Advancing Green Finance: Policy Solutions for the UK's Net-Zero Transition

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Abstract

Achieving the UK's legally binding target of net zero emissions by 2050 requires a scale of investment far beyond what public finances can provide. Mobilising green finance is essential. This paper argues that three forces are driving the rise of green finance. First, the institutionalisation of ESG investing; second, the growing role of banks and asset managers in creating loans and bonds that fund the shift to net zero, and third, regulatory reforms that improve transparency and market integrity. However, persistent challenges remain, including short-term investor incentives, inconsistent ESG data, and empty climate promises by companies. This paper evaluates policy options for strengthening the UK's green finance ecosystem and recommends prioritising four measures, a clear UK "green list", requiring proper checks on company climate plans, creating government-backed risk-sharing funds, and making pension funds publish where their money is invested. Together, these actions would improve credibility, reduce greenwashing (when providers such as banks, fund managers or insurers claim their products or services are doing more for the environment than they actually are; Financial Conduct Authority, 2024), mobilise private investment, and position the UK as a leading net zero-aligned financial centre.

Introduction

Decarbonising energy, transport, buildings, and industrial systems will require hundreds of billions in additional capital by 2050 (HM Government, 2023). Given this, the UK faces a substantial investment shortfall in meeting its net-zero goals. Public budgets cannot finance this transition alone, making private capital important. This challenge creates a problem. It involves not only issues such as scaling renewable infrastructure, but also socioeconomic factors, including investor risk perceptions and regulatory inconsistencies. This issue pits short-term economic pressures against long-term climate imperatives, with stakeholders ranging from institutional investors to policymakers holding different priorities.

Many barriers restrict the flow of green finance. Inconsistent ESG data and ratings limit comparability and undermine investor confidence (Clarity AI, 2023). ESG ratings are assessments on environmental, social, and governance factors that provide information about the sustainability

performance of a company or financial instrument, by evaluating its exposure to sustainability risks and/or its impact on people and the environment (European Commission, 2024). Transition finance instruments often suffer from weak or unverified sustainability targets, leading to "transition-washing" (ICMA, 2024). Short-term investment horizons clash with the long-term nature of climate risks, as evidenced by surveys showing 92% of investors expressing concerns that ESG factors may reduce immediate returns (EY, 2024). Regulatory fragmentation complicates cross-border investment, while liquidity constraints in green-debt markets reduce scalability (Bank for International Settlements, 2023). These barriers result in underinvestment in critical areas like hydrogen development and carbon capture, exacerbating the UK's exposure to transition risks (European Central Bank, 2024).

This can be seen as a market failure in sustainable finance, where information asymmetries and pressure on fund managers to focus on short-term profits prevent efficient capital allocation. Empirical evidence supports this view, as despite ESG assets projected to reach nearly USD 34 trillion by 2026 (PwC, 2022), greenwashing scandals have eroded trust, with 85% of investors now integrating sustainability criteria but demanding better data (BNP Paribas, 2025). Addressing this requires policies that enhance transparency, credibility, and risk-sharing.

Defining green finance

Green finance refers to private investment directed toward sustainable and climate-aligned activities, such as renewable energy, low-carbon infrastructure, and decarbonisation technologies. Key instruments include green bonds, sustainability-linked loans (SLLs), transition bonds, blended-finance vehicles, and ESG-focused equity and debt (ICMA, 2022; International Finance Corporation, 2022). These tools enable firms to structure deals that align investor returns with environmental outcomes, fostering innovation in sectors.

Why public finance is not enough

The scale of green investment required, across grid expansion, hydrogen development, EV charging, building retrofits, and industrial decarbonisation, vastly exceeds public resources (International Energy Agency, 2024). Private finance brings scalability, offers risk-sharing capacity, accelerates innovation, and aligns long-term institutional investors with infrastructure needs (UK Finance, 2023). Without it, the UK risks missing net-zero targets, facing higher economic costs from climate impacts, such as flooding and extreme weather (Climate Change Committee, 2025).

The UK's strategic position

The UK's 2023 Green Finance Strategy aims to make Britain the world's first Net Zero-aligned financial centre (HM Government, 2023). Key regulatory developments include Sustainability Disclosure Requirements (SDR), Transition Plan Taskforce (TPT) guidance, the FCA anti-greenwashing rule, and taxonomy-aligned classification standards (Financial Conduct Authority, 2024; Reuters, 2024). These build on global frameworks like the EU Taxonomy (European Commission, 2024) and ISSB standards, positioning the UK to attract international capital while addressing domestic gaps.

