Mark Carney, UN Special Envoy for Climate Action and Finance, and Prime Minister's Finance Adviser for COP26

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Private Finance Priorities for COP 26

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Introduction

Lord Mayor, thank you for your hospitality and leadership.

In February, we met in a packed Guildhall to map the Road to Glasgow. Emboldened by Sir David Attenborough, we launched the private finance strategy for COP 26 and set to work.[1] Almost immediately, Covid intervened, the journey went virtual and its timetable was extended. Some might have become concerned, but the resolve of the private sector redoubled. There's been considerable progress in recent months and the momentum is growing.

Objective

Our destination remains the same. The Covid crisis has exposed the tragedy of undervaluing resilience, ignoring systemic risks and not investing upfront. And so it is with climate change, a crisis that involves the entire world, from which no one will be able to self-isolate.

Covid is forcing social resets for countries and strategic resets for companies.

With society placing a greater value on resilience and sustainability, 126 governments have now committed to net zero, including three global giants – China, Japan and South Korea –in the last few weeks.[2]

More and more countries are recognising that green stimulus is essential. Building a sustainable future will be capital-intensive after a long period in which there has been too little investment. It will be job-heavy when unemployment is soaring. It's what the world needs for its future. And it's what we all need right now.

Given the wholesale shift in the economic and social drivers of value since Covid, it will be a rare company whose pre-crisis strategy is still optimal.

That's why more and more businesses are crafting new strategies grounded in purpose that address the most pressing issues for people and planet. Businesses of all stripes increasingly recognise that changing consumer preferences and new climate policies are creating the greatest commercial opportunity of our time. The leaders are publishing their transition plans for net zero. 500 of the world's largest companies now have science-based targets, and over 500 more are in the pipeline.[3] By Glasgow, net zero transition plans will become the norm for large companies.

[1] https://www.bankofengland.co.uk/-/media/boe/files/speech/2020/the-road-to-glasgow-speech-by-mark-carney.pdf?la=en&hash=DCA8689207770DCBBB179CBADBE3296F7982FDF5
[2] https://eciu.net/netzerotracker
[3] https://sciencebasedtargets.org/

Private finance will fund the initiative and innovation of these plans, provided that it has the necessary information, tools and markets.

That's why our objective for COP26 is to **build the framework so that every financial decision takes climate change into account.**

I would like to spend the balance of my time highlighting the progress made and setting out what more needs to be done.

We are publishing today our COP 26 private finance strategy to build a market in the transition.[4] It rests on four pillars: the three Rs of comprehensive climate **reporting**, a transformation in climate **risk management**, and the mainstreaming of climate **returns**, and one M – new **markets to mobilise** private capital, especially to emerging and developing countries.

Reporting

What gets measured gets managed. Companies need to report systematically their climate-related financial risks and auditors need to provide assurance on how companies take the impact of climate change into account.

The bedrock of this approach is the Task Force on Climate-related Financial Disclosures (TCFD).[5] Developed by the market for the market, the TCFD is the gold standard for climate reporting.

Investors, banks, insurers and pension funds responsible for assets of $140 trillion are now demanding that companies assess the risks and opportunities that climate change poses to their business models and disclose this information in line with the TCFD recommendations.[6]

Six large investor alliances, representing over $100 trillion of assets, are calling on companies and auditors to reflect fully the effects of climate change in their financial results and to disclose whether the assumptions in financial statements are compatible with the Paris Agreement.[7]

With Ireland's announcement last week, over 60 countries and national authorities now support TCFD.[8] The most forward-looking are enshrining it in law, with New Zealand leading the way.[9]

Regulators are moving too. The UK FCA recently completed a consultation on comply-or-explain disclosure obligations for premium listed companies and will publish a policy statement by the end of the year.[10] The FCA CEO, Nikhil Rathi, will have more to say later in this summit.

