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Zeroing In

The US Financial Sector Perspective on Net-Zero Lending and Investing

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About Us

About RMI

RMI is an independent nonprofit founded in 1982 that transforms global energy systems through market-driven solutions to align with a 1.5°C future and secure a clean, prosperous, zero-carbon future for all. We work in the world's most critical geographies and engage businesses, policymakers, communities, and NGOs to identify and scale energy system interventions that will cut greenhouse gas emissions at least 50 percent by 2030. RMI has offices in Basalt and Boulder, Colorado; New York City; Oakland, California; Washington, D.C.; and Beijing.

About the Center for Climate-Aligned Finance

RMI's Center for Climate-Aligned Finance was established as an "engine room" to help financial institutions partner with their clients, industry leaders, and key buyers to develop practical and scalable solutions to the barriers to climate alignment. Climate alignment is a powerful theory that could provide a definitive approach for the financial sector to drive long-term, multisector decarbonization. Visit **climatealignment.org** for more information.

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Executive Summary

With a growing number of financial institutions committing to align their lending or investing portfolios with net-zero or climate-aligned targets, a range of initiatives have emerged to develop frameworks and solutions to support their implementation. The views and perspectives of the US financial sector are critical to informing these emerging frameworks. To capture these perspectives, the UK's Foreign, Commonwealth, and Development Office (FCDO) commissioned RMI, in partnership with the Carbon Trust, to hold a series of workshops to elicit the views of US financial institutions on the topic of net-zero investing and lending.

Two workshops held in December 2020 with US banks and institutional investors of varying sizes focused on understanding the US financial sector's perspective on (1) what a net-zero commitment means, and (2) the challenges and enablers to making and implementing such commitments. This report summarizes key findings from those workshops and puts forward recommendations to enable progress on climate alignment in a US context.

Although ESG and sustainability are familiar features in the financial sector, workshop participants viewed climate alignment as distinct from these efforts—particularly in its potential to drive systemic and holistic change. Participants explained that ESG integration, in line with financial institutions' long-established role of managing risks in decision-making, has typically focused on considering certain nonfinancial factors—including those stemming from climate change—in lending and investing. In contrast, climate alignment demonstrates a marked shift from a *reactive* response to mitigating the risks of climate change toward a *proactive* approach to supporting the transition. As one participant noted, climate-alignment commitments are *"an acknowledgment that [financial institutions] are part of the solution … to help meet the end goal of not going past science-based thresholds."*

As climate alignment represents a potentially fundamental shift in the financial sector's role in a changing climate, it also requires a fundamental rethinking of how to best enable its implementation. In particular, workshop participants noted four key interconnected areas that need to be addressed to support their climate-alignment efforts. These include:

1. **Defining climate alignment** for a financial institution in a way that effectively mobilizes it to support the transition.

   As noted above, many participants agreed that a commitment to climate alignment is a clear deviation from the status quo: a commitment to reorient behavior toward a societal objective, rather than simply considering climate a risk to be managed. Because of this, participants noted climate alignment should go beyond just what is on their balance sheets, and they raised questions around their "responsibility" and "agency" to help achieve the transition to net zero. These discussions revealed a noteworthy and emerging convergence on the concept of **influencing the real economy** as central to climate alignment.

   While still emerging and largely undefined, this sentiment signals a potential shift away from a mentality of reacting to risks and returns. Instead, it recognizes a financial institution's ability to contribute to decarbonization based on its unique services, product offerings, or relationships. Participants highlighted that climate-alignment frameworks could take into account the different types of agency or influence across financial institutions—and that frameworks likely need to grow more nuanced in this regard to mobilize finance most effectively.

   Although participants broadly agreed that climate alignment implies some degree of proactive influence to support decarbonization, some disagreed about the extent to which financial institutions can influence real economy outcomes in the absence of policy. US institutions seem to be grappling with the balance between softer support for the transition and harder engagement backed by a willingness to forego certain activities that are clearly not climate aligned. In some ways, this tension points to internal and cultural challenges in implementing a climate-alignment commitment; however, in the United States in particular, which lacks a legally binding net-zero commitment at the federal level, financial regulatory factors may also exacerbate this challenge. Specifically, institutional investor participants called for **greater regulatory clarity around materiality and fiduciary duty** as it relates to climate factors, as well as consistent messaging that integrating climate into financial decisions will not be met with regulatory scrutiny. US fiduciaries in particular noted this clarity was imperative, as they perceive real legal challenges to integrating climate objectives into investment decision-making.

2. Addressing the challenge of **uncertain decarbonization pathways**, or how to guide financial decision-making today in the face of technological, regulatory, and other uncertainties around how sectors will decarbonize.

   In order to effectively implement climate-alignment commitments, financial institutions require an understanding of how real economy sectors must transform to meet climate goals. This entails translating long-term 2050 climate-alignment targets into timelines and terms relevant for executing lending and investing decisions today.

   The inherent uncertainty around which pathways—if any—the world may take to a net-zero future creates a universal challenge. But participants described this challenge as particularly acute in the United States, which lacks a track record of strong industrial policy and other top-down policymaking. However, in the absence of top-down policy, several participants recognized that financial institutions, in dialogue and partnership with corporates, can help forge a shared vision for decarbonization and ideally create consensus on **near-term decarbonization milestones**. This forward-looking perspective on what may need to happen to meet long-term climate targets is critical for informing engagement, product offerings, and other decision-making that supports climate-alignment commitments. As one institutional investor participant stressed, *"Investors need to tell companies what they can do right, and not only what they are doing wrong."*

3. Improving **data quality and the transparency** of data, tools, and products for informing climate-aligned decision-making.

