PRI RESPONSE

## THE COALITION OF FINANCE MINISTERS FOR CLIMATE ACTION GLOBAL CONSULTATION: STRENGTHENING THE ROLE OF FINANCE MINISTERS IN DRIVING CLIMATE ACTION

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# ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to The Coalition of Finance Ministers for Climate Action call for feedback on strengthening the role of finance ministers in driving climate action.

# ABOUT THIS CONSULTATION

At COP27, the Coalition of Finance Ministers for Climate Action agreed to launch a global public consultation on the role of Ministries of Finance in driving climate action, in recognition that they possess the critical tools to do this – through economic, fiscal, and financial policies – but are not being sufficiently utilised. In December 2022, the Coalition published *A Framework and Guide for Ministers and Ministries of Finance* to provide a comprehensive “menu of options” to help Ministries of Finance mainstream climate action within their core functions and capabilities.

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# KEY RECOMMENDATIONS

The PRI welcomes the work of the Coalition of Finance Ministers for Climate Action in strengthening the role of Ministries of Finance in driving climate action, particularly in assessing the Ministers' mandate, action areas, current challenges, and opportunities to do more. Adapting financial regulatory frameworks, financial policy and other policy levers (e.g. macroeconomic strategy and fiscal policies/budget) to support the goals of the Paris Agreement, to which all Coalition member governments have committed, and broader sustainability goals, is instrumental in achieving the mandates of ensuring financial stability, economic growth and societal prosperity that all finance ministers share. We particularly welcome the following:

- The framing of the three core functions (macroeconomic strategy and vision, fiscal policies and the budget, financing the transition) of Ministries of Finance and identification of barriers and opportunities for climate action; and the need for a whole-of-government approach to solve the complex challenge of climate action.
- The recognition that tackling the climate crisis, staying the course on the implementation of robust climate policies, and avoiding the worst of its impacts are in line with Ministries of Finance's pro-growth, inflation reducing agenda. The manifestation of climate change-induced physical risks and the risk of a disorderly transition are causing irreversible impacts on society and the environment, and destabilising effects on the financial system. The net zero transition provides opportunities to build the industries of the future, support sustainable development and prosperity. More ambitious and swift climate action will help, and not hurt, the primary objectives of Ministries of Finance.
- The acknowledgement that Finance Ministers have a vital role in closing the delivery gap through macroeconomic strategy, fiscal policies and the power of the budget, and market regulation. While progress has been made on all three areas, limiting warming to 1.5c requires Ministries of Finance to accelerate implementation.

We further recommend:

- The Coalition to broaden the findings of the report to incorporate considerations on nature and ensure that climate-biodiversity synergies[1] are taken advantage of, and trade-offs are better managed. Climate and nature are inextricably linked: sectors associated with land use (a key driver of biodiversity loss) are responsible for 13-20% of global emissions and a 1.5c pathway is not possible without ending deforestation globally.
- Ministries of Finance to implement market-friendly and stable policies that will enable and attract private capital and create investable business models that are aligned with sustainability goals. Over 550 financial institutions, including many of PRI's signatories, have committed to align capital with the achievement of net zero by 2050 under various net zero alliances.[2] Net

[1] This includes, at minimum embedding the "do not significant harm" criteria to biodiversity, with the explicit expectation that move rapidly to aligning financial flows with the gaols and targets of the Kunming-Montreal Global Biodiversity Framework: https://www.cbd.int/article/cop15-final-text-kunming-montreal-gbf-221222

[2] This includes Net Zero Asset Owners Alliance, Net Zero Asset Managers Initiative, Net Zero Financial Service Providers Alliance, Net Zero Investment Consultants Initiative, Net Zero Banking Alliance, Net Zero Insurance Alliance and Paris Aligned Investment Initiative. The Glasgow Financial Alliance for Net Zero (GFANZ) provides a strategic forum for bringing these alliances together.