Since February, the guidance from international standard setters has sharpened. The IASB has made clear that where climate change risk is considered material, just as with any other financial risk, IFRS standards already require disclosures to be included in *core financial statements*.[11] And the IAASB's guidance to

[4] https://www.ukcop26.org/
[5] https://www.fsb-tcfd.org/publications/final-recommendations-report/
[6] The full list of current TCFD supporters is available at: https://www.fsb-tcfd.org/tcfd-supporters/
[7] https://www.iigcc.org/news/investor-groups-call-on-companies-to-reflect-climate-related-risks-in-financial-reporting/
[8] https://www.gov.ie/en/press-release/f8f7a-minister-donohoe-adds-support-to-the-task-force-on-climate-related-financial-disclosures-tcfd-as-a-key-initiative-in-developing-sustainable-investment/
[9] https://www.cdsb.net/mandatory-reporting/1094/new-zealand-becomes-first-implement-mandatory-tcfd-reporting
[10] https://www.fca.org.uk/publications/consultation-papers/cp20-3-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing
[11] IFRS Standards and climate-related disclosures (2019): https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climate-change-nick-anderson.pdf?la=en

auditors on climate related risk shows that climate change is an issue that must be regularly assessed by the accountancy and audit professions when reviewing accounts.[12]

Allow me to translate. When the world's governments set the goal of net zero and over $100 trillion of capital are demanding action, at a minimum, major companies need to disclose whether the assumptions in their financial accounts are aligned with Paris. In other words, are they joining us on the Road to Glasgow or not?

Many companies are responding. The latest TCFD status report shows that almost half of companies with a market capitalisation greater than $10 billion disclosed in line with TCFD recommendations in 2019.[13]

This shows good momentum, but not yet enough. Full disclosure against all 11 TCFD recommendations is still rare. Disclosure of the potential financial impact of climate change on companies' businesses and strategies remains limited, and progress between sectors remains patchy, with energy companies leading but technology companies lagging.

This underscores that it is time to make climate-related disclosures mandatory. There are many pathways to mandatory climate-related reporting in Glasgow. These pathways will be complementary if we agree the direction of travel. We're therefore calling on governments to:

1. Publish pathways to show which authorities in their respective jurisdictions will be responsible for implementing climate-related reporting rules, the sectors the rules would apply to and the timeline to make it the law of the land.

2. Use the TCFD as the starting point for any mandatory disclosure regime.

3. Work with international standard setters. In particular, the IFRS Foundation – the body responsible for global accounting rules in 140 countries with a track record of robust, reliable and independent global standard-setting—is now consulting to understand the demand for sustainability standards and how the Foundation might contribute to their development. The consultation is our opportunity to shape the future of climate-related financial reporting and we would urge companies, financial firms and regulators to respond with their views.

Risk

Managing climate-related financial risks requires disclosure to go beyond the static (a company's carbon footprint today) to the strategic (their plans to manage down their emissions). Risk management means assessing such forward-looking disclosures to judge the resilience of firms' strategies to the transition.

Like reporting, there has been considerable progress in risk management over recent months.

The Network of Central Banks and Supervisors for Greening the Financial System (NGFS) has grown to over 75 members in jurisdictions that account for almost two thirds of global emissions. The NGFS has now developed standards for the supervision and management of climate risks, as well as approaches to climate stress testing and central bank policies for climate change.[14]

[12] The Consideration of Climate-Related Risks in an Audit of Financial Statement (2020): https://www.ifac.org/system/files/publications/files/IAASB-Climate-Audit-Practice-Alert.pdf
[13] https://www.fsb.org/wp-content/uploads/P291020-1.pdf
[14] https://www.ngfs.net/en/liste-chronologique/ngfs-publications

14 authorities are issuing guidance to major banks and insurers on how firms should measure and manage climate-related financial risk. The TCFD has also recently published refined guidance and best practice examples of scenario analysis.[15]

Since February, the NGFS has also published a set of scenarios that can be used and adapted by any firm, in any sector, to assess the strategic resilience of their business to different climate outcomes.[16]

This work will improve our understanding of the risks that lie ahead: if companies use these scenarios as their baseline, investors will be able to better compare results and more readily differentiate between the strategic resilience of companies.

From company-level assessments to systemic assessments of climate risks, central banks are also progressing with climate-related stress tests. 18 have committed to running climate stress tests, which will reveal the financial firms - and by extension the companies – that are preparing for the transition, and it will expose those that have not. The tests could also reveal the collective impact of these risks on the wider economy. The NGFS scenarios will be important to aligning the approach to climate stress testing and in turn reduce the burden on firms and allow comparison of results across jurisdictions. You will hear more about the Bank of England's plans for climate stress tests from Bank of England Governor Andrew Bailey later today.

International authorities are also starting to embed climate risk in their work. The IMF included the impact of climate-related financial risks in one of its Financial Sector Assessment Programmes (FSAPs) in Norway this year.[17] We encourage the IMF to mainstream this approach.

In recent months, some of the world's largest global banks, such as Barclays, HSBC and Morgan Stanley, have committed to net zero by 2050 on a *scope three* basis, which means bringing all their financed emissions in line with net zero.

