

A New Focus for Investor Climate Commitments



A NEW FOCUS FOR INVESTOR CLIMATE COMMITMENTS

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Investors representing many trillions of dollars of client or beneficiary assets have signed on to net-zero targets to limit global warming to 1.5°C with limited or no overshoot. Sophisticated frameworks have been developed to help investors identify specific actions in support of these targets. In this chapter, I explore the concerns that many investors have about making 1.5°C-aligned commitments. These include concerns about fiduciary duty, the limited ability of investors to influence climate outcomes, and the legitimate role of investors versus government in addressing externalities. Analysis of these arguments suggests that they have some force, but they do not negate the case for certain investors to set targets and take action on climate change. Nonetheless, the analysis points to ways in which investor climate commitments can be made more robust in order to make them more effective and, perhaps, secure even wider support. In particular, given that the climate externality can be addressed only through a supportive government policy framework that changes economic incentives, I propose a new focus for net-zero frameworks that starts with this core premise. The result is two-fold. First, investors seeking to have material impact on climate change must, as a first-order matter, consider their relationship to the process of policy development, including corporate lobbying. Second, direct actions with investee companies should focus on objectives where investors realistically have influence and which companies can realistically deliver. This should lead to a more limited but also more focused, achievable, and therefore impactful set of objectives for investors who are concerned about climate change.

On 3 November 2021, the Glasgow Financial Alliance for Net Zero launched with much fanfare and no small amount of bravado (GFANZ 2021):

Today, through the Glasgow Financial Alliance for Net Zero (GFANZ), over \$130 trillion of private capital is committed to transforming the economy for net zero. These commitments, from over 450 firms across 45 countries, can deliver the estimated \$100 trillion of finance needed for net zero over the next three decades.

GFANZ comprises a number of sector initiatives for asset owners, asset managers, banks, and, until recently, insurers.¹ Focusing on the investor initiatives, the Paris Aligned Asset Owners (PAAO) have 57 signatories with

¹See <https://www.gfanzero.com/membership/>.

\$3.3 trillion in assets under management (AUM). The Net-Zero Asset Owner Alliance (NZAOA) has 89 signatories with \$9.5 trillion in AUM. And the Net Zero Asset Managers initiative (NZAM) has 315 signatories with \$57 trillion in AUM.² Separate from GFANZ, another prominent initiative, Climate Action 100+, has approximately 700 signatories with approximately \$68 trillion in AUM. It is an extraordinary phenomenon that so many asset owners and asset managers have signed up to commit to a target to achieve net-zero emissions by 2050 to limit global warming to 1.5°C.

Why have they made these commitments? For *asset owners*, the motivation appears to be largely driven by universal owner theory (see, e.g., Lukomnik and Hawley 2021). The idea is that broadly diversified investors own a slice of the whole economy. Therefore, it is in their interests to address any issue that adversely affects the economy. In this view, if climate change is considered to cause long-term economic damage, it can also be claimed to harm diversified portfolio values, thereby creating a *financial* argument for investor action. As stated by the PAAO (2024, p. 1),

Most large asset owners are broadly exposed to whole national economies and given climate change presents economy-wide risks, they cannot entirely divest from these potential negative financial impacts for their beneficiaries. The economic science is clear that a rapid reduction in greenhouse gas emissions has the greatest net economic benefit, which benefits the financial returns of universal owners to their beneficiaries.

For *asset managers*, the motivations are more mixed. Some may have been influenced by the universal owner hypothesis. Others will have seen that a significant and vocal body of their clients have signed up for such commitments themselves and wanted their asset managers to show similar commitment.

The various investor coalitions have come under attack as part of the recent “anti-ESG backlash,” particularly in the United States. Coalition members have been accused of violating antitrust laws by collaborating on climate action and of violating fiduciary duty by using other people’s money to pursue political or nonfinancial goals. The Net-Zero Insurance Alliance was dissolved, and other initiatives have experienced a small number of high-profile signatory exits. Climate Action 100+ saw some investors withdraw as the initiative moved into a more assertive Phase 2, in which concrete demands are made of investee companies to reduce emissions as opposed to the earlier requests simply to provide improved disclosure. Although much of the criticism in the United States amounts to little more than political posturing, my experience is that many investors have genuine concerns about how best to reconcile ambitious climate goals with fiduciary duties and their role in society.

²Details of the GFANZ-affiliated investor initiatives can be found at www.parisalignedassetowners.org, www.unepfi.org/net-zero-alliance/alliance-members/, and www.netzeroassetmanagers.org/signatories/.

At the same time, questions have arisen about the efficacy of investor coalitions seeking to deliver climate outcomes through voluntary commitments made by themselves and the companies they invest in. In a recent report, the Transition Pathway Initiative (2024) found that although 2050 net-zero commitments are becoming more prevalent, they are rarely backed up by concrete actions to meet the commitments. Only 5% of companies in the high-emitting sectors under review had quantified an emission reduction strategy, 2% had clarified the role of offsets in net-zero commitments, 2% had plans to phase out capital expenditure (capex) in carbon-intensive assets, 2% had aligned capex and decarbonization goals, and 1% had integrated net-zero goals into climate policy and trade association membership. The most recent review from Climate Action 100+ (2023) painted a similar picture. These wider trends are also reflected in specific high-profile cases of companies walking back ambitious climate goals in the name of reprioritizing shareholder returns.

