Green Finance Strategy: Briefing and Next Steps

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This briefing accompanies a letter signed by a collective of academics, civil society and policy professionals to Secretary of State Grant Shapps, which responds to the collection of green finance policies announced at the end of March 2023, and takes stock of key developments since the coalition set out in July 2022 five key priorities for making the UK a 'Net Zero Financial Centre'.[1] It is endorsed by all signatories to the letter.

Below, we assess recent announcements against the 5 priorities we collectively set out last year, and urge the government to build on progress to date and fill urgent policy gaps to establish the UK as a global leader in sustainable finance:

1. **A whole-of-government strategy for aligning financial flows with a 1.5ºC transition pathway, adaptation and biodiversity goals.**

We welcome last week's landmark announcement committing the government to publishing a series of 'net zero investment roadmaps' before the end of the year to unlock investment at scale, reflecting growing calls from the private sector.[2] This should include detailed sectoral analysis of how investment will be generated to get on track to net zero, and be regularly assessed with independent tracking of investment gaps across public and private finance to keep the UK on track for 1.5C. The plans must amount to a joining up of financial regulation with fiscal, monetary, environmental and industrial policy to finance the transition across every sector of the economy, as well as halting and beginning to reverse the decline of biodiversity by 2030.

Importantly, the government must commit to taking further policy action as required if the proposed independent tracking of financial flows shows that the levels of private investment needed to reach UK climate and nature goals are falling short. The Net Zero-Aligned Financial Centre framework makes a first step towards establishing appropriate governance and KPIs. The government needs to move swiftly by empowering an independent body (such as the CCC or the OBR) to assess levels of green finance and any remedial actions needed[3], and establishing a clear process for the government, the Bank of England, the FCA, and relevant regulators to act on those recommendations, as set out in points (2) and (4) below.

2. **Support action on 'Phase 3' of the government's 'Green Finance Roadmap' that actively shifts financial flows in line with a 1.5ºC transition pathway.**

Recent bank failures such as of the Silicon Valley Bank and Credit Suisse underscore the need for robust regulation to safeguard against emerging systemic threats and avoid publicly funded

[1] Positive Money, '75 leading thinkers call for an overhaul of green finance rules', July 2022
[2] E3G: Investors managing £3 trillion in assets call on UK government to deliver Net Zero Investment Plan, 19 Oct 2022.
[3] E3G, UK Net Zero Review – calls for a Net Zero Investment Plan grow, 30 Jan 2023

bailouts. As the GFS recognises, climate change poses a severe threat which could lead to irreversible and escalating harm. Therefore, the government and regulators should take a precautionary approach to climate and nature related risks in the financial system, and address the financial sector's role in financing climate change and nature loss.

However, the Bank of England has indicated that it is delaying action following its recent climate and capital requirements review, despite acknowledging that 'the size and balance of future risks will be determined by actions that are taken now and in the future'[4]. We urge the government and the Bank to work together, fully integrating climate and nature into prudential and monetary policy frameworks, ensuring that the high risks related to fossil fuel financing are reflected in regulation,[5] and using policy and regulatory tools to actively shift private credit and capital in line with a rapid, managed transition.

The new GFS rightly highlights the need to lower the cost of capital for activities aligned with the transition, but fails to include policies to directly reduce the cost of green credit. Particularly in a higher-interest-rate environment, the government and the Bank of England should use targeted lower interest rate lending schemes and coordinate monetary and fiscal policy to ensure critical green investment is not impaired by high capital costs.[6][7] The Bank should also decarbonise its collateral framework to remove the implicit carbon subsidy embedded in the current approach, which the European Central Bank has already committed to doing.[8]

3. **Establish a key role for public investment and policy in driving a rapid, fair transition and reducing energy demand.**

We agree with the government's assessment that public finance institutions have a key role to play in the transition. It is therefore disappointing to see no new public investment to increase the capacity of the UK Infrastructure Bank (UKIB) or the British Business Bank. We welcome the recent news that UKIB has been placed on statutory footing, with provisions for nature as well as net zero infrastructure. However, UKIB's relatively small capitalisation of £12 billion (alongside the ability to deploy £10 billion loan guarantees[9]) remains a constraining factor.

It is concerning that energy and climate were notably absent from the prime minister's "five key priorities" for the UK in January[10], and the 2023 Spring Budget did not include any newly allocated net zero public investment. Recent research by E3G and WWF estimates that there remains a clean investment gap of £81–£111 billion between now and 2030, equivalent to 25–34% of the total investment required in key economic sectors.[11] IPPR estimates that green public investment would boost GDP by 2% by 2030 and would be supported by 7 in 10 members of the

[4] Bank of England, report on climate-related risks and the regulatory capital frameworks, 13 March 2023
[5] Chenet, Ryan-Collins, Van Lerven, 'Finance, climate-change and radical uncertainty: Towards a precautionary approach to financial policy, Ecological Economics, May 2021
[6] New Economics Foundation and Positive Money, 'Greening Finance to Build Back Better', 23 June 2021
[7] Climate Bonds Initiative, Sovereign Green, Social, and Sustainability Bond Survey, 2021
[8] European Central Bank, ECB takes further steps to incorporate climate change into its monetary policy operations, 4 July 2022
[9] Hogan Lovells, UK Infrastructure Bank's Guarantee to support UK infrastructure projects, Jan 2023
[10] UK government, Prime Minister outlines his five key priorities for 2023, 4 Jan 2023
[11] E3G, Net Zero Investment Plan Briefing, Feb 2023

public.[12] Public investment must play a critical role in driving the transition, ensuring costs and benefits are fairly distributed.