   In the United States, regulatory precedent emphasizes the need for adequate, quality-assured, and validated data and insights to form the bedrock for climate-aligned decision-making. To address concerns about data availability and quality, participants widely supported **mandatory climate-related disclosure** against a common standard, in contrast to the voluntary nature of disclosure today. Such a mandate would hold corporates accountable to accurate and comprehensive reporting on their climate performance, and it would provide accountants, lawyers, and professional advisors the confidence to move swiftly and cohesively based on this data. Participants also stressed that a **disclosure standard must be informed by the market** to ensure it prioritizes decision-useful information.

   Beyond disclosure, participants called for greater **transparency in third-party methodologies** and products intended to integrate and make sense of climate-related data. Today, participants noted that many third-party methodologies are a "black box," challenging their trustworthiness and the ease of integrating their outputs into material decisions.

4. Overcoming **internal challenges** to implementing a climate-alignment commitment.

   Participants explained that unlike ESG, climate alignment requires an evolution for all business units, functions, and operational infrastructure within an institution. Participants likened this transformation to *"changing the DNA of an organization"* and noted that **executive and leadership buy-in** is a precursor to meaningful progress. Although it is not easy to secure this buy-in, participants suggested that aligning executive compensation with progress on a climate-alignment strategy would create a more enabling environment.

   In addition to top-down leadership, participants highlighted the need for bottom-up **internal capacity building**—both by revamping training programs within individual institutions and by reshaping existing industry-wide training on climate topics. Finally, participants noted that **changing the culture** of an organization is one of the largest and most complex barriers to implementing a climate-alignment commitment. Institutional investor participants suggested that regulatory clarity on fiduciary duty as it relates to climate factors would provide the confidence required for starting to reshape internal cultures, specifically with portfolio managers and front-office investment teams.

Across both workshops, participants highlighted the need for climate-alignment efforts to support financial institutions in moving beyond managing climate as a risk—and toward solutions that enable them to proactively place climate as an objective. All participants emphasized that stronger legislation on climate change is needed to bolster their efforts. But the range of solutions they proposed indicates that there are areas where the financial sector—supported by clear, enabling financial regulation—can make progress today (Exhibit ES1). These solutions and views will be critical in shaping efforts to better define and support the implementation of climate-alignment commitments.

Exhibit ES1

Summary of key enablers to making and implementing climate-alignment commitments identified in workshops

Challenge	Market-Led Solutions	Financial Regulatory Solutions
Defining climate alignment	• Embed influence in climate-alignment frameworks, taking into account the different agency and constraints of different types of financial institutions	• Clarify materiality and fiduciary duty to provide confidence that integrating climate will not be met with regulatory scrutiny
Uncertain decarbonization pathways	• In partnership with corporates and other stakeholders in emitting sectors, establish roadmaps that lay out near-term decarbonization milestones in key sectors	
Data & methodologies	• Help shape a standard for climate-related disclosures • Ask third-party service providers to provide transparency in their methodologies	• Mandate disclosure by corporates
Organizational challenges	• Tie executive compensation to progress on climate-alignment KPIs • Revamp training programs within individual organizations and reshape existing industry-wide training to include climate integration	• Clarify fiduciary duty to provide confidence that integrating climate will not be met with regulatory scrutiny

Introduction

The US Perspective in Net-Zero Lending and Investing Debates

Private finance is rapidly climbing the global climate agenda, and increasingly private financial institutions are expected to play an active role in the transition to a net-zero future. **A growing number of financial institutions are responding to these changing expectations by making holistic commitments to align their lending or investing portfolios with net-zero or climate-aligned targets** (Exhibit 1).[i] As these climate-alignment commitments have gained momentum, so too have efforts to support their achievement through the development of frameworks, data solutions, tools, and other products.

Notable among these efforts is the agenda set forth by the Private Finance Hub, established by the UK's presidency for the 2021 UN Climate Change Conference of the Parties (COP26), which aims to "ensure every financial decision takes climate into account." This agenda—addressing topics such as climate-related reporting, financial regulation, and metrics for assessing climate alignment—has the potential to bring the clarity and consistency needed to advance the implementation of climate-alignment commitments. However, any framework or work stream focused on climate-alignment implementation must be informed by the experiences and needs of financial institutions.

The views and perspectives of the US financial sector are critical to ensure developments around climate alignment are informed in a US context. To ensure that these perspectives are understood, the UK's Foreign, Commonwealth, and Development Office (FCDO) commissioned RMI, in partnership with the Carbon Trust, to hold a series of workshops to elicit the views of US financial institutions on the topic of net-zero or climate-aligned investing and lending. This report summarizes key findings from those workshops and puts forward recommendations to help enable US financial institutions to make and implement net-zero commitments.

Overview and Participants in the Net-Zero Lending and Investing Workshops

The objective of the net-zero workshops was to understand the US financial sector's perspective on (1) what a net-zero commitment means, and (2) the challenges and enablers of making and implementing such commitments. The two workshops, held in December 2020 and lasting two hours each, were separated into net-zero lending and net-zero investing.

The workshops included participation from a diverse range of financial institutions. For the lending workshops, 15 participants represented 9 US financial institutions: 3 regional or mid-tier banks and 6 large, global banks. Representatives from these institutions held roles focused on sustainability, climate-related risk, and environmental, social, and governance (ESG) products or solutions. The net-zero investing workshop had 14 participants representing an asset owner and 9 asset managers, including 2 smaller asset managers (less than $200 billion in assets under management) and an outsourced CIO. Participants in the investing workshop generally held roles focused on ESG or sustainability (including investing, engagement, products, and strategy) but also included individuals in more general leadership or fund-management roles.

The views elaborated in this brief do not pretend to wholly represent the view of the US financial sector. Instead, this brief presents RMI's assessment and summary of the opinions of workshop participants, who themselves are subject to a self-selection bias given their interest in engaging in net-zero dialogues. This summary also does not necessarily indicate complete consensus among participants, and we have striven to provide nuance where opinions differed.