zero-committed investors want to work with Treasuries and government departments more broadly to support sustainable economic growth.[3] Indeed, many of the net zero commitments are made in the expectation that governments will follow through on their own commitments to ensure the objectives of the Paris Agreement are met, including increasing the ambition of their Nationally Determined Contributions.[4]

- Finance ministers undertake a comprehensive series of financial policy reforms that align the rules that guide financial institutions and corporations with achieving a just transition to 1.5c, halting and reversing nature loss, and achieving the Sustainable Development Goals (SDGs). Sustainable, net zero-aligned financial systems are the lynchpin for the net zero transition.
- Governments more broadly develop a high-level, overarching economic policy that integrates transition planning across all government entities, including Finance Ministries, in order to support a whole-of-government economic transition in an effective, ambitious and inclusive way.

[3] For example, the Assessing Sovereign Climate-related Opportunities and Risks (ASCOR) Project has been established to allow investors to assess governments' climate-related commitments, their policy frameworks (including carbon pricing, energy subsidies, the phase-out of combustion vehicles, deforestation and land use policies) and the actions they are taking to ensure that the benefits of the low-carbon transition and of adaptation are shared among their citizens: https://www.unpri.org/ascor-project/the-ascor-project-progress-report/10120.article

[4] For example, see Net Zero Asset Managers commitments: https://www.netzeroassetmanagers.org/commitment/

# DETAILED RESPONSE

## QUESTION 1: WHAT ROLE SHOULD MINISTRIES OF FINANCE PLAY IN DRIVING CLIMATE ACTION? ARE THEIR MANDATES AND ROLES SUFFICIENTLY WELL DEFINED?

All Finance Ministers broadly share a mandate to ensure the resilience and sustainability of the financial system. Ministries of Finance also have a responsibility to bridge widening disconnect between national climate ambitions and the financial policies, tools and resources needed for their implementation.

However, Finance Ministers do not necessarily carry an explicit mandate to enable or drive the economy-wide transformation that is needed for a socially just, ambitious and swift transition to net zero, aligned with global sustainability goals and principles. Reviewing and updating historical mandates (while considering the variability of this process amongst countries) is essential to equip economies and the financial sector with the necessary direction, tools and guidance to respond to present economic, social and environmental challenges.

Finance Ministers should acknowledge the role that financial systems play to support the governments' goals to reach net zero and ensure an orderly, effective, and inclusive transition. To enable this, the mandate of Finance Ministers should be revised to include the following:

1. **Undertake a comprehensive series of financial policy reforms that would serve to align the rules that guide financial institutions and corporations with achieving a just transition to 1.5c, "do no significant harm" to biodiversity, and supporting Sustainable Development Goals (SDGs), more broadly.[5] Priority measures include:**
    - Mandate corporate environmental, social, and governance (ESG) disclosures in alignment with global standards as developed by the International Sustainability Standards Board (ISSB), which include the climate recommendations and updated guidance of the Taskforce on Climate-related Finance Disclosures (TCFD) and credible Climate Actions Plans, which set out near term actions companies and financial institutions can take to mitigate and adapt to climate change.[6]
    - Codify active ownership[7] for investors to support corporate transitions towards net zero and maximize the overall long-term value on which returns, and clients' and beneficiaries' interests, depend.
    - Clarify investor fiduciary duties to incorporate ESG-related considerations in their investment decision making, to provide sustainability-related disclosures and to report on their ESG incorporation policies and sustainability performance targets.

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[5] For more, please see PRI's recommendations for G7 and G20 governments on committing to policy reforms that align financial regulatory frameworks with sustainability goals, and embed sustainable finance discussions at the core of the finance ministers meetings: https://www.unpri.org/policy/sustainable-finance-policy-the-role-of-g7-and-g20/8646.article

[6] For more, please see The Investor Agenda Climate Action Plans (ICAPs) Expectations Ladder and Guidance, which offers insight on the key climate actions that investors can take to accelerate the climate transition, including investment, corporate engagement, policy advocacy and investor disclosure: https://theinvestoragenda.org/icaps/

[7] For more, please see PRI's framework on Active Ownership 2.0, highlighting the need for more ambitious stewardship to deliver against beneficiaries' interests and improve the sustainability and resilience of the financial system: https://www.unpri.org/investment-tools/stewardship/active-ownership-20

- Implement science-based taxonomies of sustainable economic activities, defining common and clear criteria to classify projects or investments as green or sustainable.