In this chapter, I explore these concerns about current investor initiatives and consider the implications for the future direction of investor action on climate.³ Reports of the death of investor climate coalitions are premature: They are very much still alive, especially (but not only) in Europe. However, now is a good time to re-evaluate what is and is not credible, as well as what is and is not working. I conclude that such a reevaluation leads to the conclusion that investor climate commitments should be refocused in a way that reflects achievable outcomes and the realistic role of investors in addressing climate change. This chapter is, therefore, addressed both to the governing bodies of the key existing investor initiatives and to investors who believe climate change is a critical issue and want to be part of the solution but feel unable to sign on to existing initiatives as they stand.

The chapter starts by exploring the concerns that many investors have about setting a 1.5°C warming limit goal. Exploring these concerns with an open mind can provide insight into areas where investor climate commitments can be made more robust. It can also help inform how investor climate action can be framed to secure the widest possible support. The concerns fall into four categories. One concern is that pursuit of very ambitious climate mitigation goals may actually be bad for the economy in the medium term and for portfolio returns. A second is that, in any event, investors have little ability to affect climate outcomes and will be wasting resources and distracting from their core purpose in trying to do so. A third is that it is now unlikely that we will limit global warming to 1.5°C and investing based on an unlikely scenario is not in client and beneficiary interests. A fourth is that it is the role of governments not investors to address externalities like climate change through the democratic process. I conclude that all these concerns have some force, and the analysis gives rise to implications for how investor targets and action on climate change should be designed.

³This chapter focuses on action by investors to limit climate change in line with net-zero commitments. It is not concerned with the incorporation of climate risks and opportunities into stock selection and valuation.

In the second section of this chapter, I consider whether the concerns are so serious that investors should not be in the business of setting climate goals at all. I conclude that the concerns raised, although legitimate, do not negate the case for certain investors to set climate goals. However, a *directional goal* of supporting a *strengthening of current climate policies* may be easier to justify than a very ambitious goal based on a fixed warming target that is now, sadly, unlikely to be achieved.

In the subsequent section, I turn to the nature of suitable actions for investors who have concluded that a climate goal is appropriate. Given the foundational importance of government policy, investors who want to have an impact on climate change must consider their role in policy formation. This is a potentially controversial area, and I make suggestions for how investors can avoid being accused of overstepping the boundaries of political legitimacy. I then consider the actions investors can take when government policy is not yet supportive. These actions acknowledge that investors cannot substitute for effective policy and must instead be focused within the realistic scope of investor influence.

The chapter concludes by contrasting climate commitments of the type I propose with those arising from existing target-setting frameworks. Overall, the approach outlined should lead to a more limited but also more focused, achievable, and therefore impactful set of objectives for investors who are concerned about climate change.

Investor Concerns about Setting 1.5°C Targets

Many investors have made net-zero commitments, aligned with limiting global warming to 1.5°C.⁴ But equally many have not. In addition to the small number of investors who have recently withdrawn from the various alliances, there are many who never signed up and some signatories who are grappling with genuine concerns about how to reconcile the commitments with their obligations to clients and beneficiaries. The reasons are not always rooted in skepticism about the negative impacts of climate change for society. Exploring these reasons can provide insight into ways in which existing climate initiatives can be made more robust. It can also help understanding of how support for climate action can be broadened and made more secure in the investor community. In my experience, where investors have concerns, they can be separated into four principal categories.

An Economy That Transitions to 1.5°C May Not Be the Best Outcome for Portfolio Returns

If climate change is bad for the economy, it must be bad for portfolio valuations. Therefore, diversified investors (and their clients and beneficiaries) will be better off if they take action on climate change. This simple and compelling logic

⁴In fact, most commitments are aligned with the yet more ambitious Race to Zero goal of limiting global warming to 1.5°C with limited or no overshoot.

underpins much investor action on climate. However, some investors believe that limiting warming to 1.5°C will be very costly and disruptive to the economy and companies and may be negative for market returns. This is reflected in nonacademic studies that often project that climate action will have a negative impact on portfolio returns.

When analyzing this concern, the first point to make is that, increasingly, economists who study climate change agree on the significant economic benefits of decisive action to limit global warming. A review of economic studies by the Intergovernmental Panel on Climate Change (IPCC) found substantial benefits in limiting global warming to the Paris Agreement goal of 2°C or less, compared with allowing 3°C or 4°C (see IPCC 2022, Chapter 3, Section 3.6.2, Cross-Working Group Box 1). Not only are expected economic losses reduced, but so are the losses in downside scenarios. The consensus that continuing with current policies will ultimately, at some point, be detrimental to economic growth and welfare has only strengthened since the IPCC released its report. Indeed, when summarizing points of consensus among economists studying climate change, the first observation highlighted by Pisani-Ferry and Posen (2024) is that “whatever the views on the economic consequences of climate action, the alternative of no action would be much worse.”

However, while the economic case for climate action is strong, the *financial market* case for the specific, more ambitious goal of limiting warming to 1.5°C is less clear. First, no consensus has emerged as to whether the medium-term impacts of more assertive mitigation are positive or negative for GDP, with different economists holding different views (Pisani-Ferry and Posen 2024; Stern and Stiglitz 2023; Dietz, Bowen, Doda, Gambhir, and Warren 2018). Whether the medium-term GDP impact is positive or negative will depend on the extent of any “green growth” multiplier, the practical substitutability of energy sources, the pace of technology development, and the extent to which such assertive climate policy can be implemented efficiently and without political backlash.