[i] "Climate-aligned" targets refers to targets that are compatible with the science-based objectives of limiting average global temperature rise to well below 2˚C compared to preindustrial levels. Increasingly, climate science warns that temperature rise should be limited to 1.5˚C to avoid the worst impacts of climate change, which will require global emissions to decrease to net zero by around midcentury. Climate-aligned targets by financial institutions often use <2˚C or net-zero emissions by 2050 as goalposts.

Exhibit 1 Drivers of climate-alignment commitments and key areas for progressing implementation

Unlocking the potential of climate alignment in the financial sector

US banks and institutional investors noted that both internal and external factors are helping drive climate-alignment commitments. Although participants noted that climate alignment is a powerful concept—with the potential to reshape the role of private financial institutions in meeting global decarbonization goals—they highlighted four key issues that need to be addressed to unlock this potential.

Internal and external drivers

External pressure

- Shareholders
- Clients and customers
- Competition with peers

Opportunities

- Financing and investment opportunities in the transition
- Attracting and retaining employees

Risk factors

- Regulatory or transition risk, especially in jurisdictions with net-zero commitments
- Reputational risks

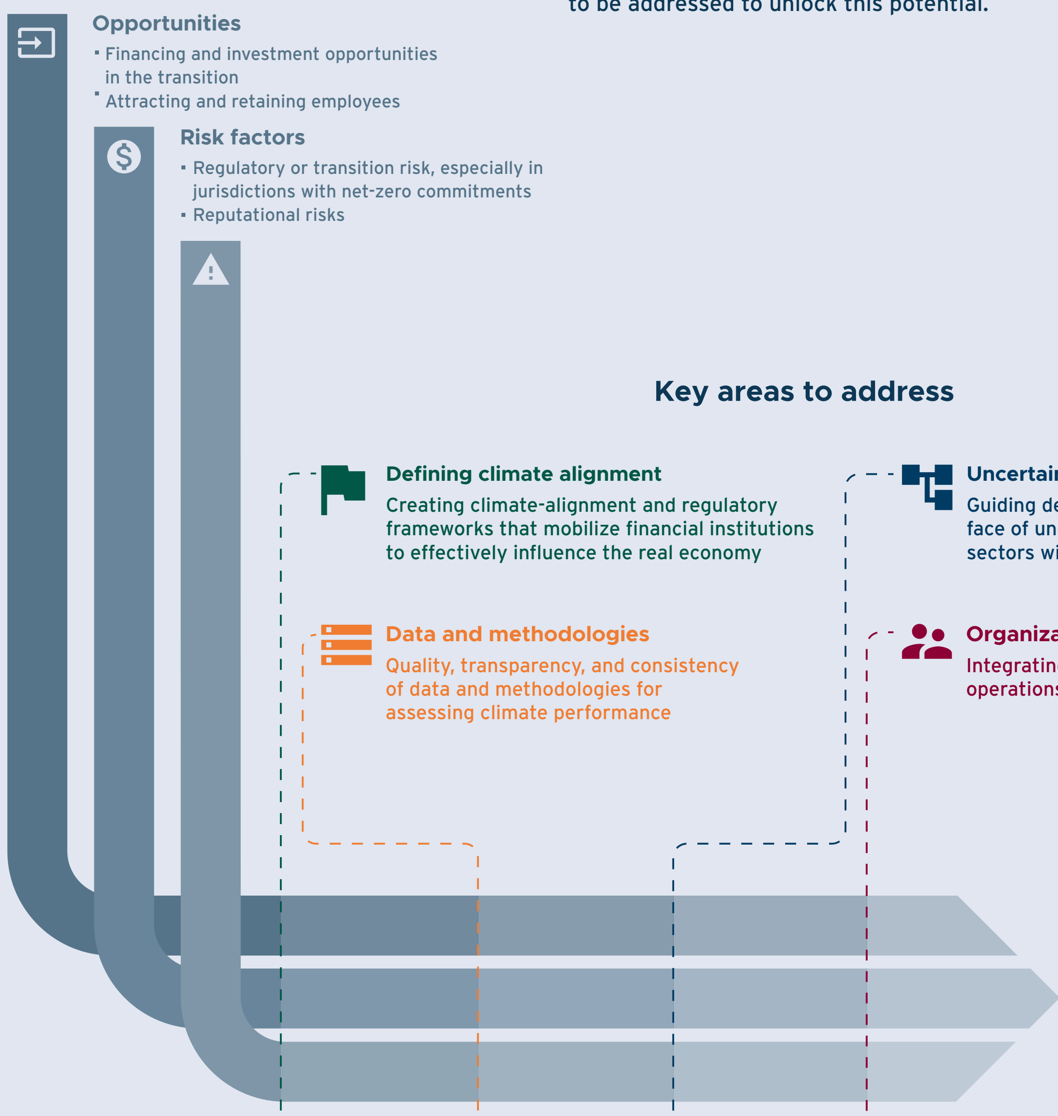
Key areas to address

Defining climate alignment
Creating climate-alignment and regulatory frameworks that mobilize financial institutions to effectively influence the real economy

Data and methodologies
Quality, transparency, and consistency of data and methodologies for assessing climate performance

Uncertain decarbonization pathways
Guiding decision-making today in the face of uncertainties around how sectors will decarbonize

Organizational challenges
Integrating climate across functions, operations, and business units



Climate-alignment efforts

The Promise and Potential of Climate Alignment

Although ESG and sustainability are familiar features in the financial sector, workshop participants viewed climate alignment as distinct from these efforts—particularly in its potential to drive systemic and holistic change. Participants explained that ESG has typically focused on considering certain nonfinancial factors when evaluating risks and opportunities in lending and investing decisions, in line with financial institutions' long-established role of managing risks in decision-making. In contrast, climate alignment implies a reorientation of decision-making toward a clear and objective outcome: supporting the achievement of a *"well below 2°C"* future. As one participant noted, climate-alignment commitments are *"an acknowledgment that [financial institutions] are part of the solution ... to help meet the end goal of not going past science-based thresholds."* These perspectives demonstrate a clear shift from a reactive response to mitigating the risks of climate change toward a proactive approach to supporting the transition.

