CLIMATE POLICY ROADMAP 2024 /25

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ABOUT THE PRI

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

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

ABOUT THIS PAPER

This discussion paper sets out:

- The imperative to act on climate change
- PRI's strategic approach to climate and objectives in relation to climate change
- Priorities for policy engagement and policy recommendations that can
    - support investors in their efforts to address climate risk
    - support investors to pursue positive outcomes on climate in line with their duties
    - and incentivise companies and capital market actors to accelerate delivery of the Paris Agreement, the net zero transition, and related commitments.

This paper invites discussion with signatories on climate issues from a policy perspective and serves as a resource for their own policy engagements on climate with governments.

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EXECUTIVE SUMMARY

Climate change is impacting lives, livelihoods, nature and economies across the globe. Limiting warming to the Paris Agreement's 1.5ºC limit is vital to avoid critical tipping points and the worst climate impacts.

The physical risks and impacts of current and projected climate changes, and the risks and opportunities of the transition to a resilient and net zero economy, are financially material for investors. And investors have a key role to play to drive, shape and respond to this transition in line with their fiduciary duties.

Public policy engagement is an important pillar of PRI's strategic approach to climate change. PRI continues to work with its signatory base to strengthen the enabling policy environment that supports investors to address risk, reallocate capital to the transition and invest in climate solutions.

In the coming years, PRI will support and engage with its signatory base to strengthen its work across financial, corporate practice and wider economic policy relevant to responsible investment. We recognise that financial and corporate policy must increasingly be complemented and underpinned by effective real economy policy to create a positive climate transition loop. A whole of government approach to the transition, with investable approaches to national transition planning, can help to strategically mobilise capital and provide certainty to investors.

The key areas of focus that PRI will work to facilitate engagement on include:

- *a whole of government approach to the economic transition to a resilient, net zero economy*
- *reforms to global and national financial and corporate policies to address climate risk and enable investment in the net zero transition.*
- *real economy policies aligned with the Paris Agreement to address climate risk and mobilise capital flows for the net zero transition*
- *reforms to the global financial architecture, to align financial flows with Paris Agreement goals, and to accelerate capital flows to EMDEs to enable their transition to a resilient net zero future*

In this document, recommendations are set out for governments across these domains, recognising that there is no universal approach that will be right for each national policy context. A targeted and coherent policy mix, certainty, clarity and scale are needed to drive forward a Paris-aligned policy framework. Creating a level playing field is crucial to drive sustainable investments and accelerate transition finance.

While the gap between national commitments to climate action and the Paris Agreement's goals loom large and the transition to net zero faces geopolitical headwinds, progress is happening in the policy environment. Progress is being made on climate-related disclosures, taxonomies and transition planning, annual investments in clean energy now exceed investments in fossil fuels, and nature, adaptation and social issues are increasingly integrated into climate-related public policy. These recommendations seek to capitalise on and accelerate this progress, whilst ensuring a system-level response that recognises the interconnectedness of risks and the need for holistic thinking to advance solutions.

SUMMARY POLICY RECOMMENDATIONS

Policy makers should consider the following recommendations in their markets:

- **Develop a whole-of-government approach to the transition** to a resilient, net zero economy, which takes account of socio-economic considerations. Embed national transition planning strategically to mobilise capital and provide investor certainty. **The next generation of Nationally Determined Contributions (NDCs) must be ambitious, credible platforms for investment.** The ability of NDCs (national climate targets and plans under the Paris Agreement) to mobilise capital will be enhanced through detailed and investable national transition plans and policies.

- **Pursue foundational financial policy reforms enabling financial flows to align with a pathway towards 1.5°C**. Significant progress has been made on embedding climate risk and climate goals in financial policy and regulation, but more needs to be done to ensure a level playing field, reduce market fragmentation and drive compatibility. Equally, policymaking must ensure depth, specificity and ambition in policy tools to drive alignment with Paris goals. This may require changes in the laws and regulations that govern financial markets, including those related to disclosures, duties, stewardship and outcomes-focused tools such as sustainable finance taxonomies and transition-related instruments (including transition plans). Nature, adaptation, human rights and social issues must be embedded in these reforms to maximise synergies.
- **Implement ambitious, urgent, just and equitable policy reforms that align economic activity with net-zero across all sectors of the economy** to mitigate climate change, build resilience and adapt to climate impacts. This includes accelerating the energy transition by implementing robust carbon pricing and market-based mechanisms, accelerating the full and equitable phase out of fossil fuel subsidies and establishing clear plans and targets for phasing out unabated fossil fuels in line with credible 1.5°C pathways. Central to the transition will be tackling fossil fuel demand by implementing the Global Pledge on Renewables and Energy Efficiency and by investing in Research and Development (R&D) and policy support for hard to abate sectors. Climate mitigation, adaptation and nature policy must also be connected to wider economic policy reforms, as current policy approaches are not sufficiently maximising synergies and addressing these issues in tandem. Implementation of commitments to tackle deforestation and land use emissions alongside nature loss are a priority.
- **Reform the global financial architecture to enable the transition across the global economy and accelerate capital mobilisation to EMDEs**. The Paris Agreement makes clear that we must align finance flows with climate objectives in order to attain them. There is sufficient capital globally for climate mitigation and resilience – but it needs to support and align with sustainability goals. However, the existing multilateral financial architecture and climate finance framework has not delivered finance at the necessary scale. These flows are crucial in shaping the future development trajectory in EMDEs. Policy reforms in this area include review and revision of the mandates of international financial institutions, scaling blended finance approaches, and agreeing an ambitious New Collective and Quantified Goal that meets the needs of EMDEs and clarifies the role of private finance. This needs to be supported by clear policy levers to deliver the large increase in climate finance required and connect with wider policy reforms needed to make financial flows consistent with the Paris Agreement.