2. **Enhance their climate action across government departments by working with other line ministries and actors across functional areas, supporting them through the power of the budget and enabling financial policies.** Not only is there the urgent need of greening finance, but Finance Ministers can also use their convening power to "finance green." This includes setting out a comprehensive plan of how Ministries of Finance will deliver finance for the transition across the whole economy, harnessing all the economic policy levers at the government's disposal. Foundational to this is to commit to integrating climate change and social impacts of the transition into the country's economic management and public finance and channelling public investment to key sectors across the economy that would support the transition.

3. **Create an enabling fiscal policy framework to accelerate green economic/industrial transformation and reorient private investment.** While industrial policy rarely falls at the helm of Ministries of Finance, they can still encourage the development of such policies, using fiscal policy to encourage sunrise industries (and correct price distortion around sunset industries), ensure financial transparency and policy clarity, and coordinate with private sector to overcome bottlenecks and improve policy results.

4. **At a multilateral level, Finance Ministers can leverage their shareholding position and political capital to call for policy reforms, deliver implementation guidance, and influence funding decisions on sustainable finance and real economy policies to multilateral organisations, such as the OECD and IMF.** Through a whole-of-government approach, multilateral organisations involved in financial policy should provide detailed recommendations on policies and levers to align economies with net zero carbon emissions. This work should aim to break existing silos between financial and real economy policies and propose concrete actions for key sectoral policy reforms, and could include, for example, an action plan for Paris-aligned infrastructure investment.

## QUESTION 2: WHAT STEPS IN THE 15 ACTION AREAS AND BEYOND OUTLINED IN PART C OF THIS REPORT ARE THE MOST CRITICAL TO ACHIEVING PROGRESS? ARE THERE ANY MISSING?

The 15 action areas set out in Part C comprehensively outline actionable steps for Ministers and Ministries of Finance. Within it, the PRI identifies the following as the most critical in achieving progress:

- **Integrating climate action into national growth and development strategies.**

Until recently, the world has not faced overarching goals of a similar level of challenge as net zero and limit warming to 1.5c. The escalating impacts of the climate and nature crisis require Finance Ministers to adapt their work to the new goal-oriented market context and implement new and revised rules and regulatory frameworks conducive for an orderly and equitable transition. The challenges, opportunities, and commitment required of governments to reach net zero and limit warming to 1.5c are like nothing we have seen in recent economic history. Finance Ministers have a key role to contribute to and serve such commitment.

Making financial flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development requires foundational changes in public policy as a whole. Financial policies and regulations have played an important role in supporting the emergence and growth in sustainable investment practices. Despite this progress, current financial flows, and the business models that they support, are not yet consistent with a net zero, climate resilient development pathways that work for people and the planet.

A key reason is that, in most jurisdictions, public policy is not always designed to support a whole-of-economy transition to a more sustainable financial and economic system that is aligned with the Paris agreement.[8] It is clear that reorienting financial and business models will require governments to go beyond stand-alone issue-specific policies (e.g. climate and energy regulation) and sustainable finance policies. What will be needed are whole-of-government approaches that integrate transition planning across all government departments.

Clear, longer-term policy goals and outcomes, and policy designed to enable and incentivise long-term thinking, can provide more certainty for investors and companies to implement their net zero strategies. This will in turn support investors' confidence to allocate capital towards net zero. Policymaking should pay particular attention to areas where capital is required (and how this is to be incentivised) and activities that should be urgently transformed.