As climate alignment represents a potentially fundamental shift in the financial sector's role in a changing climate, it also requires a fundamental rethinking of how we best enable its implementation. Workshop participants noted four key, and in many ways interconnected, areas that need to be addressed as they make and act on net-zero commitments. These include:

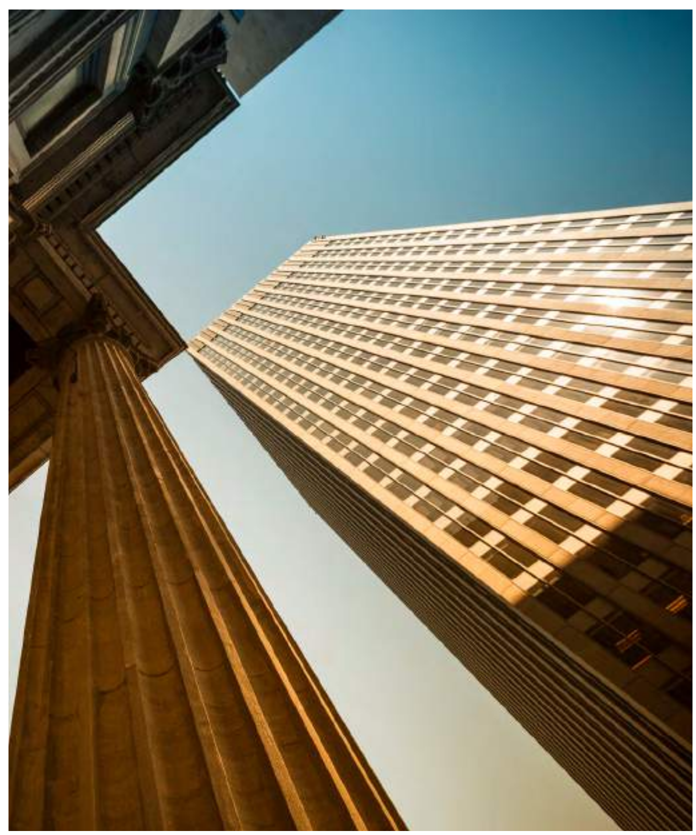
- **Defining climate alignment** for financial institutions in a way that effectively mobilizes them to support the transition

- Addressing the challenge of **uncertain decarbonization pathways**, or how to guide financial decision-making today in the face of technological, regulatory, and other uncertainties around how sectors will decarbonize. This stands in contrast to many ESG approaches to date, which have focused more on assessing backward-looking climate performance

- Improving **data quality and the transparency** of data, tools, and products for informing climate-aligned decision-making

- Overcoming **internal challenges** to implementing a climate-alignment commitment. Unlike ESG integration, participants noted that climate alignment requires an evolution in all of an institution's business units, functions, and operational infrastructure

Climate alignment offers significant promise. But as an emerging concept, attention is needed across certain key areas to ensure it capitalizes on its full potential. In the following sections, we unpack each of these areas based on workshop discussions and propose solutions to advance climate-alignment efforts in a US context.



Defining Climate Alignment and the Role of Finance

Climate alignment has significant potential to mobilize the financial sector around climate. As such, participants stressed that, at the highest level, climate alignment must be defined carefully in order to unlock the most effective role for financial institutions in the transition.

Bringing Influence to the Center of Climate-Alignment Definitions

As noted above, many participants agreed that a commitment to climate alignment is a clear deviation from the status quo: a commitment to reorient behavior toward a societal objective, rather than thinking of climate as a risk to be managed. Because of this, participants noted that climate alignment should go beyond just what is on their balance sheets. They also raised questions around their "responsibility" and "agency" to help achieve the transition to net zero. From the perspective of one representative from a bank, a climate-alignment commitment is *"a clear commitment to help clients get to net zero ... [that we] should do everything we can to help clients do everything they can."*

These comments point to a highly noteworthy convergence on the concept of "influence" as central to climate alignment. While still emerging and largely undefined, this sentiment signals a potential shift away from a mentality of reacting to risks and returns. Instead, it recognizes a financial institution's ability to contribute to decarbonization based on its unique services, product offerings, or relationships.

"...there's a role for banks that provide capital and information to the market, to help meet the end goal of not going past science-based thresholds."

Increasingly, climate-alignment frameworks for financial institutions (or frameworks that outline how financial institutions can set and be held accountable to climate-alignment targets) are beginning to integrate elements to measure influence. Participants noted especially that frameworks need to account for differences across various types of financial institutions, stressing that finance is not a monolith and that different institutions have both unique constraints and levers of influence. For example, participants noted that the Net-Zero Asset Owner Alliance Target-Setting Protocol included targets for stewardship, recognizing a key influence lever for equity investors.

Although the concept of influence is difficult to define and measure, there is likely value in working to better define and embed influence in climate-alignment frameworks moving forward. When discussing metrics and frameworks for climate alignment, workshop participants noted that frameworks should ideally be consistent, focus on the areas in which financial institutions have "agency," and create incentives that mobilize finance most effectively for the transition. There was broad consensus that, at least in the United States, there appears to be a convergence on financed emissions as a key metric for understanding the climate alignment of financial portfolios. In many ways, participants welcomed this trend: adopting a consistent approach can bring much-needed transparency and comparability to climate-alignment efforts. Many workshop participants also believed financed emissions was both powerful in its simplicity and necessary to provide a baseline understanding of the climate impact of portfolios today.