Furthermore, conclusions based on GDP outcomes do not translate directly into conclusions for asset portfolios. Financial market valuations are skewed toward developed markets, which typically show lower negative GDP impacts of climate change. GDP projections mask the significant shift from consumption toward investment that would be required over the coming decades to achieve the net-zero transition. In addition, the high discount rates of financial markets mean that for 1.5°C scenarios, the additional upfront costs of mitigation can offset the discounted value of reduced future climate damages, resulting in a net negative for portfolio returns even if longer-term economic impacts are positive.

Some argue that the focus on comparing expected damages and mitigation costs for the 1.5°C and 2°C scenarios misses the point: At lower levels of warming, the most negative consequences of climate change are overwhelmingly in the tails of the probability distribution

(Trust, Bettis, Saye, Badenham, Lenton, Abrams, and Kemp 2024). Rather than considering central cases, market participants should instead consider downside risks in the presence of climate tipping points.

But even when considering tipping points, a financial fiduciary needs to bear in mind that some tipping points, once triggered, have consequences that play out over very long timescales—sometimes measured over many centuries (for example, sea level rises from melting ice sheets; see Armstrong McKay, Staal, Abrams, Winkelmann, Sakschewski, Loriani, Fetzer, Cornell, Rockström, and Lenton 2022). To affect portfolio values, tipping points need to be imminent, severe, relevant to corporate cash flows, and fast acting. The reality is that they are hugely uncertain, and views on the risk and the extent to which that risk should be taken into account by fiduciaries can reasonably differ.

For a financial fiduciary, the likely benefits for long-term portfolio returns of limiting warming from the current trajectory of approximately 3°C to meet the Paris goals of 2°C or less are compelling (Rebonato, Kainth, and Melin 2024), based on expected climate losses before allowance for tipping points. However, the pure *financial portfolio* benefits of limiting warming to 1.5°C are much less certain. This observation may seem cavalier in the context of long-term damage from global warming in excess of 1.5°C highlighted by the IPCC and the human suffering that will result in poor and vulnerable communities around the world. But when the case for investor climate action is made on financial terms based on the impact on portfolio values, as it usually is within investor commitments, then the case needs to be assessed on that basis. Belief in imminent, severe, financially relevant, and fast-acting tipping points appears necessary to make the *investor* case for the more stringent goal of 1.5°C. Some fiduciaries may in good faith conclude that the risk of such tipping points justifies the more stringent goal, but others may not. This matters because the real-world industrial and economic differences between 1.5°C and 2°C are significant, and net-zero frameworks require signatories to set targets in line with the more stringent goal. I will return later to the implications of these insights for setting overarching climate goals.

Investors Have Limited Ability to Affect Climate Outcomes

Some investors are concerned that setting very ambitious climate targets overstates the ability of investors to influence climate outcomes. Time and effort then could be wasted on a fruitless endeavor. This is a valid concern. Severe practical problems exist, which boil down to the *efficacy* of investor action and the *gap between company- and system-level effects*, as detailed elsewhere.⁵

Starting with the efficacy of investor action, there is little evidence that investing in or divesting from companies that are or are not aligned with the net-zero

⁵See Gosling (2024b); www.ecgi.global/projects/responsible-capitalism/does-sustainable-investing-work; and www.netzeroinvestor.net/news-and-views/why-universal-owners-need-modest-objectives.

transition can have enough effect on their cost of capital to change managers' investment decisions. First of all, academic estimates of the level of impact on cost of capital are generally small (on the order of 100 bps). Some research suggests that a change of this magnitude is too small for managers even to notice and is in any case far lower than necessary levels of carbon taxation to hit net-zero goals. Indeed, some researchers argue that constraining finance to carbon-intensive firms may cause them to double down on brown rather than green activities.

Engagement has more support as an impact mechanism, although it is important not to overstate the results of academic research in this area. Although collaborative engagements can be successful, what is counted as a success in many studies is rather limited: a disclosure commitment or a general commitment to reach net zero at some point in the future. There appears to be no evidence that investors can engage with companies sufficiently forcefully to make them undertake actions that are fundamentally against the financial interests of the company. This explains why the Transition Pathway Initiative (2024) finds that investor engagement on climate has been more successful at generating promises of action far in the future as opposed to tangible progress today to reduce emissions.

Even if investors succeed in bringing about changes in a given company, there needs to be a credible model of how this leads to system change. If one company is pressed into forgoing a profitable opportunity, what is the likelihood that no other company picks it up? Displacement of polluting activities from one form of ownership to another, less scrutinized form is also a real concern. Private, state-controlled, and family-controlled firms form a substantial part of the economy, largely beyond institutional investor influence.

The link between investor action and impact is therefore highly uncertain, and investor tools to bring about change are weak. In this area, the concerns about the influence some investors have seem legitimate. A conclusion is that investors should focus their actions where they can be most impactful while still meeting their fiduciary duties to clients and beneficiaries. This approach often means influencing the environment in which sustainable outcomes can emerge rather than trying to bring about those outcomes directly.

Investment Strategy Needs to Be Focused on Likely, Not Desired, Transition Pathways

The target of 1.5°C is now widely considered to be out of reach, if not technically then at least practically and politically (Matthews and Wynes 2022). Indeed, a poll of climate scientists for *Nature* found that fewer than 5% of respondents believed warming would be limited to 1.5°C by the end of the century (Tollefson 2021). Investors who believe they have limited ability to influence climate outcomes may find it difficult to justify having—let alone acting on—a goal that is so far removed from likely trajectories. This is because the disconnect between the 1.5°C target and reality can, if investors seek to meet the target, give rise

to actions that actually increase costs and risks for investors (Gosling and MacNeil 2023). Investment allocations that seek to align with or create impact toward a 1.5°C world may underperform in a slower decarbonization scenario. Engagement demands for companies to align with unrealistic 1.5°C pathways may create a competitive disadvantage for those companies. Incurring such costs and risks is difficult to justify given the low efficacy of these actions.