[8] For more, please see PRI's Policy Briefing on the road to COP26, providing recommendations for policymakers to support ambitious commitments and take decisive action across fiscal reforms, country-specific action (See our views on EU, US, China, Japan, France, UK), and financial policies: https://dwtyzx6upklss.cloudfront.net/Uploads/q/k/c/cop26policybriefingfinal20210427_385169.pdf

## QUESTION 3: HOW DO YOU VIEW THE USEFULNESS OF THE PROPOSED FRAMEWORK? WHAT ADDITIONAL EVIDENCE SHOULD BE CONSIDERED?

The proposed framework will benefit from the following additions:

**Function 1c. Shaping 21st century industrial and innovation strategies.** Public investment is critical for scaling sunrise sectors and supporting innovation, given their long-term and risky nature, and is useful in subsidising the cost of initial capital and unlocking private investment. Ministries of Finance should also remove market distortions and correct ineffective incentives, such as fossil fuel subsidies and unsustainable agricultural subsidies, which counteract measures like carbon pricing, just transition, or nature-based solutions. Therefore, it is critical that Ministries of Finance utilise a full suite of coherent policy packages, including fiscal policy measures, that address market failures and enable fiscal incentives and regulatory reforms that transform economic systems towards efficient, full-scale alignment with net zero.

**Function 1e. Identifying and developing bankable projects and programs.** Beyond allocating public finance to investment-ready projects, Ministries of Finance should also provide preparation support to projects that are not yet bankable. Blended finance is one of the most efficient instruments to de-risk investments in climate solutions – particularly in adaptation – in market segments that do not yet have the appropriate risk-return profile to attract large-scale institutional capital. Ministries of Finance can also provide cross-sectoral insights and cross-agency collaboration towards investment-readiness, as well as engagement with the financial sector.

**Function 2a. Transforming economic incentives through carbon pricing, subsidy reform and other fiscal policy measures.** Governmental carbon pricing is a necessary part of the climate policy toolkit required to achieve net-zero emissions and reach the Paris Agreement goals. Carbon pricing provides a broad incentive for decarbonisation, driving emissions reductions where they are most cost-effective. The UN-convened Net Zero Asset Owner Alliance has called on policymakers to implement ambitious and reliable carbon prices that (1) ensure appropriate coverage and ambition, (2) deliver a just transition, (3) provide a predictable price signal, (4) minimise competitive distortions, and (5) promote international cooperation.[9]

**Function 3. Reforming financial policy and the financial system to finance the transition at speed and scale.** Ministries of Finance can leverage their share and budget holder positions in publicly backed institutions for an effective, stable, and equitable transition, particularly for that of state-owned fossil fuel companies, and Sovereign Funds. Moreover, Ministries of Finance can work closely with central banks to drive investments in the economic transition towards net zero. Within this process, Ministries of Finance can also work with central banks and financial supervisors to address the income and regional inequalities generated by climate change, and other potential side effects of the transition to a sustainable economy. This includes, but is not limited to, employment creation, given it being at the heart of central bank policies, and a critical pillar of a just transition.[10]

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[9] For more, please see the five design principles from UN-convened Net-Zero Asset Owner Alliance *Position Paper on Governmental Carbon Pricing* (June 2022): https://www.unepfi.org/themes/net-zero-asset-owner-alliance-position-paper-on-governmental-carbon-pricing/

[10] LSE Grantham Institute *Supporting the just transition: a roadmap for central banks and financial supervisors* (December 2022): https://www.lse.ac.uk/granthaminstitute/publication/supporting-the-just-transition-a-roadmap-for-central-banks-and-financial-supervisors/#:~:text=The%20just%20transition%20is%20a,and%20resilience%20to%20physical%20shocks.

