The Eighth Meeting of the San Giorgio Group

On March 24 -25, 2022, Climate Policy Initiative convened key financial sector actors and experts—that have a combined total of more than USD 13 trillion in assets under management—for the eighth meeting of the San Giorgio Group – the premier venue for open discussions on the most pressing policy and investment issues related to scaling climate action. The following summary provides key insights from this year's discussions, summarized by topic. Comments are not attributed as discussions take place under Chatham House Rules.

Participants acknowledged that, while significant progress has been made, especially in the past year with climate issues finally becoming a mainstream concern for the public and private sector, we are running out of time to take key actions required to avoid the worst impacts of climate change. With a healthy dose of pragmatic optimism, discussions at the meeting focused on the nearer-term issues we can—and must—address to scale climate finance with speed and integrity.

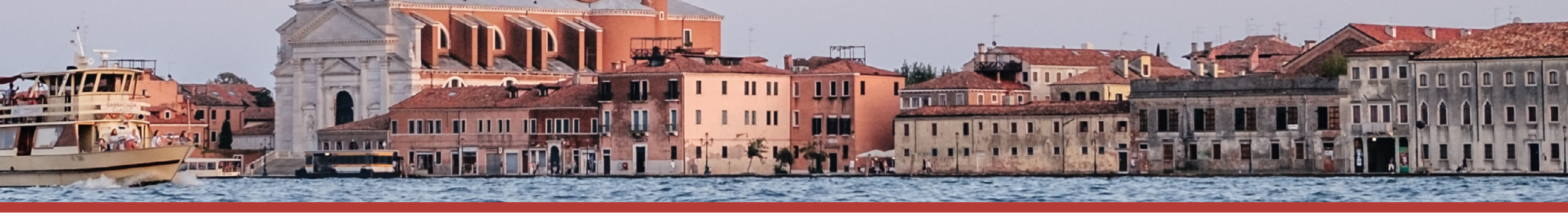
NET ZERO INTEGRITY: ADVANCING THE ACTION

The past year saw a significant uptick in voluntary commitments from the private sector; and from many governments, some much-needed public declaration of net zero goals and other policy signals. While meaningful engagement by the mainstream financial sector is underway, significant policy and regulatory facilitation is needed urgently to build on this momentum:

Timelines for meaningful commitments are too far off in the future. If we are to meet peak emission and GHG reduction targets that will keep us on an achievable path to net zero by 2050, we need detailed transition plans that include significant interim actions for both the public and private sectors. Action items for the next 12 and 24 months are what will be credible.

Deeper dives into transition requirements by country and sector are needed. Action will only occur if it is tailored to specific contexts. We need to delineate what is possible, what is not acceptable, and where the support is most needed to accelerate transition in an efficient and equitable manner.

Government accountability will be key to put climate at the center stage. In light of two years of supply chain and energy security disruption, political will and finance are more aligned than ever, but the private sector and civil society need to make clear demands and specific recommendations to trigger concrete action. The transition needs to be supported with the necessary policies, as well as regulation to prevent "climate arbitrage," i.e., having



unsustainable investment and toxic assets find havens outside the system.

Harmonized frameworks and standards will enable accountability and integrity. A concerted effort to consolidate, harmonize, and simplify rules and standards would be a significant driver of action and integrity: the International Sustainability Standards Board (ISSB) is an important trend in this direction.

By properly incorporating physical and transition risk into financial models, and providing the public and private sector with the tools and guidance to implement these changes, action for a broader sustainable transformation compelling. Such efforts will also make measuring progress more efficient, delivering more actionable information to policy makers and investors.

