

Financing the green transition

Increasing bankability, phasing out carbon investments and funding 'never bankable' activities

POLICY BRIEF SUSTAINABLE FINANCE, JUNE 2025

The environmental and climate crisis is one of the greatest challenges of our time. Limiting the consequences will only be possible through a fundamental restructuring of the state, economy, and society in a socially just and ecologically sustainable manner, a process that will require a massive redirection of financial flows from high greenhouse gas-emitting activities to green activities. This puts the financial world at a crossroads: It can drive change – or hinder it.

A global green financing gap

The global green financing gap is immense: By 2030, it will cost between USD 8 trillion and USD 9 trillion to advance the transformation towards a sustainable world (Climate Policy Initiative 2023). Over the next 5 years, additional annual investments of EUR 370 billion will be needed in the EU alone.

This shortfall is all the more glaring in view of the massive amount of capital still flowing into activities that generate high GHG emissions.

Political shift towards deregulation

Existing EU regulations on sustainable finance rely heavily on disclosure and transparency, for example, through the Corporate Sustainability Reporting Directive or the Sustainable Finance Disclosure Regulation (Baioni 2025). Such approaches, however, have no steering effect per se and therefore have neither a positive effect on the bankability of green activities nor a negative effect on the bankability of high GHG-emitting activities.

This problem is compounded by the fact that the European Union is now pursuing a more deregulatory trajectory (see, for example, the so-called 'Omnibus' regulations). The trend in this direction threatens to increase the green financing gap by unwinding even policies with only limited steering capacity.

Recommendations for a future-fit finance policy framework

- 1. The bankability of green investments must be strategically strengthened**
The lack of bankability is a crucial barrier to investment in green activities. This should be addressed through policy instruments such as financial incentives, guarantees, and regulatory measures.
- 2. Active measures should be undertaken to reduce the financing of fossil fuels and GHG-emitting activities**
The risk-return profile of high GHG-emitting investments remains attractive. Therefore, policy instruments such as higher capital requirements and investment exclusion criteria should be adopted to disincentivize or prevent such investments.
- 3. Public funding needs to be mobilized for green activities**
Although not profitable, important investments in activities such as climate adaptation measures are urgently needed for a sustainable world. They therefore require public funding. Additional public funds can be mobilized through various instruments such as an EU climate fund, a 'Green Golden Rule' or targeted taxation.

Why is there a financing gap? The answer lies in bankability

Why does this green financing gap exist despite intensified efforts in recent years to mobilize resources, particularly at the European level? What policy instruments and strategies could be used to steer financial flows from unsustainable to sustainable investments? A team of scholars from Witten/Herdecke University (UW/H) and the Institute for Ecological Economy Research (IÖW) investigated these questions within the project 'Climate Change and Global Finance at the Crossroads: Political Challenges, Political-Economic Dynamics and Sustainable Transformation' funded by the German Federal Ministry of Research, Technology and Space (BMFTR). The study focused on European and German developments in the field of sustainable finance.

Based on a mixed methods approach that combined document analysis and semi-structured interviews on questions regarding financial, regulatory and monetary policy measures as well as societal pressure, the project aimed to propose financial policy instruments and strategies that would enable and accelerate the transition towards a net zero GHG emissions economy by 2050. In its qualitative research, the team interviewed 88 experts from politics and administration, the financial sector and civil society. Insights were also gained through the analysis of 330 relevant documents as well as participation at specialist events and informal bilateral meetings with various stakeholders.

Problem: insufficient bankability

The analysis shows that **the problem lies not in the lack of capital, but in the lack of bankable green projects.**

Increases in green lending and investments by banks and other financial institutions remain negligible because green assets fail to meet the desired risk-return profiles of these lenders. In other words, they view the assets of many green companies and projects as 'non-bankable' (Aguila et al. 2025).