This explains why truly 1.5°C-aligned strategies are so rare. When bold climate aspirations collide with commercial incentives, commercial incentives generally win. At this point, the commitments themselves can create a perverse consequence, through supporting a market for approaches that appear 1.5°C aligned but are nothing of the sort. Examples include the use of portfolio decarbonization indexes, carbon offsets, disclosure-based strategies, "science-based" targets not backed up by strategy choices, and selective targets excluding hard-to-abate sub-portfolios.

Of course, it is possible to advocate for a 1.5°C world while constructing investment and engagement strategies based on more likely scenarios. However, as currently constructed and implemented, investor net-zero frameworks are predicated on the alignment between investment and engagement objectives and the 1.5°C scenario. This tension is difficult for some investors to reconcile.

It Is the Role of Governments, Not Investors, to Address Climate Change

Climate change is a problem because something we believed was free (emitting carbon dioxide into the atmosphere), in fact, has a rather large long-term cost in terms of financial and nonfinancial economic welfare. That cost, however, only partially falls on the people benefiting from the emissions. Indeed, it falls disproportionately on those who do not benefit, which is the nature of an externality.

Importantly, this dynamic is not just a matter of time horizons. Those benefiting from free emission of carbon dioxide today will not proportionally bear the costs if we simply wait long enough. Moreover, it is also not yet plausibly the case that low-carbon technologies exist at the scale or cost required to decarbonize our economy through the normal market-based actions of capitalism.

Solutions to the climate crisis ultimately could be developed through private sector activity and innovation. But the externality is too great and too urgent for this approach by itself to suffice. Significant government action will, therefore, be necessary to support a decarbonization pathway at the pace we need to keep the risks of climate change acceptable. This action includes policy to reframe economic incentives, invest in national infrastructure, support research and development, and manage the social consequences of a major economic and industrial transformation. Investors cannot substitute for government action. Indeed, in attempting to achieve the 1.5°C target without supportive

government policy, investors would almost certainly find it impossible to bring about the change in any coherent, economically efficient, or societally just way.

Most investors would, if asked, accept the importance of government action. Indeed, the necessity of government policy is built into the various investor commitments: All the NZAOA, PAAO, and NZAM commitments come with a caveat—the expectation that government will follow through with policies to achieve the more ambitious 1.5°C target within the Paris Agreement. Nevertheless, the portfolio decarbonization and engagement targets set under these initiatives are calibrated by references to a desired and ambitious 1.5°C-aligned climate pathway rather than one that is credibly backed by government policy strength. Yet it is unclear what it means for a company or a portfolio to be 1.5°C-aligned in a world that is not so aligned at a policy level. These challenges are evident in recent attempts to define “transition finance” by the UK’s Transition Finance Market Review (2024). The Transition Pathway Initiative (2024) found that corporate action on climate change is associated with the policy environment of the host country, in terms of both aggregate net-zero commitments and detailed policies such as carbon pricing, again reinforcing that politically established economic incentives are critical.

Despite its weaknesses, government policy developed through the democratic process is the *only* credible mechanism to ensure that the societal trade-offs involved in decarbonization are addressed with legitimacy, leading to a just and accepted transition.

However, the primary importance of government policy does not mean that investors should have no role at all and leave everything to governments. Policy is not developed in a vacuum but instead emerges from a process of reconciling competing pressures. Given the efforts that adversely affected incumbents will always make to limit the damage to them of climate policies, beneficiaries of those same policies need to make their voice heard.

Some investors also have concerns about the political legitimacy of them taking a leading role in advocating for policy action. This is understandable, and I am not suggesting that every investor must engage on climate policy. Rather, I am saying that any investor who claims to act on climate change as a matter of major concern to them must, as a matter of first priority ahead of other actions, develop a plan for how they can influence the political process. The foundational primacy of government policy for a successful transition should not be a footnote to or a get-out-of-jail free card for investor commitments on climate. It should, instead, be a fundamental principle underpinning the actions that the investor prioritizes.

Should Investors Make Climate Commitments at All?

Given the challenges outlined in the previous section, one might question whether investors should be in the business of making climate commitments at all. And we have witnessed some pullback from commitments, particularly

among US investors. I do believe, however, that climate commitments remain relevant for some investors.

First, the available evidence quite clearly shows that runaway global warming is likely to seriously harm both the economy and portfolio values over the long term. So, an asset owner with fiduciary obligations running several decades into the future (such as a pension fund) has a legitimate *financial* interest in seeing climate change being brought under control. Debates about what is the right target should not distract from this core fact.

However, what “under control” means will remain a highly contested matter, and for fiduciaries, the definition must always be founded on what is best for financial returns. Science and economics provide no single answer. Some argue, often based on the work of William Nordhaus (2019), that limiting global warming to 3°C or even higher strikes the right balance between costs and benefits. Others, typically focused on tail risks and tipping points, argue that conventional economic cost-benefit analysis makes little sense given the major risks and uncertainties of climate change and the limitations of economic models—and that anything above 1.5°C will be net damaging to portfolios, at least on a risk-adjusted basis (Trust et al. 2024; Stern, Stiglitz, and Taylor 2022).