THE IMPERATIVE TO ACT ON CLIMATE

Climate change is impacting lives, livelihoods, nature and economies across the globe. Limiting warming is vital to avoid critical tipping points and the worst impacts of future climate change.

For these reasons, governments committed through the Paris Agreement to limit global temperature rise to well below 2ºC above pre-industrial levels and pursue efforts to limit warming to 1.5ºC. The 1.5ºC limit reflects the scientific evidence that warming beyond this level leads to a significant worsening of impacts. To achieve this goal, global emissions must be reduced by 45% from 2010 levels by 2030, requiring governments to take urgent and substantial action to transition their economies in line with 1.5ºC pathways.

The physical risks and impacts of current and projected warming, and the risks and opportunities of the transition to a resilient net zero economy, are financially material for investors. Investors have a key role to play to drive, shape and respond to this transition in line with their fiduciary duties.

OBSERVED AND PROJECTED CHANGES TO THE CLIMATE SYSTEM

In 2023, the World Meteorological Organization (WMO) reported that the global average temperature in the past decade was 1.20±0.12°C above the 1850–1900 average.[1] The Copernicus Climate Change Service recorded that year as the hottest single year in global temperature data going back to 1850 and likely the hottest year in the last 100,000 years. On current trends, the scientific community has warned that it may be less than a decade before the 1.5°C limit is breached.[2]

Recent scientific research on climate tipping points suggests that warming beyond 1.5°C may lead to abrupt, irreversible, and dangerous impacts.[3,4] Without urgent action, tipping points may also trigger feedback mechanisms, leading to increased emission concentrations and further accelerated warming.[5] This research also suggests that the climate system may be more sensitive to elevated concentrations of greenhouse gases than previously thought; even warming of 1.0°C, a threshold that we already have passed, creates risks of triggering several climate tipping points.[6] The physical impacts of climate change already hitting most parts of the world are set to increase even if emissions are drastically reduced.[7] Every increment of warming to date has caused, and will continue to cause, more extreme weather and an intensification of multiple and concurrent hazards. These observed and projected changes provide an imperative to urgently reduce the emissions in order to stabilise the climate system.

CLIMATE RISK AND CLIMATE GOALS

Climate change can pose material risks to investments and to the financial system.

In the scientific and financial literature, climate risk is often described in terms of physical and transition risks. Physical risks stem from slow-onset chronic effects of a changing climate system (e.g., sea level rise that leads to floods and coastal erosion) and acute hazards (e.g., extreme weather that contributes

[1] World Meteorological Organisation (2024), Climate change indicators reached record levels in 2023

[2] Lamboll et. al. (2023), Assessing the size and uncertainty of remaining carbon budgets

[3] McKay et. al. (2022), Exceeding 1.5°C global warming could trigger multiple climate tipping points

[4] Nature (2022), Climate tipping points — too risky to bet against

[5] Wunderling et. al. (2024), Climate tipping point interactions and cascades

[6] Nature (2023), Why ideas of 'planetary boundaries' must uphold environmental justice

[7] IPCC (2022), AR6 Climate Change 2022: Impacts, Adaptation and Vulnerability

to floods and wildfires). Transition risks relate to exposure to changing regulations (e.g., carbon pricing that affects fossil-fuel intensive sectors), consumer preferences, and technological change. Climate-related litigation is also on the rise and this litigation risk is often described as transition risk.

Taken together, these climate risks can have adverse effects on the financial performance of assets and lead to volatility and devaluation of investment portfolios. Climate risks can also compound, interact, and extend across borders, leading to system-wide risks that cannot be mitigated through portfolio management and may destabilise the financial system and the interconnected global economy.

The climate crisis also affords institutional investors opportunities to drive system change and generate returns, for instance through investments in renewable energy and efficiency, in resilient infrastructure, and in high-integrity nature-based solutions that contribute to decarbonisation and resilience.

For institutional investors, these material climate risks have posed new challenges to investment strategy. Legal analysis has established that investors generally have a legal obligation to consider identifying and acting on climate-related financial risks, including system-level risks.[8] As the recent Legal Framework for Impact Summary Report identifies, climate is the issue on which investors have made by far the greatest progress— both in assessing the effects of their activities and in taking action to contribute to sustainability goals at the system level. However, without urgent policy action, investment portfolios remain exposed to significant system-level risks.

In this respect, financial experts have recently used the latest scientific research to improve understandings of financial and economic risk.[9] A recent cross-disciplinary research effort between earth system scientists and actuaries, for instance, examines how climate risk could impact the financial system and the long-term functioning of society.[10] This research underlines the need for policy makers to act decisively and with urgency to accelerate policy that increases the pace of the net zero transition, informed by up-to-date risk analyses and the potentially catastrophic consequences of delayed action. Those consequences could include the irreversible melting of ice sheets, disruptions in ocean currents, an increase in temperatures and sea levels, widespread agricultural failures and an intensification of extreme weather and disasters. These consequences could render parts of the earth uninhabitable, lead to large-scale financial losses, mass migration, political instability, conflict and social inequity.

Policies now in place put the world on track for a rise of between 2.4°C and 2.6°C by the end of the century. While scientists have warned that we are rapidly approaching 1.5°C of warming, it may still be possible to limit the temperature rise above that crucial limit. With urgent policy action that drives transformation in the real economy, in parallel to financial system alignment with sustainability goals, there may still be time to prevent the potentially catastrophic outcomes that occur beyond 1.5°C of warming.

[8] Freshfields Bruckhaus Deringer, 2021. A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making

[9] Trust et. al (2024), Climate Scorpion – The sting is in the tail: Introducing planetary solvency

[10] Institute and Faculty of Actuaries (2023), Emperor's New Climate Scenarios – a warning for financial services

PRI'S STRATEGIC APPROACH TO CLIMATE CHANGE

Public policy engagement is a critical element of PRI's strategic approach to climate change. PRI will support and enable its signatory base to strengthen the enabling policy environment for corporate, financial and wider economic policy. It will focus on policy that supports investors to address risk, reallocate capital to the transition and invest in climate solutions.