ENERGY TRANSITION: BREAKING THE CYCLE OF ADDICTION

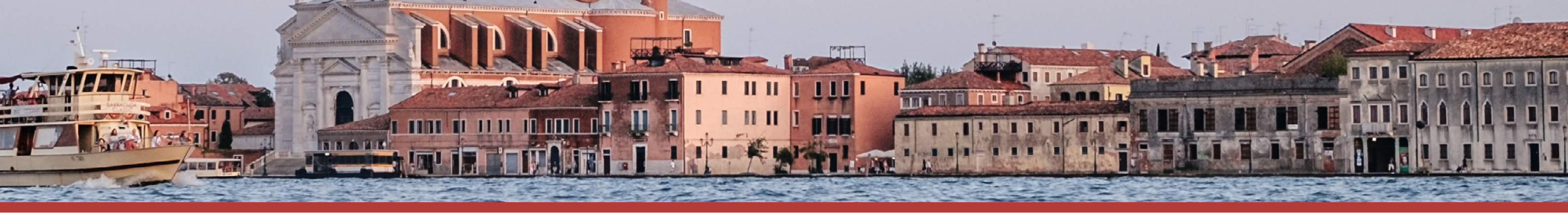
The invasion of Ukraine has brought into sharp focus what many in the renewable energy sector have been saying for a long time: energy security is national security. Given the still-falling renewable energy costs, there is near consensus now that the transition to distributed, renewable energy is also the economic path forward. This is especially true in emerging economies, where the greatest growth in energy demand will occur through to 2050. To expedite this transition, there are two primary short-term barriers to address:

Enabling a clean transition. Developing credible transition plans that acknowledge the reality of short-term fossil fuel reliance without locking in those assets for longer than necessary are key. To achieve global climate change targets, we need to see a rapid decommissioning of fossil fuel assets. But decommissioning comes with public fiscal impacts: state-owned utilities and fossil fuel production provide critical revenue and employment. The energy transition therefore requires a context- and country-specific approach, considering investment and human needs, such as capacity building and employment transition. COP27 is an opportunity to share more country-specific blueprints and develop packages for developing countries, including more performance-based debt reduction.

A new approach to renewable energy finance and development. While fossil fuel transition is critical, for much of the world the more pragmatic issue is scaling energy access, particularly in Africa. A key component for success will be to allocate risks more effectively to those who are able to take them on. In addition to debt, equity solutions need to be scaled much more quickly and affordably. Development Finance Institutions (DFIs) can play a pivotal role, taking a new approach regarding how concessionality is delivered to mobilize private investment. Better developed domestic capital markets could also make a difference, with more local currency options and better hedging instruments to help expand those markets. But this could take time because, as with scaling down fossil fuels, scaling up renewable energy requires a significant investment in human capital too—to develop capital market expertise and build the project development talent ecosystem.

PUBLIC FINANCE: EVOLVING THE MODEL

There are more than 500 DFIs operating across the globe. They hold a unique place in the financial system, bridging many gaps: political, cultural, and financial, and therefore are critical to scaling climate finance. To enable this, shareholders and managers of DFIs are called to action, evolving the approach



and incentives to better support DFIs who continue to face shifting challenges.

An updated approach to risk. There are plenty of opportunities to realign incentives, without the need for drastic changes. The current model takes a conservative approach to capital utilization, reducing the amount that DFIs can leverage their balance sheets. Are DFIs (or their shareholders) too beholden to AAA ratings? There needs to be a discussion with ratings agencies to ensure ratings methodologies accurately reflect shifting realities.

Improving mobilization. De-risking and providing pools of projects for mobilizing investment is a huge opportunity. DFIs are an important source for quality pipeline origination, but mandates likely need to change to allow for more flexibility in underwriting larger share of financings with a view to sell down to investors with appropriate guarantees and other de-risking instruments. This could be further accelerated by bundling portfolios across DFIs, by improving coordination between DFIs and working as one system rather than silos.

Anchoring partnerships. Finally, harkening back to DFIs unique role in our global finance system, there are opportunities to leverage DFI clout and convening power. DFIs can and should be coordinating better, bringing all actors to the table to expand public-private partnership, especially to build markets and local capacity, share expertise on portfolio performance, and expand the opportunities to crowd in private capital.

