IIGCC response to BEIS call for evidence on updated Green Finance Strategy

The Institutional Investors Group on Climate Change (IIGCC) is the leading European membership body enabling the European investment community in driving significant and real progress by 2030 towards a net zero and resilient future. IIGCC's 365+ members, representing €51 trillion AUM, are in a position to catalyse real world change through their capital allocation decisions, stewardship and engagement with companies and the wider market as well as through their policy advocacy.

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Consultation question 1: What are the key characteristics of a leading global centre for green finance?

IIGCC believes there are five key characteristics of a leading global centre for green finance:

1) **Credible and science-based:**
The UK's green finance system must be led by the latest scientific consensus, and insulated from political expediency. This mean ensuring that the various components that make up the system are built around a clear definition of 'net zero'[1] with low or no overshoot (both for the economy as a whole and for material sectors) and underpinned by robust science-based criteria that support the UK's net zero objective. A key consideration here will be ensuring the UK sets a high bar when developing its green taxonomy, which will underpin the wider sustainable finance framework by identifying economic activities that align with net zero. IIGCC, UKSIF and PRI recently wrote to the UK Government to express our concerns about the potential inclusion of natural gas activities within the scope of the UK taxonomy. Excluding gas (and other activities that are incompatible with net zero) will help to ensure the credibility of the UK's sustainable finance system, supporting the UK's decarbonisation targets and providing an opportunity to set a world-leading example for other international taxonomies in development.

2) **Establishes an enabling policy environment to support the transition of the real economy:**
IIGCC welcomes the publication of the Government's 2021 Net Zero Strategy, which sets out a high-level vision for how key sectors of the economy will reach net zero. However, investors urgently need more detail on what these pathways will look like in practice in order for financial flows to shift. Government should prioritise the development of sector-specific emissions intensity pathways (leveraging the work of the Transition Pathways and Science Based Targets Initiative) that align with the objective of 1.5°C with low or no overshoot. This will help to provide investors with certainty and to channel capital towards the companies and activities that will have the greatest impact on real world emissions reductions. Sector pathways should be complemented by measures such as a robust carbon price, which will further support the

[1] The definition should be consistent with the IPCC Special Report on Global Warming of 1.5 °C, which clearly states that to limit the worst impacts of climate change, we need to limit global warming to 1.5°C above pre-industrial levels. This will require global CO_2 emissions to fall by about 45 percent from 2010 levels by 2030, reaching 'net zero' around 2050, with any remaining emissions balanced by removing CO_2 from the air.

reorientation of capital by making harmful investments more expensive and sustainable investments more compelling.[2]

3) Addresses key policy barriers faced by investors:

The UK's sustainable finance framework needs to address key policy barriers investors and other financial market participants face in aligning capital flows with net zero. The forthcoming UK Sustainability Disclosure Requirements regime must provide investors with the consistent, comparable and high-quality sustainability data they need to inform the investment decision-making process. IIGCC's Investor Expectations on Corporate Disclosures sets out recommendations to support decision-useful sustainability disclosure frameworks, including:

- the need for broad coverage across the economy (both listed and unlisted entities), with carbon-intensive companies required to report in more detail
- differentiating between disclosure requirements for investors and investee companies
- the integration of a "inside-out" or "double materiality" lens to provide investors with clarity on the impact of investees' activities on the climate, as well as the impact of climate change on enterprise value
- ensuring material climate-related risks and opportunities are fully integrated into financial accounts, as well as narrative reports. This is vital for consistent and effective capital allocation, and aligns with existing international reporting requirements (e.g. International Financial Reporting Standards)[3]
- granular transition plan disclosures to support assessment of investees' alignment potential (not just long-term net zero commitments). IIGCC recommends that sustainability disclosure frameworks should leverage the recommended actions and disclosures established by the Paris Aligned Investment Initiative's Net Zero Investment Framework and the Climate Action 100+ Net Zero Company Benchmark criteria for investors and corporates respectively
- appropriate sequencing and coherency of reporting requirements. To support the flow of information across the investment chain, sustainability disclosures for corporates should enter into force before investors and other financial market participants are required to make these disclosures. This will enable investors to assess their exposures to climate-related risks and opportunities impacting their investees, and help them meet their own reporting obligations.