PRI STRATEGY 2024-2027

PRI's 2024-2027 Strategy sets out a vision for "A global financial system that rewards responsible investment, operates within planetary boundaries, promotes human rights and achieves equitable societies."

The Planetary Boundary Framework – Breaking Boundaries

The most recent assessment of the planetary boundary framework show that six of the nine planetary boundaries have been transgressed, including both most relevant to climate change (CO_2 and radiative forcing), reflecting intense human disruption to the Earth system. Research extending the planetary boundaries framework finds that seven of eight earth system boundaries have been crossed from the perspective of safety and justice, putting human wellbeing for current and future generations at risk.

- PRI's new strategy focuses on four strategic pillars that will maximise signatory value and accelerate progress towards a sustainable global financial system. These pillars encompass:
  - Driving signatory progression on RI while streamlining PRI mandatory reporting
  - Strengthening regional RI ecosystems and extending our reach in emerging markets and developing economies
  - Amplifying signatory impact by supporting and leading collaborative initiatives
  - Strengthening the enabling environment for RI by influencing government and multilateral policy and financial market practice

STRENGTHENING THE ENABLING ENVIRONMENT

The new strategy recognises the importance of intensifying the pursuit of policy and market change by coordinating, facilitating and undertaking engagement with policy makers, regulators, multilateral organisations and other actors in the financial and wider economic system.

Public policy shapes the rules by which the financial sector and wider economy operates. Regulations and policies influence how pension funds, insurance companies and other investors manage their and their customers' money. Policy critically affects institutional investors' ability and incentives to generate sustainable returns. It also affects the stability of financial markets and of social, environmental and economic systems and the scale of their portfolio risk. Policy engagement is therefore a natural and necessary extension of investors' duty to act in the best interests of their clients and beneficiaries.

Policy makers have played an essential role in kickstarting the transition to net zero and climate resilience. With the support of multilateral and national policy reforms in recent years, new investments in clean energy now exceed investments in fossil fuels, and the demand for coal, oil, and natural gas are all predicted to peak this decade. In 2023 at COP 28 in Dubai, governments also achieved an important agreement that signalled their commitment to transition away from fossil fuels and scale up energy efficiency and renewable energy, and negotiated the UAE Framework for Global Climate Resilience.

These policy reforms are fundamental to enable institutional investors to more accurately price and assess climate risk and plan their transition towards a stable, investable future. However, they are not yet sufficient to prevent rising emissions and warming, and the pace of the transition is now threatened by an increasingly volatile geopolitical environment.

Policy makers now face a decisive moment, at which they can still reduce systemic risk by committing to and implementing national policy in line with 1.5°C pathways. PRI efforts on policy are focused on supporting signatories to engage with policy makers to enable urgent action to mitigate systemic risks, including on climate change and biodiversity loss, enable the opportunities of the transition to net zero, climate resilient and nature positive economies, and provide certainty and stability for institutional investors.

ENHANCED FOCUS ON THE REAL ECONOMY

While there has been substantial focus in recent years on addressing climate risk and transition in financial and corporate policy, the financial sector cannot deliver the transition to net-zero and climate resilience alone. Decisive action from policy makers to facilitate the transition in the real economy is imperative.

This can accelerate emissions reductions and provide the stability and predictability investors need to allocate capital to climate mitigation and resilience solutions. Evidence shows that real economy policies – incentives, carbon pricing, efficiency standards and other approaches - are powerful levers for mitigation and economic transformation.[11] In combination with multiple policy levers, they can overcome barriers to transition and open new opportunities. However, this is not happening at the pace needed to meet the Paris Agreement's goals.

As the Net Zero Asset Owners Alliance puts it:

"*There is a clear need for governments and policy makers to move in line with the science…Without this collective movement from policy makers and the real economy... [institutional investors] may need to eventually "exit the majority of the investible universe".*[12]

More recently the Alliance has highlighted that "implementing effective climate policy is the single most important factor to achieving the goals of the Paris Agreement."

PRI will therefore focus on supporting and enabling engagement on financial policy, corporate practice policy, and real economy climate policy and regulation in tandem to maximise the universe of assets aligned with a climate-safe future and to address systemic risk. This approach can create a positive feedback loop that accelerates the transition.

OBJECTIVES OF PRI CLIMATE POLICY

The goal of PRI's climate policy work is to support and enable its signatory base to drive urgent climate-related policy reforms that contribute to reducing climate risks and enable capital allocation towards achievement of the Paris Agreement goals, by supporting a timely global economic transition to net zero emissions and climate resilience.

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[11] IPCC (2022), Climate Change 2022 – Mitigation of Climate Change

[12] Net-Zero Asset Owner Alliance (2023), Target Setting Protocol

This can support investors to deliver returns, discharge their fiduciary duty and manage their risks more effectively for the long term. The objective is set out in more detail below.

OVERARCHING OBJECTIVE

The PRI will support and enable its signatory base to engage in the development of key financial, corporate and real economy policies and regulations to manage climate risk and drive positive climate outcomes on mitigation, adaptation and resilience. It will seek to drive a holistic, consistent approach to these from national governments.

The PRI will support policies that enable investors to

- effectively address climate risks
- reallocate capital to the net zero transition
- and invest in climate solutions, that provide mitigation and adaptation benefits and other co-benefits.

It will also support policies and regulations which incentivise companies and capital market actors to align with the goals of the Paris Agreement and related policy architecture.

These policy solutions should ideally maximise synergies to drive other sustainability outcomes around nature, human rights, just transition, development and the reduction of socio-economic inequality, but at minimum, do no significant harm to these goals.

