Sustainability in the Financial Industry: Old Models for New Scenarios?

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1. Introduction

The ongoing process of international geopolitical fragmentation is hindering cooperation, weakening the role of multilateral institutions, and complicating the exchange of knowledge and technology. These developments, along with the new U.S. administration's stance on climate policy, are slowing down the environmental transition. Some key facts: the willingness of advanced economies to provide financial resources to support the transition in emerging and developing economies is uncertain;[1] several companies engaged in the transition are revising their investment plans downward; the main coalition of private financial operators for achieving carbon neutrality (Glasgow Financial Alliance for Net Zero - GFANZ) has suffered numerous defections and is considering moderating its decarbonization commitments. Even the EU, one of the most active jurisdictions in promoting the environmental transition, appears to be adjusting its course.

It is therefore appropriate to ask what these developments mean for those working on environmental sustainability. I am referring to the Network for Greening the Financial System (NGFS) and its members, including the Bank of Italy, the multilateral development banks, the international institutions, and, of course, the entire financial industry.

In what follows, I will briefly outline some reflections from the perspective of a central bank and supervisory authority. In short, I will argue that the changing context affects the speed of the environmental and climate transition, and some aspects of the journey, but does not alter the direction already taken.

[1] See, for example, the Joint Statement from the International Partners Group on the US Withdrawal from the Just Energy Transition Partnership in South Africa.

2. Does the New Geopolitical Context Change the Commitment to Sustainability?

The commitment of central banks and supervisory authorities to the environmental transition primarily aims to improve financial operators' ability to manage climate risks. This goal is pursued mainly through supervisory activities, including issuing guidelines, monitoring compliance, and assessing the implementation of recommendations. Given the new geopolitical context, this objective remains crucial and, in fact, gains importance, as delays in reducing greenhouse gas emissions will increase physical risks and their transmission to traditional financial risks.

For central banks, it also remains important to develop models for analyzing the impact of climate change on commodity price dynamics, both energy and non-energy (e.g., price increases in agricultural goods due to drought-induced crop failures, or damage to ecosystems). These impacts affect key variables for monetary stability, such as growth and inflation.

Central banks that hold or manage financial portfolios not related to monetary policy must also study and mitigate the effects of increasing climate risk on their investments.[2]

Additionally, efforts to reduce and ultimately eliminate the net emissions of central bank operations should continue. This goal aligns with the need to improve the efficiency of processes and operational infrastructure, such as banknote production facilities.

In summary, the evolution of the geopolitical context should not significantly alter the agenda of central banks and supervisory authorities in these areas. Similar considerations, for the relevant areas, apply to financial intermediaries as well.

A qualification is in order for transition risk. Traditionally, this risk has been attributed to two main sources, technological innovation and government climate policies, and has been thought to primarily affect fossil fuel-related activities and enterprises. This perspective is shifting for at least two reasons.

First, the fact that major jurisdictions are slowing or halting their transition efforts inevitably affects others. Considering the two extremes of the spectrum, one in which a cooperative world equilibrium to fight climate change is achieved, and one in which individual jurisdictions opportunistically fend for themselves, we clearly moved towards the latter. In the short to medium term, this reduces the risk of a disorderly transition away from fossil fuels.

Second, increasing cases of backlash against the climate transition create risks for "green" companies and their financiers. Examples include lawsuits against sustainable investment policies of pension funds and asset managers, or the challenges faced by wind energy companies due to new U.S. policies; but also the bankruptcy of major European battery

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[2] This is the case for the Bank of Italy. See the *Annual Report on Sustainable Investments and Climate Risks*, June 2024.

producers, and legal actions against transition policies in developing countries,[3] well before the election in the United States last year.

In addition to these risks facing green companies, the broader uncertainties of major technological transitions must be considered. Historically, such transitions start with many competing technologies, most of which ultimately fail, leaving only a few dominant ones – impossible to pick in advance.

Thus, while fossil fuel-based businesses probably still face relatively high transition risks, the likelihood of these risks materializing in the short to medium term appears lower today.

3. Conclusions

The new global geopolitical context calls for reflections on the environmental transition from investors and wealth managers. I offer four, with the certainty that many more will arise from today's discussion.

First, the current context is characterized by great uncertainty. It is appropriate to assess with caution what is happening, and to wait for political orientations in the United States, as well as in the EU, to clarify before drawing conclusions about the consequences for the climate transition and sustainable finance. Various indicators suggest that the transition is unlikely to stop, although it may take longer than desirable.[4]

Second, if it is true, as I have tried to argue, that much of the underlying motivations justifying a commitment to the environmental front remain unchanged, the EU should avoid the risk of excessive course corrections. For example, if the recent proposal for the so-called Omnibus directive were approved in its current version, the number of Italian companies subject to sustainability reporting obligations would be reduced by about 85 percent compared to the current status quo under the Corporate Sustainability Reporting Directive. Large companies already adopting sustainability reporting would be exempted, with marginal or no savings, while investors would be deprived of important information for an accurate assessment of risks. A measure of this kind would go beyond the desirable objective of simplifying the regulatory framework and could even create further complexity.[5]

Third, for wealth managers, transparency is needed – today more than ever. In my view, we have left behind the phase in which finance seemed destined to lead the transition, "forcing" highly polluting companies to decarbonize their production. There is now greater awareness that finance is an essential enabling element, but the fate of the transition depends on choices that are in the hands of governments and shareholders

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3 Paolo Angelini, Speech at the Conference "The many shades of Climate Change Through the Lens of Dispute Resolution" organized by Unidroit and Roma TRE University, Rome, November 8, 2024.

4 See I. Faiella and E. Bernardini, *From Revolution to Green Involution?*, forthcoming in the journal *Energia*.

5 For countries that have already incorporated the CSRD into national law (e.g., Italy and France), it will be necessary to amend the law to prevent level playing field issues.

of non-financial companies, especially those with high emissions. In this context, the fiduciary duty obligations should lead financial intermediaries to clarify to their clients that investing in sustainability can also involve a renunciation of returns, uncertain in both the “if” and the “how much”.[6] A survey by Consob on the retail market clearly shows that only a relatively small number of savers would be willing to make this renunciation,[7] but this may reflect many motivations, including an inadequate understanding of the phenomena and objectives of sustainable investments. Wealth management operators could play an important financial education role in this area.

Finally, the framework of geopolitical fragmentation encourages investments in energy efficiency for buildings and production processes, and in renewable energy generation. These investments contribute not only to the transition but also to isolating companies’ financial statements and household budgets from energy price shocks, and strengthen the resilience and strategic autonomy of national energy systems, especially in countries poor in fossil resources, like Italy.[8] The wealth management industry, helped by a clear policy framework, could promote proposals aimed at facilitating these investments.

The Bank of Italy will continue to follow sustainability issues closely for all aspects that fall within its mandate, believing that the climate and environmental transition is necessary to ensure the financial stability and economic growth of the country.

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6 P. Angelini, Portfolio Decarbonisation Strategies: Questions and Suggestions, Banca d’Italia, Questioni di Economia e Finanza no. 840, March 2024.

7 Consob, Report on the Investment Choices of Italian Households, 2022.

8 In the energy field, the term 'trilemma' is used to refer to the impossibility of simultaneously achieving energy supply security, affordability of energy costs, and environmental sustainability. In reality, this holds true in the short to medium term; beyond these horizons, a gradual and orderly reduction of fossil fuels would help resolve the trilemma, also contributing to mitigating the unwanted effects of energy price volatility.

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