Fiduciaries will need to come to their own view in good faith and based on considered reasoning, evidence, and advice. However, the investor case for strengthening climate mitigation policies compared with the current trajectory appears strong. The trajectory implied by current policies is typically considered to be around 3°C of warming (IPCC 2023). There is a growing weight of evidence that this level of warming would be materially negative for the economy and portfolio values over the long term, even in central scenarios before taking into account tail risks. It therefore seems entirely reasonable for a financial fiduciary to be in favor of more climate mitigation than we are seeing in a current policy framework.

As discussed previously, however, the evidence in favor of limiting warming to 1.5°C for *financial portfolio* reasons relies strongly on the perceived potential for imminent, fast-acting, severe, and cashflow-relevant tipping points. Although such tipping points cannot be ruled out, they are highly uncertain. The existence of low-probability but severe downside risks of course creates the case at the societal level for adoption of the precautionary principle, with democratic consent, to mitigate the risk even if costs are involved. However, given the deep uncertainty involved, this is a very difficult judgement for financial fiduciaries to make. At the same time, given the low likelihood of society achieving the 1.5°C goal, some fiduciaries may question how much sense it makes for them to adopt this goal and act on it, regardless.

Using these positions as bookends, it seems reasonable for a long-term fiduciary to at least (1) take a *directional* position of favoring significantly more stringent mitigation compared with the current policy trajectory, in line with the Paris Agreement goal of limiting warming to well below 2°C, and

(2) support progressive tightening of policy as a result, to the greatest extent that is politically feasible. Such a positioning for climate goals has a number of advantages. First, it is unambiguously aligned with the minimum ambition level in the Paris Agreement and so has democratic legitimacy as a goal in signatory countries. By contrast, the political status of the 1.5°C target (especially with limited or no overshoot) has always been less clear.⁶ Second, limiting warming to well below 2°C is consistent with credible policy pathways.⁷ Third, the purely financial case for this target is stronger for fiduciaries to rely on.

Undoubtedly the 1.5°C target has become a point of difficulty for some investors for all of the reasons outlined in this chapter so far. A reframing of the overarching climate goal to one that is biased toward a strengthening of climate policy while respecting the primacy of the political process could potentially draw in wider investor support. This reframing also lessens the force of arguments that investors are over-reaching what has been politically endorsed and in practical terms, given realistic pathways, may lead to no less ambitious outcomes. There is understandable resistance in some quarters to any perceived softening of overarching climate goals given the increasing, and potentially non-linear, nature of climate risks with every small mean temperature increase. But there is a risk that the goal ceases to be a useful basis for determining actions and targets for which investors can credibly be held accountable.

The discussion so far supports the case for investors, particularly long-term asset owners, to have some kind of position or commitment on climate. But it will not be relevant for all investors. Some asset owners will have time horizons that are too short for climate change to be among the most material factors. Some will not believe they have the expertise to take a position on climate targets or on what policies will be effective but will instead wish to focus on managing risks and opportunities for beneficiaries across a range of climate outcomes. Others will consider the tools at their disposal to influence change to be relatively weak and unable to justify specific focus on the issue. For asset managers, the materiality of climate change as an issue will depend strongly on the nature of the mandates they fulfill, their investment style, and the wishes of their asset owner clients. Some investors may believe that climate change, although important, is not their issue to address.

For investors who consider it appropriate to have an overall climate goal, the question then turns to how to translate that goal into specific objectives. The discussion of prevalent investor concerns about current target-setting frameworks provides the following insights.

First, government policy is of foundational importance to addressing climate change. Therefore, channels for investor influence on policy formation must be

⁶It should be recognized that the 1.5°C target has increased in prominence as climate scientists have become more pessimistic about the negative implications of any given level of warming, but this has only in rare cases been reflected in updated political commitments.

⁷See, for example, the Inevitable Policy Response at <https://ipr.transitionmonitor.com>.

of first-order importance. Second, direct investor influence on climate outcomes is limited, and investors need to protect the interests of beneficiaries in likely—not just desired—climate scenarios. Therefore, investors should focus on areas where they can influence company activity at the margin but in a manner consistent with the commercial incentives those companies face.

In the next two sections, I develop these themes, starting with policy influence and then turning to other forms of objective.

Influencing Policy

Given the foundational nature of government policy, it is hard to avoid the conclusion that climate-concerned investors who are serious about having an impact should first consider their influence on the policymaking process. Such influence can take a number of forms, direct and indirect.

Direct Policy Engagement

The Institutional Investors Group on Climate Change (IIGCC)⁸ started out with a major focus on creating an investor voice on policy. IIGCC can be credited with stiffening the resolve of both EU and global policymakers in the run-up to the signing of the Paris Agreement.⁹ Despite its importance, however, policy engagement receives relatively little attention in existing target-setting protocols, and of 127 investors that have published targets under the NZAOA framework and the Net Zero Investment Framework (NZIF), only 5 make any reference to public policy engagement.¹⁰ The Transition Pathway Initiative (2024) found that companies struggle to manage the interface between their activities and public policy formation.

Perhaps the key role for investors is to show strong and visible support for ambitious climate policy, particularly around key points of government policy development, such as climate finance negotiations ahead of COP 29 in Baku or the current revisions to Nationally Determined Contributions in the run-up to COP 30 in Belém. Climate policies frequently face organized and well-resourced resistance from affected business and labor interests that can be extremely influential politically. Investors are well placed to give governments assurance that the aggregate impacts of climate policies are manageable and that costs in one area are balanced by opportunities in another.