Option 1: Strengthen ESG data standardisation

Inconsistent ways of evaluating ESG investments enable greenwashing and misallocation of capital (Clarity AI, 2023). To address this, the UK could align reporting standards with ISSB, SDR, and TCFD baselines (which are the foundational recommendations of the Task Force on Climate-related Financial Disclosures for consistent climate risk reporting; Task Force on Climate-related Financial Disclosures, 2017), standardise key sustainability metrics across sectors, and support open-access ESG data platforms. This would enhance comparability, reduce information asymmetries, and strengthen investor trust (PwC, 2022; BNP Paribas, 2025). Feasibility is high, as regulatory infrastructure exists, with low-to-moderate costs focused on compliance. Risks include over-standardisation limiting innovation or burdening smaller issuers, but benefits outweigh these through improved market efficiency.

Option 2: Enhance the credibility of transition finance through stronger verification

Weak targets in transition instruments risk undermining market integrity (ICMA, 2024; International Finance Corporation, 2022). Policy tools include mandating third-party verification of sustainability-linked KPIs, developing sectoral decarbonisation pathways, and establishing minimum eligibility criteria for transition bonds. Expected impacts are stronger market trust, clearer signals to industry, and a reinforced UK role in sustainable finance. Feasibility is moderate, requiring scaled verification capacity, with moderate costs for oversight. Risks involve rigid requirements slowing issuance or firms struggling with thresholds, but these can be mitigated through phased implementation.

Option 3: Expand blended finance mechanisms to mobilise private capital

Blended finance leverages public capital to de-risk private investment, unlocking 3 to 4 times more funds (OECD, 2021; Convergence, 2023; International Finance Corporation, 2022). The UK could establish a Blended Finance Facility for priority sectors, provide first-loss guarantees, and build pension fund co-investment platforms. This would de-risk climate technologies, encourage investment in hydrogen and CCS, and accelerate infrastructure development. Feasibility is moderate, depending on Treasury commitment, with high costs for fiscal backing. Risks include governance failures or impact measurement challenges, addressed via robust monitoring.

Option 4: Shift market incentives toward long-term investment horizons

Short-term horizons clash with climate risks (EY, 2024; European Central Bank, 2024; Bank for International Settlements, 2023). Tools include issuing sustainability-linked sovereign bonds, tax incentives for long-term green investment, strengthening stewardship codes, and expanding green infrastructure bank mandates. Impacts include aligned capital flows and reduced systemic risks. Feasibility is low-to-moderate due to fiscal constraints, with moderate-to-high costs. Risks encompass political resistance or capital flight, making this less prioritised than others.

Policy Recommendations

1. ***Develop taxonomy-aligned classification standards.***

   The government should publish a straightforward, flexible classification system that defines which economic activities count as genuinely green or credible transition activities. The taxonomy must avoid rigid binary categories, stay fully compatible with the EU Taxonomy and emerging global standards (ISSB, G20), and be finalised by the end of 2026 (building on the work already underway by HM Treasury and the Green Technical Advisory Group). This single measure provides the clear rule-book investors repeatedly say they need, sharply reducing ambiguity and greenwashing (European Commission, 2024; ICMA, 2022; HM Treasury, 2025).

2. ***Require independent verification of corporate transition plans.***

   All listed companies and large financial institutions with assets above £5 billion should be required to obtain an annual independent audit opinion confirming that their published net-zero transition plans contain realistic, science-aligned targets and credible delivery pathways.

This requirement would extend the existing Transition Plan Taskforce framework and come into force from the 2028 reporting cycle. This directly tackles “transition-washing” and restores market trust in sustainability-linked instruments.

3. ***Establish a UK Net Zero investment guarantee fund.***

The Treasury should create a £5-10 billion public fund that provides “first-loss” guarantees (covering the first 20–30 % of potential losses) for priority clean infrastructure projects such as offshore wind, hydrogen networks, carbon capture, grid upgrades, and large-scale building retrofits. Private investors would only bear losses after the public guarantee has been used. The model has already proved successful internationally and can be launched using the existing powers of the UK Infrastructure Bank. This de-risking mechanism is the most powerful proven way to unlock large-scale private investment without prohibitive fiscal cost.

4. ***Introduce mandatory climate-investment transparency for pension funds and insurers.***

Every UK pension scheme and insurance company should be required to publish, in their annual report and on their website, a single standardised table showing the percentage of the portfolio invested in high-carbon sectors, and the percentage invested in activities aligned with the new UK Green Taxonomy. The format would be prescribed by the Department for Work and Pensions and the Financial Conduct Authority. This low-cost transparency measure harnesses public and member pressure to shift billions of pounds of existing retirement savings toward climate solutions.

Conclusion

Therefore, green finance is no longer a niche element of financial markets; it is rapidly becoming a fundamental aspect of the UK’s net-zero transition. ESG integration has reshaped institutional investment, financial intermediaries have developed sophisticated green instruments, and regulatory reforms aim to enhance market credibility (BNP Paribas, 2025; ICMA, 2024; HM Government, 2023). However, persistent challenges, data inconsistencies, credibility gaps, and short-term horizons must be addressed to prevent inaction or suboptimal outcomes. By implementing the recommended policies, the UK can solidify its position as a global leader in sustainable finance, accelerate decarbonisation, and underpin a competitive, resilient economy.

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