As PRI's recent discussion paper on the social dimensions of the economic transition makes clear, a successful transition to net zero depends on buy-in across diverse societal groups and sectors.[13] That work suggests that policy makers should adopt a whole-of-government approach, involving all stakeholders and all available policy levers.

THE CLIMATE POLICY LANDSCAPE

This section sets out the evolution of climate policy and explores key components of the policy mix and governance of net zero. It shows that a targeted and coherent policy mix, certainty, clarity and scale are needed to drive forward a Paris-aligned policy framework. There is also a value in flexibility, learning and driving alignment where feasible

CLIMATE POLICY THROUGH TIME

Global climate policy has seen significant evolution over the last two decades. One notable shift has been from policy rooted strongly in economic theory to a political economy approach which focusses on a pragmatic mix of policies to drive change in different markets.

Early climate policy through to 2009 focused extensively on pricing carbon through taxation and carbon markets, alongside subsidies for clean energy deployment. Efforts to support the roll out of carbon pricing across jurisdictions remains a key focus. In the decade through to 2020, multi-sectoral policy interventions on the climate transition became more evident. It saw disclosure obligations for business and financial actors, sectoral regulation, supply and demand side policies, including efficiency standards, and the notable industrial policy approach taken by China and the US to the energy transition.

The 2015 Paris Agreement marked a watershed for climate policy. In addition to the clear new temperature goals, nationally determined approaches and rachet mechanisms it put in place, it provided

[13] PRI, 2024. The Socioeconomic Implications of the Economic Transition. A Discussion Paper.

significant context for the acceleration of net zero policy and standards for private sector actors. These have been both risk and transition oriented, and many were initially voluntary. This phase saw a proliferation of measures around transparency, scenario planning and target setting, with, for instance, the development of TCFD, SBTi, green taxonomies and accounting standards. PRI's recent update to its Regulation Database has identified a significant expansion in the Responsible Investment policy universe, and particularly has highlighted the expansion of instruments that are rooted in the Paris Agreement (growing from 33 to c.200 policies since 2015).

In the last few years, with deepening geopolitical and trade tensions, challenging macroeconomic headwinds in key markets, and the ongoing social effects of the related energy crisis, we are seeing different markets adopt different approaches. This presents both opportunities and challenges – opportunities to develop climate policy rooted in national circumstances that has better social license, and challenges in creating a level playing field across diverse policy regimes.

To address this tension, a mix of policy levers across financial, corporate practice and real economy policy which respond to specific economic and social conditions is important. As the IPCC's 6th Assessment Report shows, climate governance is "most effective when it integrates across multiple policy domains, helps realise synergies and minimise trade-offs, and connects national and sub-national policymaking levels". The IPCC has also identified that nationally specific policy packages, especially wider economic packages, are critical to an effective transition. This must be coupled with moves to level the playing field through international harmonisation, standard setting and efforts to promote interoperability.

PRI'S CLIMATE POLICY PRIORITIES

Institutional investors can drive, shape, and respond to opportunities to drive global systems reform in order to achieve climate goals. The following section identifies key domains for policy influence, explains the rationale for this and highlights key policy priorities to which PRI intends to support and enable signatories to contribute.

NATIONAL TRANSITION STRATEGIES

Priority: ***Develop and implement a "whole of government" approach to the economic transition and embed national transition planning strategically to mobilise capital and provide investor certainty.***

RATIONALE

The transition to a net zero, climate resilient, nature-positive and more equitable economy demands a shift from current systems that exacerbate environmental damage, financial instability, and social inequality. While capital is being mobilised to support this transition, this is not happening at the scale needed. Well-intentioned climate policy and climate-focussed financial regulation is at times counteracted by business-as usual economic and social policy, as detailed in PRI's 2023 white paper on Investing in the Economic Transition. A successful transition will require more comprehensive and holistic approaches to address barriers and to ensure that the benefits are maximised.

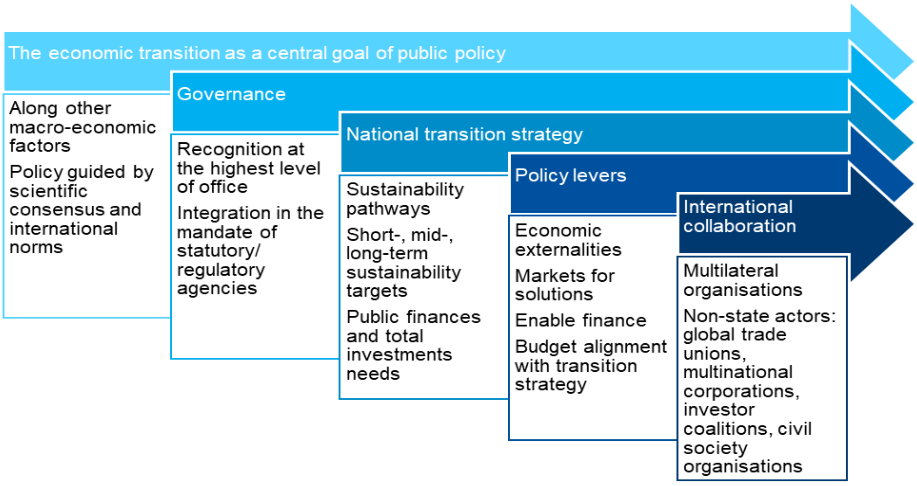
PRI's 2023 Framework Approach to implementing this transition argued that the economic transition needs to be a central goal of policymaking and that a "whole of government" approach has to be at the core of policy decisions. This approach will provide policy certainty needed to rapidly upscale finance into low-carbon solutions, nature-based solutions, adaptation and resilience.

Key elements of this approach (see Fig 1 below) include

- transparent goal setting and mission-led approach across all policies;
- the integration of strong governance mechanisms;
- the development of clear national transition strategies;
- the deployment of coherent and complementary policy levers across multiple domains (financial, corporate, real economy, public finance etc); and
- international collaboration to address barriers and enhance regulatory alignment.