Second, investors can support specific policies that may have costs, but manageable costs, for some businesses but carry significant environmental benefits. Here, strong support from the investment industry can embolden governments to take action and can dilute resistance from affected sectors.

⁸IIGCC acts as one of the convenors for PAAO and NZAM.

⁹See www.iigcc.org/our-history.

¹⁰For initial targets set under the NZAOA framework and NZIF, see <https://www.unepfi.org/net-zero-alliance/alliance-members/> and PAAO (2022).

As an example, a group of major investors pressed the US government to adopt more-stringent methane regulations (Climate Action 100+ 2021). In such circumstances, investors have the opportunity to play the role of “honest brokers,” supporting reasonable regulation but pushing back on rules that are poorly designed or excessively burdensome.

Third, for investors to influence detailed policy development, they will need to bring insight into the critical government policies required to enable the institutional investment flows needed to support the transition to net zero in the sectors in which they invest. As an example, ahead of the recent UK general election, the UK Sustainable Investment and Finance Association (2024) developed a series of focused policy requests based on policies that would support private sector investment into the energy transition. However, involvement needs to go beyond issuing high-level concept statements on policy to detailed engagement plans with government officials at critical stages of policy development (for example, development of Nationally Determined Contributions or national transition plans). Chapters 2, 3, and 6 of the UK’s Transition Finance Market Review (2024) set out what this might look like in practice.

Different investors will have different contributions that they can make where policy is inadequate. Some may be willing to engage in policy advocacy directly, either themselves or through industry associations. But to be impactful, such advocacy must be appropriately resourced, conducted at senior levels (e.g., the CEO to minister level), and carried out with appropriate vigor. Much current policy engagement is quite high level and appears to lack determined intent and resourcing, especially when compared with the very well-resourced efforts that incumbent industries deploy to defend against climate action. The UN PRI (2024) has established a pilot project on collaborative sovereign engagement in Australia. This is an initiative that deserves investor support, but its embryonic nature demonstrates how far this area has still to develop.

A problem for asset owners is that their asset managers do not have the same incentives to address the very long-term risks of climate change for portfolios. Indeed, there appears to be a large gap between the vigour with which the financial industry lobbies on climate change and the vigour with which it lobbies on regulation that it sees as harming its direct economic interests. So engagement with asset managers on their policy lobbying will be an important but challenging part of asset owner activity (NZAOA 2022).

Indirect Influence on Policy Engagement

An area that has recently gained prominence is the role that investors can play in influencing the lobbying practices of investee companies and membership of representative trade associations. Lobbying by incumbent industries against climate regulation clearly presents a significant impediment to development of rational climate policy. Investors can provide an important counterbalance to this, although it is a complex area where investors could easily be accused of

interfering in directors' area of responsibility. The NZAOA developed guidelines on policy engagement by investors directly and engagement with asset managers on lobbying alignment (NZAOA 2023). These guidelines rightly focus on governance, transparency, and alignment of policies with stated positions on climate change. The Principles for Responsible Investment (PRI) has developed guidelines for responsible political engagement (PRI 2022).

Lobbying has also recently been the focus of specific corporate engagements, showing that action is possible. Climate Action 100+ (2024) has successfully engaged with a number of high-emitting companies to ensure improved governance and greater transparency in relation to climate lobbying positions of firms themselves and their trade associations.

Nonetheless, action on corporate lobbying also has limits. Investors cannot order directors to lobby in a particular direction. Directors will always see some engagement with lobbying as being part of their duty to act in the best interests of the company. Policy engagement and action on policy lobbying should not be seen as the new silver bullets in the fight against climate change. As with other aspects of investor influence, they are inherently limited.

Maintaining Legitimacy in the Policy Debate

Investors are understandably concerned about becoming involved in any way with politics or political advocacy. A lesson many have taken from the anti-ESG backlash in the United States is simply to keep their heads down. Dangers clearly exist for investors wading into what many now see as a highly politicized swamp. Nonetheless, investors should not shy away from engagement on policy matters where they perceive that to be in the interests of their beneficiaries. Or if they do, they should accept that they have forsworn their single most material channel for climate impact and moderate their claims accordingly. Investors should, however, bear in mind several factors to help maintain the perceived legitimacy of their voice on climate policy:

- First, policy advocacy should be based on a very clearly articulated and robust case founded on the investor's financial interests. Investors should avoid speculative cases or implying too much certainty on highly uncertain conjecture.
- Second, to the extent possible, policy advocacy should be based on positions of fact that cannot be interpreted as taking a partisan political stance.

These first two conditions provide further support for the idea that a directional position of seeking to strengthen climate policy compared with current policies as rapidly as politically feasible may be preferable to lobbying for the more ambitious absolute goal of limiting warming to 1.5°C.

- Third, active policy engagement should focus on matters in which investors have expertise and that are directly material to them and should avoid areas that are readily characterized as political in nature.

As an example of this third point, an energy and utilities investor may have detailed knowledge about the requirements for government subsidy, planning, permitting and grid connections, and wholesale market reform in order to enable acceleration of investment in renewables, storage, and grid services. These policy requirements are also material to the investor's strategy. By contrast, investors are unlikely to have particular expertise or agency in relation to policies for a just transition for workers¹¹ (notwithstanding the importance of this issue), nor are such policies likely to be directly material to their investment strategy. Investors broadening policy engagement beyond their direct areas of interest and expertise can easily be perceived as acting from political motives or imposing their values on the rest of society.