Finally, it will be vital to build on and enhance the existing stewardship framework through the creation of an enabling environment for investors to hold their investees to account on climate commitments and accelerate ambition where needed. The methodology established by IIGCC's Net Zero Stewardship Toolkit could provide a basis for embedding 'net zero' stewardship approaches into regulation. Guidance on how investors can undertake stewardship activities

[2] In line with the positions set out in the Network for Greening the Financial System's latest report (p.2) – 'The ability to…price climate-related risks is a key enabler for…investors to integrate climate-related risks and opportunities into their business strategies, risk management processes and capital allocation decisions. This will in turn help to accelerate the channelling of capital to green and transition activities, thereby helping to foster a more sustainable future.'

[3] IFRS requires material information (i.e. information that could reasonably be expected to influence decisions made by investors) to be disclosed in financial statements under International Accounting Standard 1 (IAS1).

across a wider range of asset classes will be helpful in accelerating progress in meeting the UK's climate goals.

4) **Promotes interoperability and drives international ambition**
A leading green finance centre should promote interoperability between sustainable finance frameworks and disclosure standards to support financial market participants with global investment horizons. The UK is well-positioned to drive greater international adoption of mandatory TCFD reporting frameworks, which provide a credible baseline for consistent, comparable climate-related disclosures focused on enterprise value. The UK should also champion a 'building blocks' approach[4] that allows jurisdictions to build on these disclosures with complementary reporting where they want to go further (e.g. via the incorporation of a "double materiality" lens).

Interoperability of green taxonomies will help UK-based financial market participants to assess the sustainability of their globally-held assets, and support users of foreign taxonomies in assessing assets they hold in the UK. However, full 'equivalence' of taxonomies will likely be challenging, and some constructive divergence may be necessary to ensure the UK Taxonomy is appropriate for the UK market and remains robust and science-based (e.g. differentiated sectors for inclusion/technical screening criteria).

Beyond driving greater global consistency and interoperability of financial regulation, the UK should also use its influence to accelerate international ambition on net zero commitments.[5] This includes encouraging governments to ensure their 2030 targets in their Nationally Determined Contributions are aligned with limiting temperature rises to 1.5°C and implement the domestic policies necessary to achieve this objective. In addition, scaling the provision of public finance for climate mitigation, adaptation and resilience – with a particular focus on emerging markets and developing nations – could provide a catalysing role for private finance flows into these areas.

5) **Encourages flexibility and innovation**
The sustainable finance landscape is a fast-evolving space. The UK will need to develop a green finance framework that is flexible enough to accommodate for new developments while maintaining appropriate levels of protection for consumers and investors. There should be a focus on using regulation and best practice guidance to deliver high standards that create a clear and reliable brand for UK-led finance initiatives, including the development of new financial products and services (e.g. sustainability-linked bonds).

Innovation needs to account for the opportunities presented by climate change, as well as management of the risks. The UK must encourage and facilitate increased investment in the range of climate solutions needed to meet the objective of net zero by 2050 or sooner. Where such solutions are based on revenues and/or capital expenditure that align with the UK

[4] See International Federation of Accountants overview here.
[5] The Investor Agenda's 2022 Global Investor Statement, due to be published in September 2022, will call for national governments to raise their ambition and to focus attention on adopting and implementing the specific policies needed to enable large scale zero-emissions, climate-resilient investments.

Taxonomy, it will be critical to ensure the criteria for assessing alignment are useable (perhaps via a more 'streamlined approach' to do no significant harm (DNSH) requirements) while remaining credible and science-based. In addition, encouraging the development of investment products and solutions that support climate adaptation, (including solutions which align with the Taxonomy's climate adaptation objective), should also be a priority area of focus for the UK.[6]

As well as climate solutions, a leading green finance centre needs to provide incentives to channel capital towards companies on a credible alignment pathway. IIGCC welcomes the proposed introduction of a UK investment funds labelling regime, and particularly a 'transitioning' fund label, which recognises the role these investments will play in helping the UK to achieve its climate objectives. However, it will be vital to ensure that the importance of holding carbon-intensive assets on a credible path to net zero is communicated clearly to end-investors, and that robust criteria are put in place to mitigate the risk of greenwashing.[7]

Consultation question 5: How can the UK government measure progress towards becoming a leading global centre for green finance?