It is essential to embed socio-economic considerations into this approach to avoid societal backlash and polarisation resulting from unintended impacts and to realise the social benefits of the transition in reducing inequalities and enhancing wellbeing. Alongside a "whole of government" approach, this requires policy makers to have a holistic understanding of the stakeholders in this transition in order to mediate their needs, and to identify systemic policies that address the root causes of inequality. It also requires policy makers in advanced and emerging economies to engage with their counterparts in developing and vulnerable economies to minimise unintended impacts of their climate policies on the global scale and that justice is appropriately interpreted and integrated.

Figure 1. A high-level policy framework for a whole-of-government approach to the economic transition



Investable National Transition Plans and NDCs

Recent research has looked at the importance of national transition planning and the need to make plans "investable". This work has primarily focussed on the next round of Nationally Determined Contributions (NDCs) due in 2025 but aligns closely with the "whole of government" approach in terms of its emphasis on strategic national planning for the transition to enhance investor confidence.

Concretely, this means identifying the economic and wider goals of the transition; understanding and spelling out its macroeconomic effects; setting out detailed sectoral transition plans and policies; and setting out investment plans (which might include total investment needs, the role of the private sector in meeting them, and potentially financing vehicles).

For investors, this serves as a compass and clear signal to assist their allocation of capital, increasing confidence in the credibility of government commitments and the intended vehicles to achieve them.

PRI's Collaborative Sovereign Engagement Pilot Project, which has been supporting investor engagement with Australian sovereign entities in its first phase, has set out investor expectations around the next Australian NDC, outlining the national transition planning components that would make the NDC investable and emphasising the materiality of NDCs for institutional investors.

POLICY RECOMMENDATIONS

National Transition Planning

Develop a whole-of-government approach to the transition of the real economy to a net zero, climate resilient, nature-positive and more equitable economy. This needs to take account of its socio-economic and environmental implications and be placed at the heart of public policy making.

- **Make the next generation of Nationally Determined Contributions (NDCs) in 2025 ambitious, credible platforms for investment**
  - **Use the opportunity afforded by the next round of NDCs to rachet up ambition** in line with the science and evidence of worsening climate impacts. Governments must align NDCs with 1.5°C pathways with early and sustained action on policy and finance, taking account of countries' respective capabilities, development needs and common but differentiated responsibilities.
  - **Support NDCs with detailed and investable national transition plans.**

- Use the opportunity of the NDCs submission, ongoing ratchet and review opportunities, and related processes (including required Long-Term Strategies which have a longer time horizon), to mobilise private capital.[14]
- Provide clear information to investors and companies about where national governments seek to allocate capital for the transition.
- Include sectoral decarbonisation roadmaps with credible milestones and timelines to strengthen investor confidence.
- Specify the role of the private vs public capital within this and the timelines and proposed key funding vehicles.

FINANCIAL AND CORPORATE ALIGNMENT WITH PARIS GOALS

Priority: ***Support reforms to global and national financial and corporate policies to address climate risks and enable investment in the net zero transition***

RATIONALE

PRI has long engaged on regulatory reforms to align financial flows with the Paris Agreement goals. Work in this area covers: climate-related financial risk disclosures; recognition of fiduciary duty to act on climate risk; regulatory frameworks for transition planning; international alignment of sustainable finance taxonomies; due diligence, and investor stewardship regulations. Increasingly, PRI has engaged on system-wide risks to the financial sector (prudential risks). Most financial policy reforms that PRI addresses have been "issue neutral". We will continue to work with signatories to address foundational policy reform, investing for sustainability impact and a number of key regulatory instruments detailed below.

The recent expansion of corporate and financial instruments that support the strategic reorientation of companies and financial institutions and the effective management of physical and transition risk is an important development. But key issues need to be addressed including the need for enhanced regulatory compatibility and interoperability to reduce market fragmentation and level the playing field, and the need to align policy instruments with delivery of the Paris goals. The Taskforce on Net Zero Policy, which PRI serves as Secretariat is currently considering examples of good practice across the G20 to support compatibility and delivery of the global goals.

PRI will also support its signatories to encourage a financial system policy response that accounts for new evidence on escalating physical and transition risks and the increasing likelihood of a breach of 1.5^{o}C of warming. Whilst this indicates redoubled effort to accelerate mitigation focussed policy, it also increases focus on ensuring that existing risk-based and prudential tools are fit for purpose. Further, it requires a strengthened focus on meaningful carbon removals and on adaptation in real economy policy.

As financial and corporate practice policy are addressed, it is vital to embed nature, adaptation and social issues into these reforms. These domains are deeply intertwined. Net-zero will not be achieved without halting and reversing biodiversity loss, and we cannot tackle biodiversity loss without addressing climate change as a driver. PRI's recent Nature Policy Roadmap sets out key priorities to address these risks across the financial regulatory landscape . Additionally, increased action on climate adaptation is urgently needed to manage the physical risks from the increased frequency and severity of climate hazards. All these must centre the needs of the people who are most at risk from climate impacts and are most exposed to social risks in the transition.

[14] UNFCCC (2024), Long-term strategies portal

POLICY RECOMMENDATIONS

To align the financial and corporate sectors with the goals of the Paris Agreement, policy makers should consider the following recommendations in their markets:

Pursue foundational financial policy reforms enabling financial flows to align with a pathway towards 1.5°C.