Reasons for this include:

- significantly higher upfront investments on average, and longer time horizons for generating revenues compared with the financing of fossil fuel projects;
- long investment periods, often 15 to 25 years (in contrast to the typical bank lending horizon of 5 to 7 years);
- low profit expectations (only 40% of CO₂ mitigation and 20% of adaptation projects are profitable);
- political uncertainties (lack of planning security); and
- high interest rate sensitivity, as debt servicing accounts for a large part of expenditures and loans have longer terms and therefore higher exposure to interest rate risk.

Which activities are 'green' and which are high GHG-emitting?

We define activities of 'high GHG-emitting' firms and projects as those that are inconsistent with Europe's 2050 net-zero GHG emissions target and above the threshold as set out by widely used climate and transition policy scenarios. Conversely, we define 'green' activities as those that are consistent with a net zero GHG emissions target for 2050 and in line with the threshold defined by widely used climate policy scenarios.

What is bankability?

Bankability refers to the capacity of an asset to secure funding. It involves assessing whether an investment in the productive economy or in financial assets is profitable enough to meet the investor's expectations and whether it presents an acceptable level of financial risk. Contrary to what the term suggests, bankable investments are not limited to private and public banks. Investors can also be non-bank financial institutions (NBFIs), or so-called shadow banks, such as investment banks, hedge funds, asset managers, pension funds or (re)insurance companies.

High bankability of high GHG-emitting investments

High GHG-emitting investments are considered profitable and low risk. To date, climate-related and environmental risks have not been adequately factored into the investment decisions of banks and investors. This is partly due to the fact that financial supervision is strongly oriented towards microprudential

criteria (Urban et al. unpublished). In addition, risks can be outsourced through shadow banks that include various financial actors such as asset managers, insurance companies or pension funds. This system of 'shadow carbon financing' accordingly tends to further stabilize high GHG-emitting investments (Schairer et al. 2025). Another reason why many financial players hesitate to exit emission-intensive but highly profitable sectors is their fear of being left at a competitive disadvantage.

Important green activities with little likelihood of ever becoming bankable

In current demands for more private financing of the green transformation there is an implicit assumption that all sustainable activities have the potential to become bankable (Fichtner et al. 2025). This, however, is not the case. Many activities necessary for the green transformation are unlikely to ever become bankable. These include the renaturation of wetlands, flood protection, green urban infrastructures, and other such initiatives that normally have little or no potential to generate private financial returns.

The expansion of renewable energies and environmentally friendly mobility are relevant transformation areas that require investment



Recommendations for a future-fit financial policy

Based on our analysis, we propose a classification that considers two criteria:

1. **Is the activity green or does it generate high GHG-emissions?**
2. **Is it bankable, not yet bankable, or never bankable?**

This taxonomy, which results in six categories (see Table), makes it possible to systematically assign activities to specific financing challenges. Accordingly, it forms the basis for targeted monetary and financial policy recommendations. The fields highlighted indicate activities with a particularly urgent need for action.

In order to close the financing gap, it is crucial to influence financial investments so that they lead to significantly more green investments and fewer investments that generate high GHG emissions. This can be achieved through the development of:

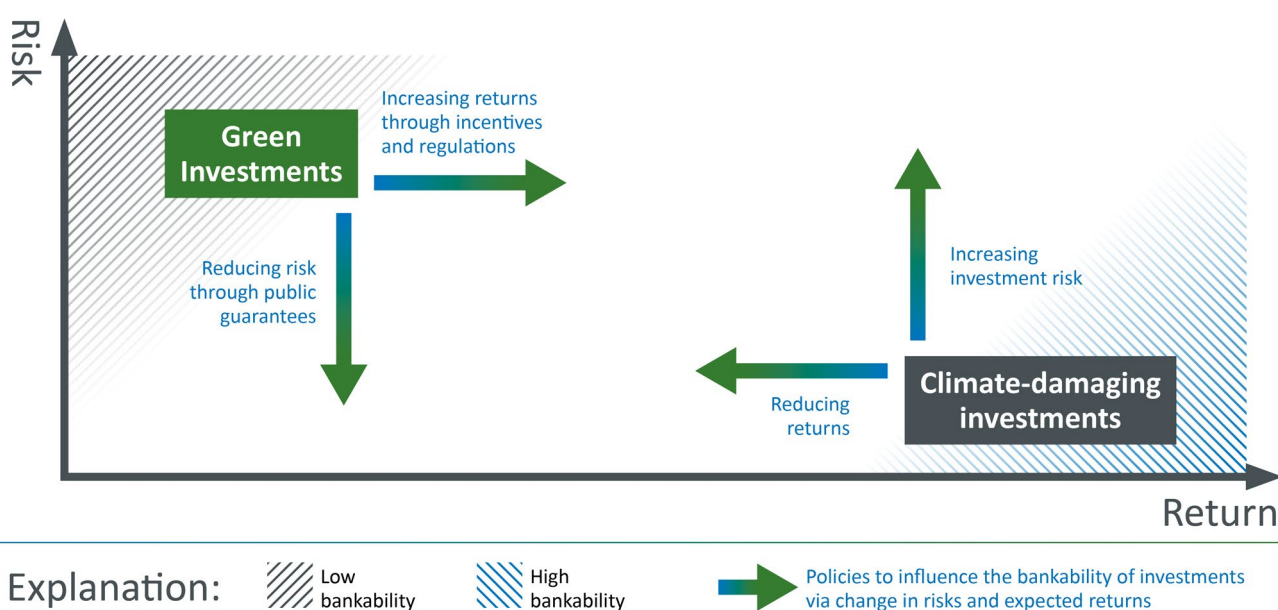
1. policy instruments that positively influence the bankability of green companies and projects;
2. measures that have a negative impact on the risk-return profile of high GHG-emitting companies and projects; and
3. policies that expand public financing to never-bankable green activities necessary to achieve global climate goals and adapt to the increasing climate crisis.

The figure on page 5 shows how policies in the sense of recommendations 1 and 2 can influence the bankability of investments.

Table: Different types of activities in the green transition according to their bankability

	Green (sustainable)	Harmful to the climate (high GHG emissions)
Bankable	Investments that are already privately financed	Investments that must be phased out such as oil and gas exploration and production
Not yet bankable	Investments that are not yet bankable but can become so with political intervention such as offshore wind farms	Investments that no longer receive private funding
Never bankable	Investments that will never be bankable such as biodiversity conservation	Investments that do not receive private funding

Figure: How policy can influence bankability



1. Targeted support to increase the bankability of green projects

Green activities that are not yet bankable require targeted political support. Examples of such support include reducing investment risks and increasing returns. This would make investments more attractive for private financial market actors. However, such interventions always involve the risk of privatizing profits and socializing risks or costs.

Important for biodiversity conservation, but never bankable: Wildlife bridges over highways or other infrastructure that fragment habitats

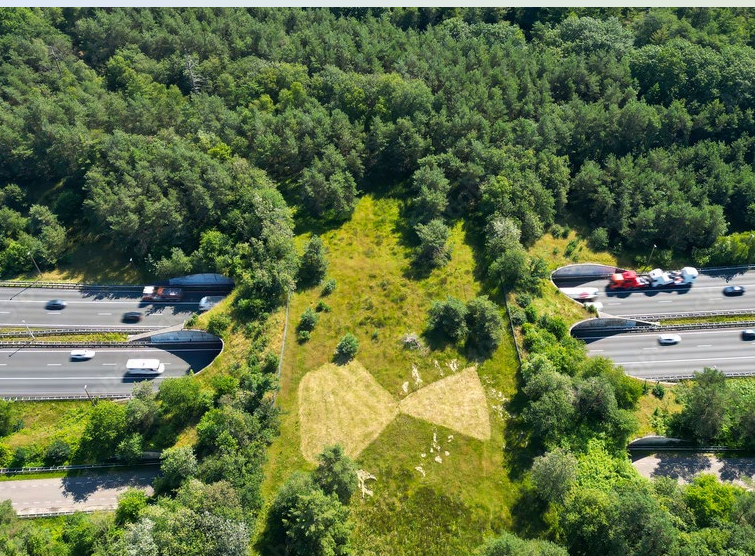


Photo: © [Rob] /Adobe Stock

Taking this into consideration, we recommend the following policies:

→ Creation of green targeted longer-term refinancing operations (TLTROs):

The European Central Bank (ECB) should provide green credit facilities with interest rates below the key interest rate.

→ Expansion of financial guarantees:

The European Investment Bank (EIB) and national development banks should offer targeted guarantees for green investments.

→ Strengthening the EIB's risk-taking capacity:

EU Member States should allow for higher risk tolerance and credit margins for green projects.

→ Purchase of EIB green bonds by the ECB:

This would significantly increase the EIB's financial scope to support not yet bankable but necessary green activities.

→ Setting minimum quotas for green loans:

The EU should create a legal basis for introducing mandatory lending quotas to require financial institutions to allocate a set share of their financing to green initiatives.

2. Measures to disincentivize high GHG-emitting investments

To divert capital flows away from emission-intensive sectors, risks must be increased and returns must be reduced. To this end, we propose the following interventions:

- **Steps should be taken to curb carbon capital mobility:**
Analogous to ‘Know Your Customer’ (KYC) policies, relevant regulatory bodies should introduce ‘Know Your CO₂’ principles (KYCO₂) and comprehensive emissions reporting requirements (including indirect emissions covered under Scope 3).
- **Higher capital requirements:**
should be adopted and incorporated into microprudential banking and NBFi regulations to address high GHG-emitting activities.
- **Climate-related maximum exposure limits and systemic risk buffers:**
should be integrated into macroprudential banking and NBFi regulation and supervision.
- **Mandatory transition plans:**
should be integrated into macroprudential regulation and supervision.
- **High GHG-emitting assets:**
should be progressively excluded from the ECB’s collateral framework.
- **High GHG-emitting assets:**
should no longer be eligible for securitization.

In order to overcome the environmental and climate crisis, it is crucial to steer capital flows away from emission-intensive sectors towards green activities



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3. Provision of public funds for never bankable green investments

Activities such as peatland protection, infrastructure for non-motorized mobility or flood protection cannot be financed by private funds or only to a very limited extent. Therefore, they must be financed with public funds. We recommend the establishment of:

- **A European climate fund:**
With a conservative estimate of at least €200 billion by 2030, EU member states should finance green activities that will never be bankable.
- **A Green Golden Rule:**
Investments in climate and environmental protection should not be counted towards fiscal rules.

Financial policy as part of a broad policy mix

There is no quick fix for financing sustainable transformations. None of the recommended policy measures would be sufficient on their own to significantly increase the necessary green financing or to substantially reduce the financing of high GHG-emitting activities. Instead, the measures should ideally be combined and understood as part of a broader policy mix that also includes other instruments such as the European emissions trading system.

A key finding of the project concerns the limits of sustainable finance. It is crucial for the green transformation to increase the available financial resources for green projects and companies, as well as to reduce the financing of high GHG-emitting projects and companies. However, financial policy approaches have limitations (Aguila/Wullweber 2024). Financial and monetary policy should therefore be complemented by fiscal, sectoral, innovation, and industrial policies aimed at sustainably transforming the state, economy, and society.

This policy brief is based on the policy report developed by the project team:

Wullweber, Joscha; Aguila, Nicolás; Urban, Janina; Haufe, Paula; Schairer, Simon; Baioni, Riccardo; Kern, Florian; Progscha, Sophie (2025):

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Download policy report



More about the project

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