Amidst the Noise Expect Critical Action on Transition Finance from COP28

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Whilst COP28 in Dubai triggered controversy from the outset, alongside geopolitics, finance is likely to take center stage again at this summit in the desert. Aside from the UAE wanting to show it can unite a polarised audience, behind the scenes, intense preparations are afoot across the ecosystem to announce breakthrough actions and pathways on transition finance.

Everyone knows we are at a critical moment on the need for private finance to flow. So expect announcements that trigger a tsunami of transition finance not just to fund the energy transition but also finance pathways for protecting nature and, most importantly of all, supporting and rebuilding our social tapestry. This is going to bring innovation at scale.

To set the scene, this year's stated COP objectives in Dubai are:

Fast-track the energy transition

Transform climate finance

Put people and nature at the center of the transition

Make COP decision-making inclusive.

All of this is framed around the results of the first Global Stocktake; for those unfamiliar with this, organizations and institutions worldwide have been collating data to show where the world is on achieving the Paris Agreement. Effectively, KPIs on how the world is progressing in managing global warming. It is already clear that the world is falling far short, and the results are being used for a renewed emphasis on practical action over goodwill statements.

What does all this mean for mainstream finance?

There are clear signals to help read the readiness for action from Climate Week in New York earlier this year. Clearly, the SEC has to move within the strict parameters of its authority. However, Janet Yellen's announcement on the principles for net-zero financing is a clear weather vane of unstoppable momentum.

These voluntary principles were supported by renewed commitments by financial institutions through GFANZ, its consultation on transition finance frameworks, and some of the powerhouses in climate philanthropy identified to support capacity building of technical expertise. One cannot help but feel these are deftly facing off the political shenanigans in the US.

Many can remember October as one of the busiest consultation and conference season periods around sustainability. Aside from the scaling up of sustainable finance conferences globally, we have seen multiple launch events and support for the Taskforce for Nature-Related Financial Disclosures (TNFD). As an initiative by the IFRS, the International Sustainable Standards Board (ISSB) recently created a watershed moment in building awareness and adapting climate standards. They will apply from 2024 onwards and will serve to focus corporate board and investor minds on the transition.

Together, these are laying the foundations and putting into place the necessary plumbing for transition finance.

COP28 indeed has to be the catalytic moment that governments, the private sector, and civil society come together to agree on concrete action to turn on the taps for capital to flow and trigger action from finance through to the real economy, its infrastructure, production and ultimately the protection of people and planet.

Transition Finance – it's not just about climate

In a world where the term 'polycrisis' is no longer hyperbole, the undeniable interconnectedness of climate change, nature conservation, and social issues has become evident. These global crises intricately amplify each other's impacts. Nature is one of the most powerful resources we have in sequestering carbon and controlling the heating up of the planet, however none of this will happen if people cannot feed themselves and look after their families. Put simply, we will not have an energy transition without a social transition.

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So why does this matter to finance? The unraveling of social norms, unrest, and political polarisation have become a systemic risk to the financial system. Profitable businesses need robust economies that rely on a thriving society. Finance must remember that long-term society is the lifeblood of economies and business.

Climate change, environmental degradation, and social inequalities are inherently linked, exacerbating each other. Corporate boards and executives have to think about issues previously reserved for politicians. They are waking up to the fact that it is not only in their best interests to ensure their business model, business culture, and their raison d'etre are aligned with supporting society, but that their stakeholders will hold them accountable and punish them if they do not. The status quo of "business as usual" is untenable.

So, how does this manifest itself into action within finance? Reporting regulation is the loudest wake-up call. Whilst not a solution in itself, it creates transparency for stakeholders to truly understand the impact of business on people and the planet. It enables them to make informed choices. Secondly, it forces businesses and finance to open their eyes and truly understand the weaknesses and opportunities to improve business practices, where they can improve and where they can innovate. We are entering an era where doing good will be consequential to business.

Europe is continuing to push forward on reporting regulations, after October's final adoption of the European Sustainable Reporting Standards that bring 50,000 companies within scope for 2024 data. The ripple effect will create the imperative for many supply chain companies to fall into line.

We also have ISSB currently reviewing its open consultation on its next set of priorities after climate, focusing on Nature and Human Rights reporting.

The direction of travel is unstoppable, and the sheer momentum will create a gravitational pull in finance that will create alignment through government policy, investor signaling aligning with business's need to transition, and re-knitting social fabric.

This is more than reporting – this is about the business of finance

Make no mistake, whichever side of the fence you are on with regards to the rights and wrongs of ESG, transition finance is a structural market trend that will direct and capture a significant flow of money and increasingly how assets are valued in the years (not decades) to come.

For this reason, we will see fewer counter-arguments about fiduciary duty, increased signaling by institutional investors on avoiding stranded assets, and the push for investing for returns and with purpose by future generations of clients.

For proof, look at the Inflation Reduction Act in the US. At its first anniversary, it is lauded for incentivizing nearly $380 billion of investment and creating 70,000 new jobs. And where has most of this taken place? In the red states whose politicizes have been waging war on ESG. Money talks at the end of the day, and sustainability is increasingly becoming consequential to business.

As a final note, CAIA was also involved in the "Sustainable Investment Summit" organized by the TÜYİD- Turkish IR Society and SustainFinance. As with the COP goals, similar themes of energy transition, climate finance, climate justice and inclusion were also discussed at this one-day conference in Istanbul.

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