- These reforms may comprise changes in or clarifications of laws and regulations that govern financial markets, which may mean enhanced consideration by regulators of disclosures, duties, stewardship, transition planning and outcomes-focused tools such as sustainable finance taxonomies.
- **Clarify investor legal duties** on pursuing sustainability impact goals where necessary, while shifting the emphasis decisively to policies that support and incentivise investor action to contribute to sustainability goals. The Legal Framework for Impact summary report by the PRI, UNEP FI, and the Generation Foundation finds that the debate is shifting from whether investors should consider sustainability outcomes at all, to asking how investors can play their full role in addressing sustainability risks and challenges.
- **Codify active ownership** for investors to support corporate transitions towards net zero and maximize the overall long-term value of investments and companies with clear guidance on Paris-aligned transition planning, as transparent transition planning provides crucial decision-useful information for investors.
- On disclosure, **adopt the ISSB standards** – IFRS S1 and IFRS S2 – with as few deviations as possible and on an economy-wide basis, promoting availability of consistent and high-quality data across investment portfolios to support effective investment decisions. Jurisdictions may consider complementing this with further forward-looking disclosure requirements building on additional resources, for instance on just transition, nature impacts, due diligence, taxonomy alignment or lobbying and engagement, to provide supportive foundations for transition planning.[15] These include those released by initiatives such as the Taskforce on Nature-related Financial Disclosures (TNFD) and the upcoming Taskforce on Inequality and Social-related Financial Disclosures (TISFD).[9]
- Provide clear guidance on **Paris-aligned entity-level transition plan requirements** for investors and corporates, building on an emerging convergence among principal frameworks, standards, and initiatives about the key elements of such plans: climate-related governance; scenario analysis and setting climate targets; identification of impacts, risks, and opportunities; decarbonisation strategies, actions, and levers to implement the plan; financial planning, including capex (capital expenditure) plans; accounting and verification; policy engagement; and value chain engagement.
- **Develop and implement sustainability classification instruments** including sustainable taxonomies, sectoral technology and investment pathways and labelling schemes for financial products. These should build on scientific consensus and international norms. Given the proliferation in sustainable taxonomies – with approximately 50 taxonomies in place or in development globally - there is a particular need to address compatibility between frameworks, as well as alignment with Paris goals. These instruments must also support transition finance. Financial authorities may consider connecting these to transition plans and stewardship strategies to facilitate financial flows toward phasing out polluting technologies while supporting activities aligned with climate goals and international standards. Well-designed financial policies can incentivise climate- and transition-

[15] Additional resources may include the Transition Plan Taskforce Disclosure Framework and climate-related disclosures from the GRI Standard but additions should only be on top of the ISSB's global baseline.

related bond issuance that increases investor confidence and transparency in directing capital towards the transition.

- **Embed nature, adaptation, human rights and social issues** into these reforms, seeking to maximise synergies. These should aim to deliver a fair and equitable transition through dedicated corporate disclosures and practicable human rights and environmental due diligence requirements in line with international standards.

REAL ECONOMY TRANSITION TO NET ZERO, CLIMATE-RESILIENCE

Priority: *Align real economy policy with the Paris Agreement to manage climate risk and mobilise capital flows for the net zero transition*

RATIONALE

Meeting the goals of the Paris Agreement will require decisive action to reduce emissions in across all major high-emitting sectors. While decarbonisation is accelerating, the transition is not happening at a sufficient pace to prevent rapid rates of warming and worsening climate impacts. On one hand, the Global Stocktake outcome at COP28 saw nearly 200 countries agree to support a just and equitable transition away from fossil fuels and set a goal to triple renewables and double energy efficiency by the end of the decade and highlighted the importance of other issues like methane reduction and deforestation. According to the IEA, implementing this outcome would drive down emissions by 10bn tonnes compared to what was expected.[16] But this progress is counteracted by record fossil fuel subsidies that governments have justified in part as a response to the energy crisis. Several major high emitting companies, including oil majors, have also retreated from previously announced decarbonisation targets.

The scientific imperative is unambiguous—global greenhouse gas emissions must peak in 2025 to keep the 1.5°C goal within reach. This starts with transforming the global energy system, which accounts for around three quarters of the world's greenhouse gas emissions.[17] Finance for clean energy alone needs to scale globally from 1.8 to 4.5 trillion USD annually by the early 2030s, the vast majority of which will come from the private sector.[18] Recent public policies—including the US Inflation Reduction Act, the EU Fit-for-55 Package and China's industrial policy—have helped drive global investments in clean energy.

- A significant decline in fossil fuel production is necessary—no new oil and gas fields and no new coal mines or coal extensions are required to align with 1.5°C.[19] However, fossil fuel production in advanced economies has surged, with resulting greenhouse gas emissions expected to exceed 12 billion tonnes.

Achieving the alignment of the energy sector with the goals of the Paris Agreement requires a significant expansion in the universe of investable climate solutions and a disruption in capital flows to fossil fuels. This in turn requires an enabling economy-wide policy environment. For policy makers, delivering this transition requires a focus on systemic interventions that drive demand reductions, improve efficiency, and increase supply of low-carbon energy sources. These actions are critical to incentivise capital mobilisation for the transition and decrease the attractiveness of investments that lead to carbon lock-in.

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[16] IEA (2024), From Taking Stock to Taking Action

[17] IEA (2021), Net Zero by 2050

[18] IEA (2023), The path to limiting global warming to 1.5C has narrowed, but clean energy growth is keeping it open

[19] IEA (2021), Net Zero by 2050

Equally, extensive focus is needed to transform land use sectors, including agriculture, and halt deforestation and land degradation. Deforestation represents the second-largest source of annual greenhouse gas emissions behind fossil fuel combustion and is a key driver of biodiversity loss.[20] The transformation of land-use sectors requires extensive focus on production and consumption dynamics and associated policies such as subsidies, which are covered in PRI's Nature Policy Roadmap.

POLICY RECOMMENDATIONS

To accelerate the real economy transition to net zero and climate resilience, policy makers should consider the following recommendations in their markets:

Implement ambitious, urgent, just and equitable policy reforms that align economic activity with net-zero across all sectors of the economy to mitigate climate change, build resilience and adapt to climate impacts.