- Fourth, when addressing corporate lobbying (or for asset owners, when addressing asset managers' lobbying), the focus should be on governance, transparency, and alignment between public positions and lobbying activity rather than trying to enforce particular lobbying positions.

Trying to mandate corporations to engage in a particular way on policy will likely be met with accusations of micromanagement and overreach into areas that are the preserve of company boards. Such efforts also may infringe on activities that boards consider to be part of their fiduciary duty to support the long-term interests of the company. Demanding transparency and alignment of lobbying activities, however, is simply a question of business ethics and plain dealing and so is less likely to be controversial, while still offering hope of modest change.

Exerting Influence at the Margin in Favor of Climate Action

I have devoted some time to the question of government policy given its foundational importance to and currently underemphasized role in investor climate targets. But what can investors do when government policy is not yet supportive of the desired change? Investors can influence climate action in other ways. Because these have been extensively covered elsewhere, I refer to them only briefly here. It should be emphasized, however, that in many cases, the practical influence of these actions is likely to be much lower than that of effective policy engagement.

¹¹Some aspects of just transition policies may be highly relevant for investors—in particular, the necessary finance structures to secure private sector financial flows to developing markets.

Corporate Engagement

Previously, I highlighted the fact that investor engagement, although well evidenced as a channel of investor influence on companies, has limited power. For this reason, engagement needs to be “limitations-aware” to be effective.

For example, engagement to try to force oil and gas companies to set production-cut targets, which these companies’ boards view as fundamentally against company interests, has largely failed. Engagement to encourage these companies to take methane emissions more seriously, however, has arguably been more successful. The latter issue, despite its high environmental impact, is low cost for the company to address and does not challenge the company’s core business model. Limitations-aware engagement involves investors focusing on low-cost adjustments companies can make that are consistent with long-term value creation but that have positive environmental impacts.

On the positive side, engagement can also create a supportive environment for directors who are seeking to innovate with strategies that create long-term value with lower environmental impact. Private sector investment in innovation will play a crucial role in addressing climate change. Directors have a significant zone of discretion in how they seek to create value, and investor support and challenge can encourage directors to seek value-creating pathways that are consistent with decarbonization. In other cases, investors may spread best practice gained from other investments they hold—for example, in relation to potential decarbonization within supply chains.

However, it is questionable how credible it is for investors to engage with companies in order to press them to become “aligned to 1.5°C.” Absent government policy designed to meet that outcome, it remains unclear whether such alignment is even a meaningful concept. This challenge is emerging within transition plans being published by companies and the complexities of defining “transition finance.” Such engagement has tended to focus on extracting corporate net-zero commitments and emission reduction targets. To date, however, there is little evidence that these efforts are leading to sustained emission reductions or business transformations, especially of a systemic nature.

Instead, I believe investors can make a greater impact in the climate arena by focusing on understanding and engaging with industry participants on key blockages in decarbonization pathways, helping understand and support the technology and policy developments needed to remove these impediments, and pressing companies to accelerate where there are transition opportunities that are at or close to cost parity. It is therefore encouraging that in its Phase 2 program, Climate Action 100+ (2024) chose to place greater emphasis on sector and thematic engagements. Ultimately, to be successful, investor engagement should focus on matters that enhance long-term value in portfolio companies and make decarbonization commercially viable. Investor action

cannot substitute for government regulation in the matter of addressing externalities.

Climate Solutions

Investment in “climate solutions” is a key part of target-setting frameworks under the various investor initiatives. Depending on how it is implemented, however, such investment may or may not have impact. At one extreme, investment in a fund of listed clean energy providers probably has little or no impact on climate change because the investment is not contributing to the provision of additional capital. At the other extreme, the provision of concessionary capital to finance-constrained and pre-economic climate solutions—a pure impact investment—will, almost by definition, have impact.

For most fiduciaries, impact investment in its purest sense will likely be off limits, although I have argued elsewhere that, perhaps, it need not be (Gosling 2024a). Climate-concerned investors, however, can focus on aspects of climate solutions investment that are likely to be more rather than less impactful.

Examples include the following:

- *Investments in private rather than public markets.* Investors who use their risk capacity and expertise to invest in private markets are more likely to provide genuinely impactful and catalytic capital. However, investors should guard against the assumption that private market investment automatically qualifies as impact.
- *Investments in climate bottlenecks.* Investors with an industry focus may be able to identify key technologies requiring development in order to unlock decarbonization in key industries. Examples might include regenerative agriculture, lab-grown meat, low-carbon cement, or green steel. Here, investors use their expertise to enable capital flows toward the technologies most likely to be successful.
- *Investments based on the provision of resources and expertise to develop new investment products.* This example might include development of blended finance structures, in which the ultimate investment provides a market rate of risk-adjusted return but the investor has used their time and expertise to help create an investible project.

This list is not comprehensive, but it illustrates how investors who want to have impact should pick their targets carefully, focusing on those dimensions where they can apply their expertise for greatest leverage and where their interventions are genuinely additional in some way.

Climate Integration

The final area where I believe investors can influence positively for change at the margin is through integrating climate considerations into the investment process. Investors who take account of climate risks and opportunities help

markets correctly price these factors and thereby ensure efficiency of economic signals. Although it is easy to lament slow progress on climate change, at the same time, the world is on a powerful and inevitable decarbonization trajectory, driven by improving technology and economics. Investors actively participating in these opportunities can also help with the efficient propagation of signals from policy or where there are economic tipping points.