The sum of these actions creates welcome momentum and is encouraging, but more is needed. The TCFD status report found that only one in 15 of the companies reviewed disclosed information on strategic resilience, yet this disclosure was considered the most useful by users of the information.

For Glasgow, we're calling on more firms to use the NGFS scenarios in their climate risk management, more central banks to conduct climate stress tests, and to develop and disclose their management of climate risks on their balance sheets. And in order to build expertise and embed the management of climate risk like any other financial risk, we encourage authorities to make clear their expectations of companies and financial firms approach to climate risk management.

Returns

Given that climate change is an existential risk, it follows that those companies that are part of the solution to climate change will create enormous value. The financial sector is increasingly focused on this opportunity of a lifetime…which is also, in fact, the opportunity *for* our lifetimes.

As one illustration, in the first three quarters of 2020, ESG Funds received $87bn net inflows globally, compared to over $123bn net *outflows* from Broad Equity Funds. More significantly, the assets under

[15] https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Guidance-Scenario-Analysis-Guidance.pdf
[16] https://www.ngfs.net/sites/default/files/medias/documents/820184_ngfs_scenarios_final_version_v6.pdf
[17] https://www.imf.org/~/media/Files/Publications/CR/2020/English/1NOREA2020001.ashx

management for members of the UN's Principles for Responsible Investment grew by 20% in a year to over $100 trillion.[18]

Valuations are beginning to reflect the shift from the unsustainable past to the sustainable future. Goldman Sachs estimates that the implied carbon price for long-term oil projects is $80/ton, and that hurdle rates for renewable power investments are one quarter those of long cycle oil developments.[19] The market capitalisations of disrupters in renewable energy and zero-emission vehicles already exceed those of fossil fuel based incumbents, not least because carbon abatement costs continue to fall rapidly.

As I mentioned earlier, transition plans will be critical in exposing how businesses will respond to these changing conditions. Investors are increasingly calling for credible transition plans from companies. Climate Action 100+ - a group of over 500 institutional investors controlling almost $50 trillion of assets - recently demanded that the world's 161 highest-emitting companies (representing 80% of industrial emissions) publish strategies to reach net zero by 2050.[20]

On the road to Glasgow, investors are clarifying their expectations for company transition plans. Emerging best practice are plans with scope 1, 2 and preferably 3 targets; balancing absolute emissions reductions with appropriate use of offsets, governed at the board level, and tied to executive compensation. Over time, the absence of transition plans can be seen as either an intention to wind down the business over coming years or, an assertion that business is separate from society. The former may be logical, the latter unforgiveable.

Transition plans will reveal the leaders and laggards on the road to Glasgow. Rather than have authorities be overly prescriptive on plans, it may be desirable for investors to have a "say on transition" – an automatic annual advisory vote on transition plans just as they have on pay. This would establish a critical link between responsibility, sustainability and accountability.

Over time, investors won't just judge company transition plans, they too shall be judged. Investors should disclose how closely their portfolios are aligned with the transition to net zero.

Some of the world's largest and most influential investors are making this commitment. The members of the Net Zero Asset Owner Alliance, with over $5 trillion in assets under management, have committed to manage down their carbon footprints by up to 29% preferably on a scope three basis by 2025, and to be at net-zero by 2050. This metrics-based approach will likely become increasingly common.[21]

In the run up to Glasgow, investors will need to agree how best to demonstrate how clients' investments are aligned to climate targets. One of the most important tasks for the next twelve months is to determine the best approaches for managing transition risks and opportunities.

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[18] https://www.unpri.org/pri/about-the-pri/annual-report
[19] Goldman Sachs, *Carbonomics.* 13 October 2020: https://www.goldmansachs.com/insights/pages/gs-research/carbonomics-innovation-deflation-and-affordable-de-carbonization/report.pdf
[20] http://www.climateaction100.org/
[21] https://www.unepfi.org/wordpress/wp-content/uploads/2020/10/Alliance-Target-Setting-Protocol_Final-Consultation-Draft.pdf

Any measure of portfolio alignment needs to be:

- forward looking, giving appropriate credit to efforts by companies to decarbonise;
- anchored in real-world climate targets; and
- dynamic, to show progress over time and accommodate new technologies.

These criteria encourage engagement with companies across the economy that are seeking to decarbonise. We won't get to net zero in a niche nor will divestment alone deliver the whole economy transition that we need.