Carbon Pricing

- **Implement robust mandatory carbon pricing mechanisms** to incentivise cross-sectoral low-carbon innovations and increase the attractiveness of sustainable solutions. Effective carbon pricing must provide predictable price signals, minimise competitive distortions, promote international cooperation, show appropriate coverage and ambition, be aligned with national targets, and enable a just transition.
- **Embed carbon markets** – both in-country and globally - as an important tool to support the transition in a cost-effective and flexible way and to mobilise finance for climate and nature goals. These are expanding in national and sectoral coverage, including in emerging markets.[21] Supporting linkages between existing markets and agreeing guidance to enable the operation of global carbon markets under Art. 6 of the Paris Agreement will be important to remove barriers, help level the playing field and mobilise finance.
- **Voluntary carbon markets** can play a complementary role in incentivising emissions reductions and removals. Well-designed voluntary markets may support mitigation in jurisdictions and sectors that do not have the readiness to implement a compliance system. They may also help neutralise residual emissions from the hardest-to-abate sources

Fossil fuels

- Commit to a clear timeline and **accelerate the full and equitable phaseout of fossil fuel subsidies**, including the elimination of subsidies for fossil fuel exploration and production, consistent with credible pathways for limiting global temperature rise to 1.5ºC, including those set out by the International Energy Agency (IEA).
- Additionally, establish clear, **time-bound targets and plans for phasing out all unabated fossil fuel production and use** in line with credible 1.5ºC pathways, including through ramping up greenhouse gas emission standards for large emitters and energy efficiency standards in end-use sectors. This is vital to help prevent carbon lock in and stranded assets.
- **Implement the Global Methane Pledge** to cut damaging methane emissions by 30% by 2030, including through setting national strategies and targets, introducing new policies and regulations to tackle flaring, venting and fugitive emissions, providing technical and R&D support, and improving monitoring of methane sources.

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[20] SEI (2019), Agricultural and forestry trade drives large share of tropical deforestation emissions

[21] World Bank (2024): State and Trends of Carbon Pricing

Renewable energy and energy efficiency

- **Implement the Global Pledge on Renewables and Energy Efficiency** agreed at COP 28 to triple the global installed renewable energy capacity and double the annual rate of energy intensity improvement by 2030. Provide tax exemptions and/or subsidies for clean technologies or equivalent market-based policies and support measures for early-stage innovation and research & development. This should include creating enabling conditions for rapid electrification, including grid and transmission infrastructure and storage capacity

Steel, Cement, and Heavy Industry

- **Implement tax incentives, procurement and R&D policy aimed at maximising emissions reductions in the construction industry** focused on materials with high embodied carbon, including steel, cement and concrete, asphalt, and flat glass. Additionally, invest in low-carbon steel and cement production, including through the deployment of green hydrogen and CCS/CCUS. Prioritise CCS deployment in hard-to-abate sectors alongside clear transition plans.
- **Strengthen and enforce existing environmental standards to tackle industrial pollution**, including across iron and steel, cement, aluminium, ammonia, and glass, addressing historical under-regulation of hazardous pollution in these sectors in tandem.
- **Adopt equitable, carbon-conscious trade policy** to enhance consistency, reduce carbon leakage, and drive decarbonisation across the full supply chain. This may include implementing a carbon border adjustment mechanism which puts a fair price on carbon-intensive industrial goods, designed in a way that is equitable and ensures that the social implications, including cross-boundary, are addressed.

Circular economy and demand management

- **Reduce virgin material and energy demand by applying circular economy approaches** and **Leverage Green Public Procurement (GPP)** at national and international levels**.** Public bodies should use GPP for their investment decisions, stimulate demand and investment for the net-zero economy

Connect climate mitigation, adaptation and nature policy

Physical risks from extreme weather events are escalating globally due to rising temperatures and increasingly volatile weather patterns, posing financially material risks for investors. Even with drastic emissions reductions, global temperatures will continue to increase in the coming decades due to cumulative locked in greenhouse gas emissions, and physical impacts will increase. Policy reforms must therefore consider mitigation and adaptation in an interconnected manner, including in relation to nature.

- **Develop national transition strategies with coherence between climate, nature and adaptation**. Countries should deliver NDCs alongside clear, robust and ambitious National Biodiversity Strategies and Action Plans (NBSAPs) aligned with the Global Biodiversity Framework. They should give clear mid- and long-term signals to investors. Equally, inclusive National Adaptation Plans and associated financing plans should be developed to support resilience, especially in underserved and climate-vulnerable communities that are often least prepared to deal with the effects of a changing climate.
- Key additional policy reforms to deliver on **climate-nature-adaptation nexus** include
  - Deliver on the Global Stocktake outcome and the **Glasgow Leader's Declaration on Forests and Land Use** commitments to halt and reverse forest loss and land degradation by 2030.
  - **Align national food systems and agriculture policies with climate and nature** objectives in a proportionate and equitable way to address forest loss and land degradation and reduce emissions, while ensuring the resilience and long-term health and productivity of food systems.

- **Support the Global Goal on Adaptation** by implementing the Sharm-El-Sheikh Adaptation Agenda, the UAE Framework for Global Climate Resilience and scaling up nature-based solutions and ecosystem-based adaptation approaches.
- **Scale up the deployment and utilisation of nature-based solutions** to capture climate and nature co-benefits. For climate mitigation, this means prioritising nature-based carbon sinks over industrial carbon removal techniques. For climate adaptation and increased resilience, it means focusing on ecosystem-based adaptation approaches.