"Whether or not capital stays on our balance sheet, we're affecting emissions impacts."

Although many participants at the lending workshop noted that financed emissions may provide a useful starting point for understanding where financial portfolios stand today, participants also communicated that climate-alignment metrics and frameworks need to grow more nuanced to provide the flexibility for financial institutions to effectively support the transition. For example, several banks noted their influence through capital markets activities that are typically not yet covered under financed-emissions approaches, explaining that "whether or not capital stays on our balance sheet, we're affecting emissions impacts." [ii]

More critically, some participants cautioned that focusing solely on financed emissions could ultimately constrain capital to carbon-intensive sectors that will need to see significant investment to successfully transition, with many citing the outcomes from the recent Global Financial Markets Association (GFMA) publication.[iii] Several of the representatives from banks that participated viewed a climate-alignment commitment as a clear signal that they will proactively support their clients to transition—including clients in sectors that are carbon-intensive today. This might mean their financed emissions will need to rise in the near to medium term, which raised the question of whether a financed-emissions approach would penalize them for injecting capital for the transition.

Removing Regulatory Barriers to Redefining the Role of Finance

Although participants broadly agreed that climate alignment implies some degree of proactive influence, they also stressed that finance is not a silver bullet and cannot decarbonize the real economy alone. Nearly all participants noted the importance of policy in accelerating their own efforts, and several recognized that climate-alignment efforts have been enabled in other countries by legally binding net-zero commitments at a federal level, such as in the UK or France. However, there was disagreement around the extent to which financial institutions *can* influence real economy outcomes in the absence of policy.

US institutions seem to be grappling with the balance between softer support for the transition—for example, by providing advisory services to clients or creating financial products to support the transition of nonfinancial corporates—and harder engagement backed by a willingness to forego certain activities that are clearly not climate aligned. Finding this balance is especially difficult in areas where risk and return rationales do not yet exist for "climate-aligned decisions." In some ways this tension points to internal and cultural challenges in implementing a climate-alignment commitment, but in the United States in particular, regulatory factors may also exacerbate this challenge.

The regulatory uncertainty around materiality, fiduciary duty, and which factors can inform financial decision-making has often created inherent boundaries to the influence US financial institutions are willing to wield. US fiduciaries in particular noted that regulatory clarity on these topics is imperative, as they perceive real legal challenges to integrating climate objectives into decision-making. Certain recent rulings in the United States may have even created explicit barriers to climate-aligned decision-making. For instance, a 2020 amendment from the US Department of Labor's Employee Retirement Income Security Act (ERISA) limited the fiduciary duty of institutional investors managing ERISA-regulated retirement funds to solely financial objectives.[iv] Another example is the Office of the Comptroller of the Currency's proposed ruling against exclusion policies in fossil fuel sectors.

These developments contrast sharply with the clear move toward double materiality established in the EU, which several participants cited as critical for driving and supporting investor action on climate in Europe. Although a similar consensus of double materiality could support efforts by US financial institutions, at the very least, financial regulation must remove explicit barriers to action and create greater clarity that integrating climate into decisions will not be met with regulatory scrutiny.

[ii] A notable exception to this exclusion of capital markets activities from climate-alignment scopes is Barclays' BlueTrack methodology for measuring financed emissions, which includes both lending and capital markets activities.
[iii] The Global Financial Markets Association, together with BCG, solicited the inputs of financial-sector and other market participants in the drafting of their report *Climate Finance Markets and the Real Economy*. Estimating that the 10 highest-emitting sectors will require $100T–$150T in investments over the next three decades, the report is a clear call to action to significantly ramp up the volume and pace of investment and the creation of financing instruments to support today's most carbon-intensive sectors.
[iv] Note that the final ERISA ruling does not explicitly prohibit consideration of ESG factors in decision-making, but it requires that such factors are proven to be pecuniary. Although this creates potential barriers, given the need for fiduciaries to expressly demonstrate materiality of certain factors, it does leave the door open for inclusion of climate factors in decision-making—particularly moving forward, as certain climate factors are likely to prove material in time.

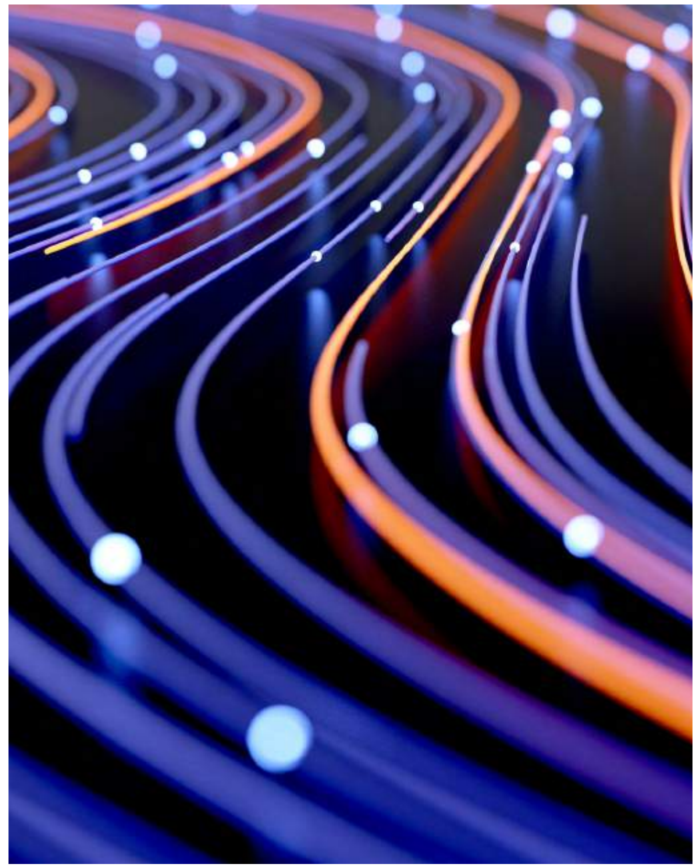
Overcoming Uncertainty: Creating Consensus on Decarbonization Pathways