Conclusion

For valid reasons, even climate-concerned investors may have reservations about signing on to the major investor initiatives on climate. There are legitimate fiduciary concerns about adopting 1.5°C-aligned targets, based on reasonable views of the impact of climate change on the economy and financial markets. There are also legitimate concerns about whether the primary focus of those initiatives, in terms of portfolio and asset alignment to 1.5°C pathways, is either credible or effective.

In this chapter, I have laid out these concerns, which I believe demand a fair hearing and which could influence how climate-concerned investors think about where to focus their efforts. Investors who hold these views should not automatically be seen as climate deniers; the concerns are often reasonable given the available climate and economic science and investor duties. However, analysis has also identified the limits of these concerns. For example, they do not negate the case for some investors to set climate targets. However, the analysis has provided insights into how climate commitments and targets could be made more robust and effective and, potentially, how support for them could be broadened.

I have argued that two particularly relevant factors are the foundational primacy of government policy to a successful transition and the inherently marginal nature of investor impact. These factors imply that a *directional* goal of supporting accelerated climate action to meet the Paris goal of 2°C or less may be both more realistic and more appropriate than the *absolute* goal of 1.5°C, which is a long way from the trajectory of likely policy. They also imply a different focus for specific climate targets for those investors who choose to take a position on the issue.

First and most importantly, influence on policy would be at the heart of investor activities, given its foundational role in securing an efficient and fair transition to a low-carbon economy. Investors cannot claim they are making a material direct contribution to climate action without a robust and well-resourced plan for influencing public policy development. Such influence can include both direct policy advocacy and indirect influence on the policy lobbying activity of investee firms or, for asset owners, their delegated asset managers. Although this area is important, it is also extremely sensitive, so I have made suggestions for how firms can maintain legitimacy in the policy arena.

Second, under this model, investors would not set portfolio decarbonization targets (or equivalent targets, such as implied temperature increase). Currently, these are the single most common type of target. Portfolio-level targets, however, bear no relation either to real-world decarbonization or to the channels by which investors can realistically influence decarbonization. Such targets involve significant data gathering, manipulation, and adjustment (for example, for portfolio growth and acquisitions) but ultimately are not very meaningful. Institutional portfolio emissions have fallen during recent years, yet global emissions have grown (Atta-Darkua, Glossner, Krueger, and Matos 2023). The portfolio decarbonization approach perpetuates a false narrative whereby “investors-as-central-planners” can squeeze the economy down on a decarbonization path to net zero. Moreover, the ability to manage portfolio coverage, start dates, methodologies (absolute versus intensity), emission scopes, and portfolio allocations makes such targets ripe for obfuscation and gaming. This can create a perception of investor action on climate that is not reflected in reality.

Third, engagement targets would no longer be based on the concept of asset alignment. Asset alignment is the idea that it is possible to identify companies as either net-zero aligned or not (for example, through adoption of “science-based” targets) and then to credit investors for the portion of their portfolio that is net-zero aligned. Net-zero alignment is inherently a society-wide phenomenon, which cannot be decomposed into company-level net-zero targets.

Reliance on forward-looking corporate targets is particularly problematic given the oft-demonstrated reality that commercial considerations trump carbon targets, when push comes to shove. Instead, engagement targets would be extremely focused and based on specific outcomes that an investor is trying to achieve (for example, exact real-time renewable energy matching for tech firms running data centers or methane reduction for oil and gas firms) according to the investor’s specific sector focus and expertise. Engagement targets would be “limitations-aware,” recognizing the marginal nature of investor influence and the impracticality of pushing for engagement outcomes that are against firms’ fundamental financial interests.

Fourth, generic targets relating to investment in climate solutions would not play an important role. Such targets enable extremely varied definitions of climate solutions and often involve investment in solutions that face no serious funding deficit. They therefore have no assurance of additionality. Instead, investors would adopt very specific targets where they can make a difference based on their expertise or influence. Such targets might include, for example, support for development or scaling of technologies to address key decarbonization blockages (e.g., low-carbon cement, carbon capture and storage, meat substitutes) or demonstration projects, such as project development in critical areas in developing markets. Climate solutions investment, to be impactful, will usually occur in private markets.

The resulting targets would likely be few in number and specific to each investor based on the investor's potential for maximum impact and points of leverage, recognizing the marginal nature of investor influence. Some may criticize such an approach for lack of comparability or lack of connection to economy-wide decarbonization trajectories. But the comparability and connection to economy-wide decarbonization trajectories of existing target-setting norms are an illusion. They create a false sense of accountability but with little connection to the real-world task of decarbonization.

The good news is that the areas of focus I recommend are far from new. Some members of the existing climate initiatives are already engaging on policy and on lobbying, although the intensity and resourcing are often wanting. Thematic and industry groups exist that focus on specific industry blockages and seek to find a way to remove these impediments. Investors are encouraging innovation in companies that will be crucial to the climate crisis. But there is also a significant volume of investor activity relating to portfolio and asset alignment with 1.5°C pathways that is time-consuming, expensive, not very impactful, and increasingly difficult for some investors to endorse. A focus on specific objectives related to investors' marginal ability to influence and on key blockages to decarbonization could enable larger and more impactful coalitions while avoiding some of the accusations of political overreach.

The approach set out in this chapter aims to contribute to the debate about the most appropriate form of investor action on climate. If adopted, it would be the basis for development of more focused and modest—but also, in my view, more effective—commitments. Such focus and modesty are simply appropriate recognition of the sphere of investor influence. Targets and objectives can still be ambitious, but they should be ambitious along realistic dimensions.

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