Finance Ministers and policymakers, as shareholders of the world's multilateral development banks (MDBs) and development finance institutions (DFIs), can also optimally incentivise and utilise blended finance approaches at scale. Urgent collaborative action is needed by all stakeholders to (1) scale the necessary investments in the short- and medium-term and (2) address the systemic and regulatory barriers. Members of the UN-convened Net Zero Asset Owner Alliance have called on policymakers, particularly Finance Ministers to undertake key actions that allow for collaboration with actors across the financial value chain to mobilise capital flows into climate solutions at the required scale and pace, especially into emerging markets and developing economies (EMDEs) to fund the net-zero transition.[11]

**Cross-cutting: Just transition to sustain public support and inform policy design.** The only feasible transition is one that is coupled with the broader aims for equitable social-economic development. The just transition sits at the intersection of the climate emergency and the need to ensure inclusive socio-economic development, as underpinned by the Paris Agreement and international human rights standards. While net zero commitments and climate actions are multiplying, they need to have strong social component from the get-go in order to mitigate (or remedy) the unintended social implications these commitments might bring. Ministries of Finance should work closely with line ministries to actively consider the positive and negative social impacts, as well as affected stakeholders, in decision-making processes.[12] This can be through the development of just transition plans and policies for all key sectors in the equitable transition to net zero.

[11] UN-convened Net-Zero Asset Owner Alliance *Call on Policymakers to Support Scaling Blended Finance* (September 2022): https://www.unepfi.org/wordpress/wp-content/uploads/2022/09/NZAOA_Scaling-Blended-Finance.pdf

[12] For more, please see the PRI co-signed letter calling G7 governments to action for a just, affordable, and urgent transition: https://dwtyzx6upklss.cloudfront.net/Uploads/z/x/u/friendsofg7_g20calltoaction_v2_530950.pdf

## QUESTION 4: WHAT ORGANIZATIONAL REFORMS ARE THE MOST IMPORTANT FOR STRENGTHENING THE CAPABILITY OF MINISTRIES OF FINANCE TO ACT ON CLIMATE? HOW SHOULD MINISTRIES PRIORITIZE THEIR EFFORTS?

Addressing cross-cutting issues like climate change and biodiversity loss and effecting the necessary whole-of-government solutions require Finance Ministries to work across all government departments.

Importantly, Finance Ministries do not operate in a vacuum, at either the national or global level. Domestically, a shift from a siloed approach to a whole-of-government approach is essential to confront the cross-cutting nature of climate change and biodiversity loss. This will have an impact on both the budget and governmental staffing structure and skills, so as to tackle institutional inertia.

It should be made clear by Ministries of Finance that the transition to a zero carbon, sustainable economy that works for the people and the planet is an explicit macroeconomic policy goal for the government. Finance Ministries can also enhance their coordination and collaboration with other public agencies, private sector, civil society, MDBs, global financial institutions, and other actors in mainstreaming climate action.

Ultimately, Ministries of Finance should call for the mandate of every institution within the international financial architecture, including national and supranational regulators and supervisors to be reviewed and updated towards one collective goal: catalyse and support the delivery of an orderly, stable, and equitable transition to the outcomes of the Paris Agreement and the Global Biodiversity Framework. Ministries of Finance should operate with the mission, vision, and strategy in full alignment with Article 2.1c of the Paris Agreement, *"making financial flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development"* as well as Goal D of the Global Biodiversity Framework, specifically "*aligning financial flows with the Kunming-Montreal Global Biodiversity Framework and the 2050 Vision for Biodiversity."* [13]

[13] CBD/COP/15/L.25 – Convention on Biological Diversity: https://www.cbd.int/doc/c/e6d3/cd1d/daf663719a03902a9b116c34/cop-15-l-25-en.pdf

## QUESTION 5: WHAT ARE THE KEY CHALLENGES THAT HOLD BACK PROGRESS BY MINISTRIES OF FINANCE? HOW CAN THESE BE OVERCOME?

Enacting a paradigm shift in financial system and aligning the mandate and activities of Finance Ministers to the Paris Agreement will require great collaborative vision, ambition and implementation within the Ministry and with other line ministries. In addition to the case studies provided in the Consultation, the PRI identifies the following challenges that are holding back progress by Ministries of Finance, many of which align with the diagnosis that the consultation document has provided:

- **Lack of overall alignment and incorporation of climate goals within the Finance Minister's mandate.** The ultimate goal of ensuring a stable, orderly, and equitable transition to net zero should be duly embedded in Finance Ministers' roles in governments' financial accountability, governance, and financial management frameworks. Ministries of Finance need to place climate and nature action at the heart of their national development and industry plans, and systematically engage in the process of formulating nationally determined contributions (NDCs), national adaptation plans (NAPs), low emission development strategies (LTSs), and national biodiversity strategies and action plans (NBSAPs).
- **Lack of cross-ministerial (and regulatory agency) coordination between Ministries of Finance and other line ministries on climate and environmental strategies.** Ministries of Finance and other line ministries and lead agencies should establish clear ways of working and responsibilities so as to ensure plans towards net zero are developed with their financing and investment plans in mind, thus closing the implementation gap. A coordinated delivery of near- and long-term plans towards net zero will represent the need of not just finance, but of all sectors and civil society (whose money and interests the financial system ultimately services). It will also harness the expertise and capital embedded in the private sector.
- **Lack of granularity and specificity in sector-neutral and sector-specific measures and targets.** Actions in the next five to ten years matter even more than mid-century net zero targets, both for the prospective of future limiting temperature rise, and for financial markets. Not only is near term accountability important to ensure plans are realistic, financeable, and useful for providing inputs into other strategies, it is also key for investors and companies with net zero plans. Clear and consistent policy direction galvanises investor confidence in setting clear targets for own activity and investment, lending and underwriting, and using stewardship and engagement to encourage ambition and delivery from corporates. It also strengthens finance mobilisation in innovation and breakthroughs, which creates more space for public and private sector action and delivery.
- **Lack of synergistic policymaking between climate and nature.** Humanity is facing a triple planetary crisis of climate change, biodiversity loss and pollution, impacting millions of people today, especially the most vulnerable, and future generations. We cannot reach net-zero without halting and reversing nature loss, and we cannot tackle biodiversity loss without tackling climate change. Coordinated action within government agencies to tackle climate change and halt and reverse biodiversity loss is needed to ensure synergies are taken advantage of, and trade-offs are better managed. A robust and interlinked policy framework would provide clarity in the alignment of financial flows towards joint climate and nature outcomes; support the assessment and disclosure of nature-related impacts and dependencies; provide clear targets and definitions to take action; and support the development of nature-positive projects and investments.

## QUESTION 6: WHAT KEY ACTIONS CAN THE COALITION OF FINANCE MINSTERS FOR CLIMATE ACTION TAKE TO MOST EFFECTIVELY SUPPORT ITS MEMBERS TO DELIVER ON THE AGENDA PROPOSED IN THIS GUIDE?

In addition to the recommendations provided for Question 1, Ministers of Finance can take the following step to ensure the alignment of public and private financial flows with the Paris agreement:

- **Embed the goals of Article 2.1c of the Paris Agreement into the work of Ministries of Finance.** The power of financial markets must be harnessed by putting delivery of the objectives of the Paris Agreement and the Global Biodiversity Framework at their heart. Doing so necessitates effecting a paradigm shift in the financial system, one that is guided by the "North Star", which is Article 2.1c of the Paris Agreement, which stipulates *"making financial flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development"* as well as Goal D of the Global Biodiversity Framework, specifically "*aligning financial flows with the Kunming-Montreal Global Biodiversity Framework and the 2050 Vision for Biodiversity."* [14]

*The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of The Coalition of Finance Ministers for Climate Action further to strengthen the role of Ministries of Finance in driving climate action globally.*

*Please send any questions or comments to policy@unpri.org.*

*More information on www.unpri.org*

[14] CBD/COP/15/L.25 – Convention on Biological Diversity: https://www.cbd.int/doc/c/e6d3/cd1d/daf663719a03902a9b116c34/cop-15-l-25-en.pdf