The recognition that climate alignment is a commitment to help steer the real economy toward net zero is a significant and noteworthy development. But in order to effectively act on and implement these ambitions, financial institutions require an understanding of how real economy sectors must transform to meet climate goals. This entails translating long-term 2050 climate-alignment targets into timelines and terms relevant for financial decision-making today.

The inherent uncertainty around which pathways—if any—the world may take to a net-zero future creates a universal challenge, but participants explained that this challenge is particularly acute in the United States. The United States lacks a track record of strong industrial policy and the top-down policymaking approaches that in the EU have helped give rise to frameworks such as the EU taxonomy for sustainable finance, which explicitly identifies "sustainable" activities. Participants also noted that this uncertainty is compounded with the prospect of administration changes, with one describing apprehension about a potential *"policy cliff in four years."*

"Investors need to tell companies what they can do right, and not only what they are doing wrong."

However, in the absence of top-down policy, several participants recognized that financial institutions, in dialogue and partnership with corporates, can start to forge a shared vision for decarbonization pathways. Specifically, when speaking about making stewardship more effective, an institutional investor participant explained that their engagement objectives need to be "systemic" rather than firm-by-firm. Furthermore, their objectives must be based on consensus around specific guide rails or milestones for meeting net-zero targets.



A participant in the lending workshop called these "business-type" milestones that establish more near- to medium-term targets for areas such as technology deployment or capital expenditure in a sector. The participant noted that *"setting science-based [emissions] targets is more of an aspirational tool; business targets are more how banks are regulated and oriented."* Investor participants suggested that holding dialogues with corporates in key sectors can help to create consensus on these near-term milestones. This forward-looking perspective on what may need to happen to meet long-term climate targets is critical for informing engagement, product offerings, and other decision-making that supports climate-alignment commitments.

Data and Methodologies for Climate-Aligned Decision-Making

Even if financial institutions understand how real economy sectors and corporates need to transform in order to meet climate-aligned goals, they still require adequate data and insights on climate performance to form the bedrock of their decision-making. Data repeatedly arose in the workshops as a structural barrier to integrating climate objectives into financial decisions, with participants citing disclosure gaps, quality, and consistency as key challenges.

Addressing Data Quality and Consistency: Mandatory and Consistent Disclosure

To address concerns about disclosure gaps and quality, participants widely supported mandatory climate-related disclosure by corporates. A mandate from a body like the SEC would alleviate some of the participants' largest pain points around quality and assurance. Although such a mandate would not address all the gaps participants cited, it would hold publicly listed corporates accountable to accurate and comprehensive reporting on their climate performance.[v] This quality assurance and validation is especially critical in the United States, where the regulatory precedent makes legal and accounting departments even more uncomfortable basing decisions on unverified data. Greater data quality would also enable professional accountants, lawyers, and advisors to move swiftly and cohesively to support executive leadership in a way that catalyzes progress.

"Accountants and legal have the most questions around [data] estimations and what the ramifications are. The US perspective is so different from the EU perspective because the litigation process is so different."

Banking participants also noted that mandatory disclosure against a single standard could support greater data consistency and ensure all financial institutions are working with the same core set of information. Across sectors and asset classes, the kinds of data needed for different kinds of financial decision-making are nuanced and therefore often require tailored disclosure. For example, the information needed for understanding risk, backward-looking climate performance, and forward-looking climate performance may all be distinct and specific to sectors.[vi] Because of this complexity, financial institutions today often ask for bespoke disclosures from nonfinancial corporates. Participants noted this can create an uncomfortable reporting burden on clients and investees, as well as an unlevel playing field in terms of which institutions can gain access to different kinds of data.

Although participants supported mandatory disclosure against a common standard, they also cautioned that a disclosure standard must be informed by the market to ensure it focuses on decision-useful information. Many of the participants communicated that they did not believe it is the role of regulators to unilaterally determine a standard for disclosure. Rather, financial institutions, in partnership with corporates, have a role to play in establishing specifics of what a disclosure standard might entail, and several participants welcomed the prospect of a body like the International Financial Reporting Standards (IFRS) Foundation codifying a standard with inputs from market actors.

Although not explicitly stated in the workshop, RMI sees potential value in working groups and collaborative dialogues with nonfinancial corporates. These interactions can be avenues for knowledge sharing, coordinated advocacy, and driving agreement around common assumptions to mitigate disclosure

[v] Mandatory disclosure by the SEC, for example, would address nondisclosure by small- and mid-cap publicly listed companies but would not apply to private companies.
[vi] Backward-looking climate performance refers to where nonfinancial corporates sit in relation to their peers and a climate-aligned benchmark today, whereas forward-looking climate performance would help project how a company may perform in the future.

gaps or around minimum standards for common disclosure. These bottom-up efforts can accelerate progress, building consensus while ensuring standards ultimately address the priority concerns and requirements of diverse stakeholders.