- **Provide policy support for emissions removal**, both nature-based and technological, including financial incentives, portfolio mandates and targeted support for R&D and strategic demonstration projects. While the primary focus must remain on deep decarbonisation and mitigation in land-based systems, emissions removal is complementary to mitigation and adaptation and essential to meet Paris temperature goals, especially given new evidence of escalating climate risk**. Ensure bioenergy policies and the harvesting of biomass does not weaken natural carbon sinks** – mainly in forest stocks and peatlands – needed for carbon removals and storage

Social dimensions of climate impacts and the transition

Climate change is having profound impacts on human wellbeing. Its impacts are already being felt by the most vulnerable communities and are spread unevenly, with those who have contributed least to the problem at the frontline of its impacts. Public policy reforms should account for the extensive social and justice impacts of climate change and the transition underway to address the climate crisis. These relate to conflict, inequality, public health, considerations over employment shifts, energy access and affordability, and the potential to safeguard health and wellbeing, and social equity, in the economic transition to net zero.

Policy makers should:

- account for **competing priorities of all stakeholders**, and conduct effective engagement
- **advance justice as a wide concept** and respect fundamental rights, including the rights of indigenous peoples, particularly to give free prior and informed consent to transition activity.
- account for the **rights of workers and communities** in the transition, both in terms of transitioning out of high emitting sectors, as well as transitioning into more sustainable activities and sectors.

REFORM OF THE GLOBAL FINANCIAL ARCHITECTURE TO ENABLE THE TRANSITION

Priority: *Reform the global financial architecture to align financial flows with Paris Agreement goals. This should accelerate capital flows to EMDEs to enable their transition to net zero and climate resilience. This should support PRI's upcoming Emerging Markets Strategy.*

RATIONALE

The stability and fit-for-purpose of the global financial system are highly relevant to responsible investors, not only in the case of mobilising and aligning financial flows to areas most in need but also in strengthening the broader global finance policy agenda.

The scale of finance to reach net-zero, nature positive is beyond the scope of the public or private sector alone to deliver. USD 2.4 trillion will be needed annually in EMDEs (ex-China) by 2030 to deliver on a just energy transition, tackle loss and damage, conserve nature and enhance adaptation and resilience (at least a fourfold increase in investment), with at least USD 1 trillion from private finance (domestic and international), while a fifteen-fold increase in international private finance will be needed to deliver climate mitigation goals in EMDEs (ex-China). However, the existing multilateral financial architecture and climate finance framework has consistently failed to deliver finance and implementation at the necessary scale and speed. Many investors are cautious about engaging in emerging markets, and perceptions of risk are often higher than borne out in data – in part due to a lack of access to historical data and reliable metrics[22]

The Paris Agreement makes clear that we must make finance flows consistent with climate objectives if we are ever going to attain them. From a system view, this component of action recognises that financial flows are crucial in shaping the future development trajectory in EMDEs. Mobilising private capital at an unprecedented scale is part of the system reform needed, including for adaptation and resilience.

POLICY RECOMMENDATIONS

To reform the global financial architecture to enable the transition, policy makers and shareholders should consider the following recommendations, as appropriate in their markets. More detailed insights and recommendations are found in PRI's Policy Brief on Reforming the Multilateral Financial Architecture.

Align the multilateral financial architecture with sustainability goals.

- **Review and revise the organisational mandates** of international financial institutions to focus on promoting sustainable economic growth and social equity while simultaneously tackling the planetary crisis of climate change and biodiversity loss.
- **Mobilise capital for EMDEs** through scaling credit-enhancement programs and other blended finance approaches; exploring auxiliary financial structures and leveraging the strengths and complementarities of pools and financing vehicles that reduce the capital costs for borrowers; concessional public finance; technical assistance and capacity building support to EMDE governments; and enhanced use of collaborative platforms such as Just Energy Transition Partnerships. Improve investor access to historical risk data in EMDEs to address misperceptions.
- Accelerate capital mobilisation towards mitigation, adaptation and resilience in EMDEs through the **New Collective and Quantified Goal (NCQG)** on climate finance, due to be agreed at COP29. The new goal should be ambitious, meet the needs of EMDEs, and recognise the important role of non-Party Stakeholders (NPS) and private finance, as well as multilateral forums such as the G20. It should also consider the policy levers to deliver the large increase in climate finance required.
- **Accelerate related progress on Article 2.1c of the Paris Agreement** which seeks to make financial flows consistent with net zero and support climate resilience, including on the policy levers to deliver this. There is sufficient capital globally for climate mitigation and resilience – but it needs to support and align with sustainability goals.

[22] IFC (2024), Reassessing Risk in Emerging Markets: Insights from GEMs Consortium Statistics

LOOKING AHEAD

The scope of these climate policy priorities has been guided by the latest scientific evidence, global policy debates, the experience within PRI-led or supported initiative activity, signatory engagement, and the evolving ESG investment landscape. Regional policy teams have identified key opportunities for policy reforms in their jurisdictions. Priorities by region are identified in PRI's 2024-2025 Policy Strategy and will be set out in further annual strategies.

The PRI will refer to this Roadmap as key reference material in its climate policy engagement activities towards COP30. This paper is also intended to serve as a resource to support investors' own policy engagements on climate policy that they are pursuing in line with their fiduciary and stewardship duties.

POLICY ENGAGEMENT OPPORTUNITIES

The PRI will conduct policy engagement with multilateral organisations, including UN entities, and national governments to promote the policy reforms described in this paper on an ongoing basis, initially via the biodiversity COP16 in Columbia and climate COP29 in Azerbaijan.

We will engage with signatories and stakeholders throughout this process, including through our Global Policy Reference Group and Regional Policy Reference Groups. We will also continue to support and facilitate climate policy engagement through PRI-led or supported Net Zero Initiatives, stewardship initiatives such as Climate Action 100+ and the Collaborative Sovereign Engagement Initiative, which is due to expand to new markets in 2025.

NEXT STEPS FOR POLICY RESEARCH

PRI will continue to engage with its signatory base and relevant stakeholders to further develop, refine and evolve policy recommendations as necessary in line with global developments and policy priorities for a sustainable financial system. The PRI recognises that climate policy is a dynamic, complex topic.