IIGCC suggests that progress towards/achievement of the following outcomes should help UK Gov to gauge progress towards becoming a leading global centre for green finance:

- **Credible and science-based green finance centre:**
    - Sector pathways align with 1.5°C and are underpinned by robust, science-based methodologies, reflecting the specifics of the UK economy
    - Taxonomy excludes activities that are incompatible with net zero.

- **Green finance centre that supports the transition of the real economy:**
    - Development of detailed sector pathways for material sectors, underpinned by credible scenarios (e.g. IEA net zero scenario) and supported by clear interim targets and milestones
    - Emissions Trading System broadened to encompass more sectors and mitigate risk of carbon leakage; robust carbon price that increases over time and which sends the right long-term price signals to the market.

[6] For more information on adaptation solutions, see IIGCC's publication: Building Resilience to a Changing Climate: Investor Expectations of Companies on Physical Climate Risks and Opportunities
[7] See IIGCC's response to the FCA's November 2021 Discussion Paper on Sustainability Disclosure Requirements and investment labels for more information.

- **Green finance centre that addresses policy barriers faced by investors:**
  - Broad scope for disclosure requirements, with clear proportionality mechanisms introduced to ensure companies operating in material sectors and/or of a certain size are required to report in more detail
  - Consistent, comparable and sufficiently granular climate and broader sustainability-related disclosures, that provide investors with a view on both the "inside-out" and "outside-in" impacts of climate factors on/of reporting entities; clear expectations and guidance for companies to develop 'Paris-aligned accounts' by reflecting material climate impacts in financial statements
  - Coherent sustainable finance regulatory framework that leverages the same terminology, concepts and substance across various regulatory files, and which is appropriately sequenced (e.g. corporate disclosure requirements entering into force prior to investors, so the former feeds into the latter)
  - Enhanced stewardship guidance which supports investors in demonstrate the outcomes of their stewardship and engagement activities; high-quality and comparable transition plan disclosure requirements that inform investor approaches to 'Say on Climate' votes; legal clarity on how investors can take climate-related risks and opportunities into account in the context of their fiduciary duties.

- **Green finance centre that promotes interoperability and drives international ambition:**
  - Greater global adoption of mandatory TCFD-aligned reporting
  - Global reporting initiatives such as ISSB adopt a 'building blocks' approach that allow climate-related disclosures focused on enterprise value to provide a baseline on which jurisdictions seeking to go further can build (e.g. by incorporating a "double materiality" lens or which are aimed at a broader group of stakeholders)
  - International taxonomies adopt interoperable frameworks to support comparison of foreign assets held by UK investors and vice versa (e.g. common environmental objectives, common concepts of substantial contribution, DNSH and minimum safeguard requirements, and common metrics for assessing technical screening criteria)
  - Increased number of national governments align their 2030 target in their Nationally Determined Contributions with 1.5°C and take early action to implement the domestic policies necessary to achieve this (e.g. sale up of low-carbon energy system and infrastructure, phase out of thermal coal/fossil fuel subsidies, robust carbon price, etc)
  - UK Infrastructure Bank catalyses greater public and private investment in international projects in emerging market and developing nations, including cornerstone investment, technology development and capacity building.

- **Green finance centre that encourages flexibility and innovation:**
    - Increased investment in climate solutions that align with taxonomy climate mitigation/adaptation criteria, and corporate revenues/capex that align with the taxonomy's climate-related objectives
    - Increased range of high-quality financial products and services that credibly support investors' sustainability objectives and the UK's climate goals, aligned with evolving best practice
    - A well-constructed fund labelling regime that strikes a balance between principles and prescriptions, that is underpinned by robust criteria, and enables capital to flow towards assets on a credible alignment pathway, as well as those which are already sustainable
    - Development of low-carbon benchmarks that are less reliant on the achievement of aggressive initial emissions reductions achieved via exclusions. Climate benchmarks should capture the transition potential of assets in the short term, while achieving overall emissions reduction requirements via index constituent's weighting towards best-performing assets according to alignment criteria.