Transparency in Third-Party Tools and Methodologies

Beyond access to consistent and quality climate-related data, financial institutions need the tools and methods to enable use of that data to inform decision-making. As one participant explained, *"the data challenges can be overcome. Making the tough decisions of what to do with that data and making impact in the real economy is another challenge."*

Participants noted that financial institutions ultimately need to build this analytical capacity, but also acknowledged some of the frustrations they face with the myriad of third-party service providers that have emerged in response to demand for climate-related data and tools. Specifically, participants explained that few third-party providers offer a full suite of solutions, that many tailor their solutions to highly specific insights (e.g., transition readiness or physical risk), and that nearly all are a "black box" that provides little information on methodologies or assumptions. As a result, the various outputs from tools and product offerings are not only hard to compare, but they are ultimately difficult for financial institutions to place confidence in and integrate into decisions. Participants stressed that their institution needs to internalize this information and understand it rather than relying on a black box.

Although it is unlikely that a standard methodology will emerge for assessing the climate performance of nonfinancial corporates, participants called for greater transparency in third-party methodologies. Greater transparency in methodologies will likely need to be driven by the market, where banks, investors, and other users of these products can start to demand transparency from providers. However, if the market begins to converge on a few third-party providers whose insights prove to be material, there could be a role for regulators to mandate transparency and minimum standards within methodologies. For a helpful analogy in this regard, RMI believes the sector can look to the example set by the credit-rating ecosystem in the United States (see "Transparency and Minimum Standards" below).

Transparency and Minimum Standards: Learning from the Credit-Rating Ecosystem

The credit-rating ecosystem is heavily regulated but lends itself to a common set of criteria and a universally accepted rating system, together facilitating comparable and decision-useful data across third-party providers. The existing credit-rating ecosystem has also become widely accepted for signaling creditworthiness to investors, and regulatory oversight requiring accepted levels of transparency provides the level of confidence needed to make credit ratings decision-useful. This transparent, standardized system that is universally leveraged and widely understood for investment and lending decision-making gives investors and lenders a certain level of confidence and helps facilitate capital allocation. It is not the be-all and end-all for decision-making but represents an important cornerstone that is universally relied on by both lenders and investors. This same ecosystem for methodologies on climate alignment would be welcome.

Internal Challenges to Implementing Climate-Alignment Commitments

In order to create the holistic change that climate alignment promises, climate must be integrated into all facets of financial decision-making—a task that one participant likened to *"changing the DNA"* of their organization. The organizational barriers to achieving internal transformation at the scale required are amplified in the context of increasing uncertainty and heighten the barriers relating to data, metrics, pathways, and tools. These internal and organizational challenges may represent the greatest obstacles for certain financial institutions to aligning revenue-generating activities with climate goals, yet they are underrepresented in much of today's discourse.

Starting at the Top: The Importance of Executive Leadership Consensus on a Climate-Alignment Strategy

Gaining executive and leadership buy-in on a financial institution's reorganization on climate through all levels of an organization is a precursor to meaningful progress. Without senior commitments, undertaking such a reorientation is like trying to fundamentally change an institution's DNA "on the margins." Some participants noted that the leadership buy-in required could stem from a top-down directive or from an organic bottom-up approach by building consensus across multiple levels of leadership to prioritize a strategy on climate alignment.

"At the C-suite level, there must be an understanding of actual changes that need to take place, particularly the speed with which change needs to happen."

Although it is not easy to gain executive leadership buy-in for climate alignment, participants suggested that aligning executive compensation with the implementation of, and progress on, a climate-alignment strategy would create a more enabling environment.[vii] Participants cautioned that this approach would require metrics for measuring and benchmarking climate-alignment progress, but it has the potential to move the needle and signal a strong commitment across the organization and externally.

Internal Building Blocks: Institution-Wide Capacity Building

Even after executive leadership at all levels of a financial institution has coalesced around a strategy on climate alignment, financial institutions must still build the internal infrastructure and capacity to support a holistic realignment on climate. Internal capacity building was cited by both bank and institutional investor participants as a key barrier they did not feel could be completely solved in isolation. Although participants agreed individual institutions could revamp internal training programs for employees at all levels, including new-hire trainings, they also agreed it is necessary to reshape existing industry-wide training to include climate risk and climate alignment. This is especially true for analysts, whose primary role is to conduct research and provide transaction recommendations. Participants cited the importance of their institutions prioritizing climate and sustainability in order to attract new talent and remain competitive in the hiring process, as these topics become increasingly important screening criteria for employees.

The Challenge of Reshaping an Institution's Internal Culture

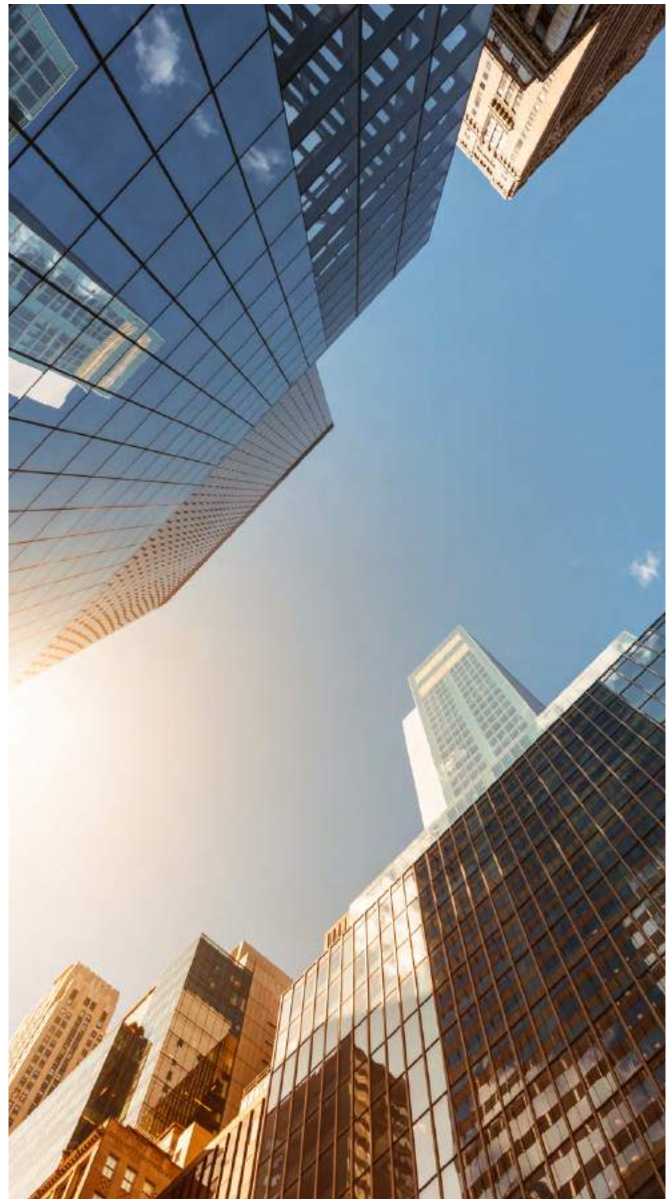
Finally, internal culture was raised by participants as one of the most complex yet overlooked internal challenges—and one that lacks a clear roadmap for resolution. Culture is deeply rooted within the DNA of an institution and is often highly resistant to change, especially if it has been built over decades or even