4. **Establish a science-based, credible and robust legal and regulatory framework to incentivise and enforce the private sector's net zero and nature positive transition**.

We are glad to see the government will be consulting on the UK green taxonomy in Autumn 2023, after delays to the process, and welcome the creation of the Land, Nature and Adapted Systems Advisory Group (LNAS). To ensure the market has access to clear and credible data on environmental impact, the government should ensure strict science-based criteria and reject classifying gas or biomass as 'green' in the taxonomy.[13]

The commitment to consult on disclosure of transition plans by large companies, as an extension of the FCA's current requirement of listed companies, is welcome. However, the FCA's current "comply or explain" basis for the disclosure of transition plans does not amount to the COP26 commitment of mandatory disclosure. Across the board, transition plans should be aligned with a 1.5C transition, embedded in robust legal and regulatory frameworks that incentivise and oversee implementation, and are supported by access to high quality data and analytics to aid financial decision-making.

Additionally, the reiteration of support for the TNFD, and its consideration by the ISSB is welcomed. However, a commitment to making TNFD aligned disclosure and nature recovery plans mandatory, as well as a robust implementation and oversight framework, would send the strongest signal to financial institutions. We welcome the government's acknowledgement that the fiduciary duty of pension schemes must be reviewed. To be effective in aligning with net zero goals, it is essential that the government amends the law on fiduciary duty to require pension funds to consider the impact of their investments on people and the planet.

The new GFS rightly recognises the role of regulators in supporting the strategy's goals, but the government's Edinburgh Reforms are pushing regulators into a 'race to the bottom' on regulatory standards through the new objective of promoting 'international competitiveness' and are likely to increase risks in the financial sector by lowering capital adequacy requirements. We urge the government to give financial regulators statutory objectives for net zero alignment and nature protection,[14] and clear remits for the phase-out of fossil fuel financing.

5. **Set clear objectives for UK international leadership and cooperation, informed by global justice principles.**

It is welcome that the GFS lists supporting the alignment of global financial flows with climate and nature objectives as one of its goals. While it provides more detail on how the UK will use its considerable influence in international political, multilateral and supervisory fora[15] to drive international standardisation of ambitious policy and regulation, it fails to set clear UK leadership by ending the City of London's role as one of the world's largest centres for enabling new fossil fuel investment. The GFS importantly identifies reform of the international financial infrastructure

[12] IPPR, Green investment: The prudent choice for prosperity, Dec 2022
[13] E3G & 60 signatories, 'United call for a gold-standard green taxonomy', 1 June 2022
[14] Finance for our Future coalition: https://financeforourfuture.org/
[15] Such as the G7, G20, UN, IMF, World Bank and the Bank for International Settlements, Network for Greening the Financial System, and Financial Stability Board.

as a key aspect for the UK to influence, but it falls short of the ambition needed to make World Bank and IMF operations fit for purpose in supporting a just transition for low- and middle-income economies.

The various initiatives for unlocking more private capital through multilateral funds are welcome, but to support climate-vulnerable countries the UK must go further and restore its overseas aid budget to its previous level of 0.7% GNI, as well as meaningfully consulting with climate-vulnerable communities and governments to scale up grant-based climate finance and other forms of assistance.

It is particularly concerning that the government has left a loophole open for ODA to still support fossil fuel energy overseas ‘in exceptional circumstances’. The government must ensure high integrity implementation (by closing such loopholes) of its commitment to end public financing for new fossil fuels overseas, and expand this to private finance.

Based on this analysis, and as set out in the letter to Secretary of State Grant Shapps, we recommend ten urgent next steps to fill crucial gaps in the UK’s climate, nature and adaptation financing architecture:

1. Ensure accountability mechanisms are in place to track progress against planned ‘net zero investment roadmaps’, empowering an independent body to assess financial flow gaps and setting out a clear process for relevant authorities to act.
2. Fully integrate climate and nature into prudential and monetary policy frameworks, including by decarbonising the Bank of England’s collateral framework and accounting for the high risks associated with fossil fuel projects in the capital framework.
3. Coordinate monetary and fiscal policy to ensure critical green investment is actively supported, including measures to reduce the cost of capital.
4. Increase strategic public investment and capitalisation of public finance institutions such as the UK Infrastructure Bank and the British Business Bank.
5. Clarify that the UK taxonomy will use strict, science-based criteria to define “green” economic activities, and that gas and biomass will not be labelled 'green' in the UK taxonomy.
6. Extend the disclosure of transition plans to all large companies on a mandatory (not ‘comply or explain’) basis, and to align with a 1.5C transition pathway, with robust frameworks to oversee implementation.
7. Make TNFD-aligned disclosure and nature-recovery plans mandatory for all large companies and financial institutions, and set out a robust framework for implementation and oversight.
8. Amend the law on fiduciary duty to require pension funds to consider the impact of their investments on people and the planet.
9. Give regulators statutory objectives for net zero alignment and nature protection.
10. Outline how the UK’s priorities in reforming international financial institutions would significantly shift global financial flows to meet the transition and adaptation financing needs of low- and middle- income countries, and commit to scaling up grant-based financial assistance for low-income countries.

We would be grateful for the opportunity to meet with you to discuss how we can best support the next phase of the government’s work on these crucial issues. We are also happy to provide further briefing material on any of the proposals set out here.