Funding the Future

Article URL

Published: January 12, 2026, 6:19 pm

The FT has a headline this morning that says:

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Global industry groups push back on climate disclosure rules

At the same time, the Guardian has front pages news that:

Oil firms' climate claims are greenwashing, study concludes

Most comprehensive scientific analysis to date finds words are not matched by actions

The contents of the stories is, to a very large degree, entirely predictable. For example, the analysis of the financial reports of large oil companies in an academic journal, which underpins the Guardian article, notes that there has been a massive increase in the number of references to climate related issues over the years, but that the reality is that these companies are continuing to focus the vast majority of their investment in carbon fuel exploration, from which they also earn the by far the largest part of their profits. The green veneer is, then, wafer thin.

The FT article takes a different tack. It covers a range of issues, but all with a theme. Of particular importance is the push back it notes against climate reporting by financial institutions in the EU and banks in the US. The regulations in question are quite different but the motivation for each is broadly similar.

The assumption is that if there as a market amongst investors who want to save in ways that promote good governance, social conduct and environmentally high standards. It then places a duty on the fund intermediaries who manage most such savings to ensure that they can meet such objectives. This is the purpose of the so-called EU Taxonomy for Sustainable Actvities.

There are, I think, many flaws in this taxonomy. First, it presumes that both nuclear and gas production can be green, and I seriously question that.

Second, and more important, it assumes that investment intermediaries can effectively rank the activities of the companies whose shares and bonds they buy on the basis of the greenwash that they publish, whose misleading nature the Guardian notes. I seriously doubt that.

Broadly speaking, the same logic is implicit in US banking regulation. The assumption is that banks can tell how green their clients are and as a result can balance the environmental sustainability of their loan books.

The simple fact is that both assumptions are false. We only have voluntary environmental disclosure standards for companies at present. None of these require any comprehensive disclosure of the financial impact of climate change on the companies in question. All of them, including the leading Task Force on Climate-related Finance Disclosures, only require what is, in effect, narrative information in the front-end of the audited accounts i.e. in the part where the directors decide what is disclosed. The back end of those accounts, where the real financial disclosure is in the form of the actual accounts, is entirely unaffected by these requirements. Worryingly, this is the model to be used by the new IFRS standards for sustainability disclosure.

Although the FT article does not explore this issue in the way I note here , what is actually being seen in both the EU and USA is a kickback by intermediaries against reporting requirements being imposed upon them that they will have enormous difficulty in fulfilling precisely because inadequate and very largely unverifiable information will be supplied to them by the companies in which they supposedly invest for the purposes of undertaking the appraisals that they will be required to do.

Not surprisingly, they are not entirely happy about that. For once, and this is rare, I have some sympathy with those who are protesting about climate change reporting demands being made upon them. I cannot see how a demand can be made upon financial intermediaries without an equivalent demand for reliable, audited, data being made of the companies on whom they are actually reporting. What is more, unless there is demand being made of those companies for hard, backend financial data on the actual costs of climate change, including of replacing the activities that many companies will have to close if they are to become net zero carbon compliant, then to pretend that informed investment decision making is taking place is, to be kind, a joke.

I am, of course suggesting that what we really need is sustainable cost accounting, which is as far as I know is the only proposal currently on the table anywhere in the world that suggests that the cost of climate change should be built into the accounts of large companies so that those who invest in them can appropriately appraise their ability to assess the climate risk that they face; to allocate capital in the face of the consequent issues that arise; and to appraise their ability to survive this entire process by indicating their capacity to raise the necessary capital to finance this process of transition.

My suspicion Is that we are heading for a crisis on this issue. We need climate change reporting. We have to know which companies can invest to survive the crisis that is coming. Without that information the whole purpose and function of financial markets will fail. So too will pension schemes. But, right now regulators are building a myth that information to appraise climate change can be created without imposing a requirement on all large companies to report what is actually happening within their operations, and that is quite obviously wrong. Only data from what might, appropriately, be called the coal face will deliver on this goal, and no one is as yet willing to demand that information. They will have to, soon.

The Corporate Accountability Network, which I direct, hopes to publish a new draft Financial Reporting Standard on this issue in the next few weeks to take this argument forward. What we will seek to show is that such a standard is possible. What this will demonstrate is that in that case all that is missing is the political will to deliver this essential change on which the entire future of our financial markets depends.