[vii] It has been suggested, and is possible in theory, to tie compensation at all levels to climate goals. However, in today's ecosystem, tying all compensation to climate KPIs could create conflicting incentives—for example, between a fund manager's expected performance by an asset owner versus their expected performance by their employer.

centuries. Participants highlighted the potential need for a shift in moral beliefs across an organization. Often the buy-in on a climate strategy sits squarely within a siloed sustainability function, making the challenge even harder to overcome, and again pointing to the need for executive leadership to start these cultural shifts.

For institutional investors, overcoming cultural challenges would be supported indirectly by a clarification of the regulatory uncertainty for fiduciaries in the United States. The lack of regulatory clarity on fiduciary duty, specifically as it relates to ESG, has led to a solidification of organizational cultures that prioritize a constrained definition of the actions that an institutional investor can take to place climate at the core of investment strategies. Some institutional investor participants pointed to the specific barriers to gaining consensus on an investment strategy that prioritizes climate from portfolio managers, whose sole responsibility is to uphold their fiduciary duty when making investment decisions on behalf of clients.

Regulatory clarity would provide the confidence required for reshaping internal cultures, specifically with portfolio managers and front-office investment teams, to support the consideration of other investment objectives. This is not the only shift required to support the cultural transformation necessary within institutional investors, but it would certainly help the cause.



Conclusion

Across both workshops, participants highlighted the need for climate-alignment efforts to support financial institutions in moving beyond managing climate as a risk and toward solutions that enable them to proactively place climate as an objective. Although participants broadly agreed that a policy environment that supports decarbonization is needed to support the US financial sector in playing this role, they also identified clear roles for market-driven action as well as financial regulation—demonstrating the potential for actions that can be taken today to move the needle on climate alignment in the United States (Exhibit 2).

In terms of market-led actions, participants cited actions that financial institutions can take both individually and collectively. Individually, financial institutions can take steps such as tying executive compensation to climate-alignment KPIs or demanding greater transparency in third-party methodologies that assess climate performance. Collectively, financial institutions can help shape climate-alignment frameworks to better capture and incentivize their specific levers for influencing the real economy.

Workshop participants also noted areas where they could make progress through partnerships with other external stakeholders. For example, financial institutions and nonfinancial corporates can develop market standards for climate-related disclosure or create decarbonization roadmaps in key sectors. In collaboration with industry bodies, financial institutions can also work to revamp training programs to prepare the next generation of analysts to better integrate climate into their research and recommendations.

Although workshop participants acknowledged actions they can take today, financial regulation can also help enable and accelerate financial-sector efforts on climate change. This is particularly true in the United States, where the legal ramifications of pushing regulatory boundaries can deter action today. In a key outcome of the workshop, participants expressed widespread support for mandatory climate-related disclosure by corporates, but with an understanding that this disclosure needs to be both standardized and informed by the market to ensure it is decision-useful. Beyond mandatory disclosure, institutional investor participants noted that explicitly allowing climate-related factors to be considered within the scope of fiduciary duty would remove some of the internal paralysis around pursuing climate alignment.

Many of the proposed solutions are not easy, but they will be critical in shaping efforts to better define and support the implementation of climate-alignment commitments. In particular, many of the solutions discussed will likely require a level of coordination across the financial sector that will not come naturally, creating a need for initiatives to bring together the necessary disparate stakeholders, foster harmonization, and facilitate collective action.

Exhibit 2

Summary of key enablers to making and implementing climate-alignment commitments identified in workshops

Challenge	Market-Led Solutions	Financial Regulatory Solutions
Defining climate alignment	• Embed influence in climate-alignment frameworks, taking into account the different agency and constraints of different types of financial institutions	• Clarify materiality and fiduciary duty to provide confidence that integrating climate will not be met with regulatory scrutiny
Uncertain decarbonization pathways	• In partnership with corporates and other stakeholders in emitting sectors, establish roadmaps that lay out near-term decarbonization milestones in key sectors	
Data & methodologies	• Help shape a standard for climate-related disclosures • Ask third-party service providers to provide transparency in their methodologies	• Mandate disclosure by corporates
Organizational challenges	• Tie executive compensation to progress on climate-alignment KPIs • Revamp training programs within individual organizations and reshape existing industry-wide training to include climate integration	• Clarify fiduciary duty to provide confidence that integrating climate will not be met with regulatory scrutiny

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http://www.rmi.org/insight/zeroing-in/.

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