ARE PRIVATE INVESTORS ADDRESSING CLIMATE TRANSITION RISK?

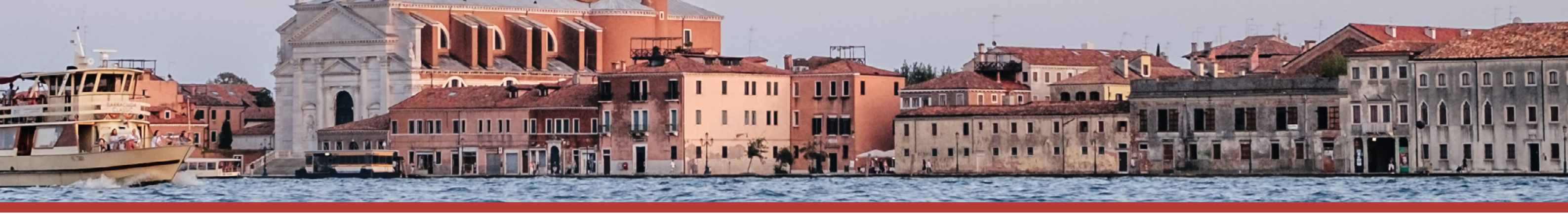
Some of the most significant recent progress made in advancing net zero goals is proactive course shifts by the private financial sector—made even in the absence of supporting regulatory frameworks. These actions are based on a growing body of evidence around longer-term sustainability-related performance and real risks for certain portfolios. But questions remain about the basis for the private sector's sustainable finance transition, and the integrity and actionability of the increasing number of (welcome) net zero commitments.

The importance of policy and reporting frameworks. Recent studies confirm that the private sector is not adequately addressing climate transition risk. To do this, continued emphasis on integrating physical and transition risk into pricing models and business plans is needed, as are stronger policy signals and reporting frameworks. Clear industrial policy on transition that could include national goals by sector, aligned mandatory and standardized—or at least converging—reporting frameworks, and transition support that is sector specific could address current gaps.

The importance of metrics and clarity. Stronger signals can also further expedite the transition of investors, particularly by expressing risks in a better way and making risk assessments comparable. Universal, easy-to-understand metrics must be developed that better signal transition risk and transition readiness for investors to have confidence to invest, reinforced through more investor-relevant statistics and approaches that better deal with uncertainty to ultimately provide better forecasts.

HOW TO ENSURE A JUST AND RESILIENT TRANSITION TO NET ZERO?

The recent IPCC report made clear that societies and economies are ill-equipped to adapt to climate change. We are just seeing the beginning of physical asset losses, supply chain disruption, and social upheaval, all of which will have total economic losses that will get big quickly if we don't act now.



Notwithstanding progress, current adaptation efforts and financing are anemic compared to the need and more work is needed to accelerate action and investment. The financial ecosystem must incorporate resilience in all investments it supports and ensure that the transition it finances is just.

Simplified metrics and frameworks. While there have been a few positive examples, including adaptation and resilience bonds, an adaptation taxonomy, the Task Force for Nature-related Disclosures (TFND), and capacity on promoting alternative investments, adaptation still lacks the rigor seen with mitigation efforts. An organizing principle for adaptation and resilience similar to "net zero" could help putting adaptation on an equal footing as mitigation.

A fresh look at investment opportunities. A potential supply chain crisis looms much larger, broader, and deeper than the energy transition. But with that comes additional opportunity to mobilize capital towards mitigation and adaptation and resilience with a holistic value chain approach. Expanding beyond sustainable bonds to portfolios of sustainable infrastructure as an asset class is much needed. Insurance has a critical role to play in ensuring a just transition as it can support risk management, reward proactive risk mitigation, and provide a social protection shield.