Existing climate-related metrics serve useful roles but aren't best suited to measuring a whole economy transition. Carbon footprints and CO^2 emissions per dollar invested aren't forward-looking. ESG metrics are inconsistent, poorly correlated, and their 'E' is not benchmarked to net zero. And taxonomies, while useful for measuring the percentage of assets invested in certain activities, capture only a small proportion of business activity, cannot chart progress through 50 shades of green and are not yet dynamic enough to account for new technology developments.

There are, however, ways to measure who is on the right and wrong side of climate history. The 'Measuring Portfolio Alignment' report published today by a private sector team led by David Blood, Co-founder of Generation Investment Management, assesses various alternative metrics.[22] It examines several methodologies, including:

1. The percentage of assets that are net zero-aligned ("Paris aligned");
2. Transition progress versus scientifically determined transition pathways by sector; and
3. Calculations of a 'degree warming metric' to assess the quality of transition plans relative to the Paris goals in a given portfolio.

Over the next 12 months on the road to Glasgow, industry should use David's report as a basis for a discussion on the most useful measurement of portfolio alignment. As you will hear from Richard Curtis later in the summit, investors will need transparent and readily understandable answers when their clients ask if their money is being invested in line with the transition to net zero. The challenge to the industry is to 'make a material meaningful metric' so that people can 'make their money matter'.

Mobilisation

Climate change is a global challenge. Much of the critical investment will take place in emerging and developing economies —possibly as much as three quarters of the $3.5 trillion *annual* infrastructure investment required over the next three decades.[23] For this to happen, we need to turn billions of public capital into trillions of private capital.

Part of this will be through Scope 3 emission transition plans because they bring in the entire supply chain and align incentives.

[22] https://www.tcfdhub.org/resource/measuring-portfolio-alignment-assessing-the-position-of-companies-and-portfolios-on-the-path-to-net-zero/
[23] https://www.iea.org/news/deep-energy-transformation-needed-by-2050-to-limit-rise-in-global-temperature.

Part will be through investing to mitigate physical risks, to which these economies are most exposed, by increasing resilient infrastructure investment and widening insurance coverage.

Part will be through a new platform we are developing through the Global Investors for Sustainable Development (GISD) for blended finance that brings qualifying projects in the developing economies together with eager private capital from advanced economies.

And part will be in the creation of new markets, particularly one for carbon offsets.

As more and more companies commit to net zero targets, demand for credible and verifiable offsets will soar. The most cost-effective of these, with the biggest emission reduction potential, are in developing and emerging economies. These can generate large flows of private capital over many decades.

Despite its importance, this market barely exists at present. Buying offsets is an opaque and cumbersome process. A market that should be measured in the tens of billions of dollars was less than $320 million last year.[24] To conserve our carbon budget, we have to stop spelling billion with an M!

For finance to flow to emissions reduction projects, we need a professional, transparent and resilient market. We've brought together experts from across the financial sector and carbon markets value chain from more than 50 firms, to solve this problem. The Task Force is chaired by Bill Winters, CEO of Standard Chartered, managed by Annette Nazareth formerly of the SEC and now of Davis Polk & Wardwell, and sponsored by the IIF under Tim Adams' leadership. This group has been moving at lightning speed and is on track to deliver the blueprint for a carbon market infrastructure early next year.

Tomorrow, they will launch the consultation for this blueprint, and we're calling on all interested parties to respond to shape the infrastructure for a scaled up, robust voluntary private offset market.[25] By Glasgow, the taskforce should aim to have a functioning pilot market.

Conclusion

I have only highlighted a few vehicles in the private finance caravan to Glasgow. You can learn about them all in the detailed private finance strategy.[26]

For now, I want to thank the very many of you from thousands of organisations around the world in the private sector, governments, the standard setters and the NGOs who are working tirelessly to make this journey as success. Your energy, ideas and innovation are critical.

My Lord Mayor, there is an old proverb: *if you want to go fast, go alone. If you want to go far, go together.*

We have a long way to go in a short period of time.

The private financial sector is moving fast on the Road to Glasgow. With the UK and Italian presidencies of CO26, the G7 and the G20 next year, governments now have a unique opportunity to amplify these efforts and ensure that we go far towards achieving the world's climate goals.

Thank you.

[24] State of Voluntary Carbon Markets 2020, available from: https://www.ecosystemmarketplace.com/carbon-markets/
[25] To be published on 10 November 2020: https://www.iif.com/tsvcm
[26] https://www.ukcop26.org/