Alongside growing consumption and demand, the dangers to the climate of the ongoing supply of fossil fuels on a business-as-usual basis have become very clear over the last few years. The latest (2021) UNEP Production Gap Report says that the world’s governments plan to produce more than twice the amount of oil, gas and coal than would be consistent with limiting warming to 1.5°C. Last year’s landmark IEA Net-Zero 2050 Report said that in order to keep within 1.5°C, there was no need for new investment in fossil fuels.

To limit warming to 1.5°C, 90% of discovered fossil fuels must remain in the ground as unburnable carbon. Limiting to 2°C would still require around 60% to stay in the ground.

Against this background, a new report from Carbon Tracker Initiative has researched the major role that the world’s financial centres are playing both in enabling ongoing investment in fossil fuels, and the risks these financial centres carry in their exposure to the fossil fuel complex.

This is because - while a significant proportion of fossil fuel reserves are owned by unlisted state-owned companies or are in private hands - many are held by companies which trade publicly on global stock markets and are therefore under the influence of investors. Fossil fuel companies rely on equity and debt markets to finance capital-intensive projects, both to raise capital to finance new investments and to maintain existing production facilities. Financial centres (and the spectrum of business providers which service financial centres) facilitate and profit from both the primary equity raising and ongoing finance requirements for these companies, as well as secondary trading activities.

Governments and policymakers should draw a number of important implications from this report.

**Headline Takeaways**

Certain governments, from Ministers downwards, may wish to reflect on whether the role and activities of their principal financial centre align with their climate policies and targets

- Although some exchanges have set “net-zero” goals, these exchanges and the financial centres around them, continue to enable the ongoing activities of the incumbent fossil fuel industry, in many cases to a far greater degree than national reserves. This includes a broad range of financial services companies many of which have likewise set net zero goals yet continue to support new fossil fuel development.

- In this light, net zero goals become questionable if those entities continue to facilitate the activities of companies which are so clearly unaligned with global climate goals and Paris-aligned national emissions reduction targets.
Financial centres heavily weighted towards fossil fuel producers are particularly exposed to the global energy transition. Over $1 trillion of oil & gas assets risk becoming stranded; the majority, some $600bn, is held by listed companies.

- Policy action on climate and the global rise in renewable energy — and the likelihood of the acceleration to a low-carbon economy - creates financial risks for the companies listed on these exchanges.

- The over-exposure of financial centres to fossil fuels raises serious questions about their ability to support a smooth and orderly transition.

- Energy transition risks apply not just to producers, but across the full oil and gas value chain (e.g., refiners) as well as a wide range of different financial services providers. Banks, insurers, and auditors all derive income from the sector.

Carbon Tracker research has demonstrated that risks are not being properly disclosed by companies in their financial statements and other reporting. Financial regulators should set requirements which align financial markets with national climate strategies and provide sufficient disclosures to allow investors to assess financial risk.

- Existing accounting and auditing requirements for companies (and their auditors) to consider and disclose material climate-related matters should be properly enforced. Specifically, the requirements for financial statements to include the quantitative assumptions and estimates used in the assessment of climate-related matters should be better enforced.

- New rules should be introduced rules go beyond the Task Force on Climate-related Financial Disclosures (TCFD) recommendations and mandate the disclosure of Scope 3 emissions were material.

- All requirements should also be extended to those issuing on a stock exchange a new prospectus looking to raise new or additional capital through equity or debt offerings. New listings or share offerings of fossil fuel companies should be required to explain why their reserves are necessary or will be developed ahead of other, already listed, fossil fuel companies.

**Conclusion**

We contend that current financial market regulation is not fit for purpose overall, as it is failing to protect investors from the systemic risks posed by climate change. Consequently, financial markets continue to enable the extraction of fossil fuels beyond climatic limits whilst simultaneously increasing the risk of future losses from stranded assets.

The present environment of high commodity prices, and a focus on securing fossil fuel supplies in the wake of the Russian invasion of Ukraine, risks amplifying a carbon bubble in financial markets through further investment in fossil fuel projects which are not needed over the medium to longer term.

As investments and trade flows are outside of national carbon accounting, policymakers working on climate and energy policy tend not to be informed on issues such as financial risk exposure and the role of fossil fuel financing. This argues all the more for a whole-of-government approach - from the top down - to ensure that climate policy and carbon budget management are mainstreamed across ministries and institutions, including finance ministries, regulators and stock exchanges.