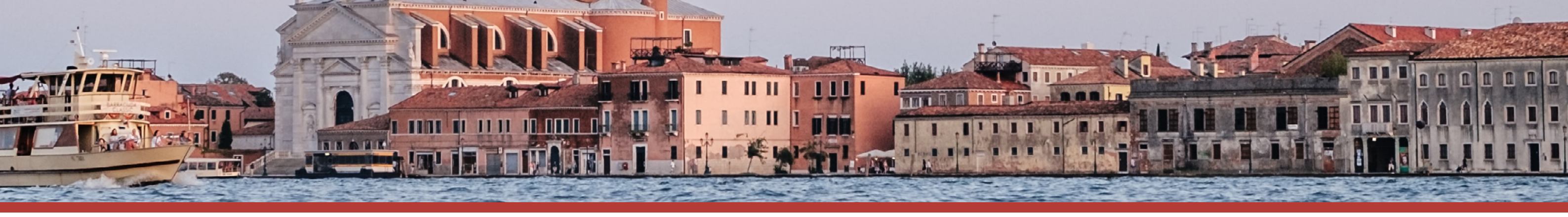
Putting Just Transition first. The 'just transition' element needs to be front and center in the design of new financial solutions. The human element is critical: from better understanding the impacts for the most vulnerable, to improving the support for technical assistance and capacity building. Along those lines, an array of existing technologies can help accelerate the transition, including ones that improve agricultural productivity, the water cycle, and human health.

ON THE BRINK OF TRANSFORMATION: HOW TO GET TO SCALE AT SPEED?

Despite progress over the last decade, we need to address the elephants in the green finance room: speed and scale. To harness the opportunities of the transition, strategies to address both are needed:

Enabling scale. Most development and climate investment currently occurs with significant risk management (or thwarted because of a lack thereof). Developing local capital markets and associated human capacity can help address this, but it will take time. We need a paradigm shift in climate finance so it is more rooted domestically. Coherent policy frameworks need to be developed to simplify reporting, reduce the cost of capital, and better link investment flows and project development. Public and private finance need to get better at working together, within and across geographic boundaries. Blended finance should be big, boring, and repetitive.

Enabling speed. Speed also may require greater risk tolerance by those who are best able to bear it, including host sovereigns, and acknowledgments that failures provide important lessons. A Basel IV approach to climate risk for banking could further support this acceleration and fault capacity, complete with capital weighting, new reserve requirements, and better incentives for adopting more sustainability-focused approaches.



CONCLUSION

Throughout the eighth meeting of the San Giorgio Group, several key themes were repeated.

Policy matters. Costs matter, but so do incentives—enabling environments, standard-setting framework, and regulations. Technology makes progress but we need more industrial policy to break the status quo, and we need a systemic approach to link implementation with policy.

Risk is a key lever. It needs to be managed radically to address technology risk, first-time risk, off-taker risk, and local currency risk. We need to make de-risking instruments more efficient, and also scale the use of instruments by replicating those that have worked.

MDBs and DFIs are critical, and a huge opportunity to leverage even more. We need to significantly adjust their mandates to take advantage of their unique strengths. The focus should be on the effectiveness of capital deployed and mobilized: balance sheets should be reconfigured; convening power could be used much more effectively; and new capital should come with requirements to be fully supporting the transition to net zero.

Invest more in capacity. We must invest in humans, particularly the development and capital market communities in emerging and developing economies, who have a multiplier effect for capital mobilization and job creation. Targeted technical assistance that is highly leverageable will amplify this effort.

Expand data and integrity. We need to go beyond the language of commitments and towards real metrics. There needs to be coherence and integrity on net zero, with credible and transparent plans.

Collaboration is critical. We need to work together, both the siloed status quo and expanding the role of those not already in the room—countries, financial institutions, industries, cities. This will accelerate efforts while addressing and avoiding fragmentation.

At CPI, we remain committed to supporting this pathway, together with all our partners. We thank all our participants from the eighth San Giorgio Group meeting for their excellent and very open contributions to our discussions.

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