UK SUSTAINABLE FINANCE POLICY EVENT – SUMMARY

27th June 2023

INTRODUCTION

The Principles for Responsible Investment (PRI), the UK Sustainable Investment and Finance Association (UKSIF) and the Institutional Investors Group on Climate Change (IIGCC) held an event on UK Sustainable Finance Policy with our organisations' members, policy officials, and investment industry stakeholders. This provided an opportunity to discuss, network and collaborate on the suite of policy developments outlined in the publications released on the 30th of March.

The 60 attendees included policymakers, investors and financial institutions representatives and lawyers. We would like to particularly thank the policymakers that gave presentations.

We had open and lively conversations about the opportunities and challenges of achieving a sustainable financial system and the UK's Net Zero targets. The main topics discussed were:

- the UK as a Net Zero-aligned Financial Centre and the UK's options for green growth support;
- the role of fiduciary duty in addressing systemic risks and outcomes; and
- transition finance and decarbonisation of the real economy.

This document presents a summary of points raised throughout the event. The views presented in this summary do not represent the positions of the PRI, UKSIF and IIGCC.

SUMMARY OF THE EVENT

THE UK AS A NET ZERO-ALIGNED FINANCIAL CENTRE – UK OPTIONS FOR GREEN GROWTH SUPPORT

The opening session to our London Climate Action Week event considered the UK's evolution towards a net-zero aligned financial centre, and options for government to further support green growth opportunities in the wider economy.

The session began with an introduction to the UK's updated 'Green Finance Strategy – Mobilising Green Investment' by the Head of the Green Finance Team at the Department for Energy Security and Net Zero.

Participants were given a broad overview to the updated Strategy, as well as the 'Powering Up Britain' publication which outlines government's latest agenda on net-zero and energy security policy. A number of key upcoming announcements for stakeholders to look out for in the coming months were mentioned, including: the publication of new net-zero investment roadmaps in the Autumn, the launch of a Transition Finance Market Review (see further detail in the Transition Finance section below), and details of the planned framework to assess the suitability of the International Sustainability Standards Board's (ISSB) finalised standards for adoption in the UK.

During the discussion, many of the contributions from attendees highlighted the importance of building on recent announcements made by government, for example identifying where additional support from policymakers may be required to decarbonise certain sectors. As part of the roundtable discussions, attendees addressed three main guiding questions:

1. What are the key sectors that may require further focused policy interventions and incentives (i.e., onshore wind, home retrofits and energy efficiency)?

2. What further policies could form the basis of a UK government's green growth package in the Autumn Budget?
3. How can these priorities support the development and operationalisation of the proposed "Net Zero Financial Centre framework" as set out in the 2023 Green Finance Strategy?

MAIN TAKEAWAYS FROM THE ROUNDTABLE DISCUSSIONS

What are the key sectors that may require further focused policy interventions and incentives?

During the first part of the discussion, a number of sectors were identified by participants that required further intervention and government incentives. These included the following:

- **Energy storage and the UK's energy sector**: suitable energy storage techniques are a prerequisite to developing the green transport sector in the UK. More broadly, the need for greater investment in the UK's grid was emphasised repeatedly: tackling access to the grid is necessary not only from a "green" perspective, but also as a longer-term solution to support households and businesses – in a more cost-effective way than the government's current energy price cap. It was noted that it is not feasible to maintain the energy price cap on a longer-term basis, and therefore the UK government should consider what action to take to bolster access to energy so the price cap could be lifted in future without serious ramifications. A number of positive policy successes were mentioned by participants in terms of the UK's energy policy; such as the UK's leading global position in offshore wind.
- **Transport:** attendees noted the need to introduce new policies on air travel, specifically the development of biofuels and sustainable aviation fuels. The key focus of discussions was on electric vehicles and hydrogen cars/hydrogen fuel cells EVs, in particular the need to build suitable infrastructure for charging points of EVs across the UK. There needs to be specific encouragement or incentivisation to establish rural charging points. Finally, a policy adjustment is needed to allow large-scale investment into the UK's transport sector to transition large-carbon emitters in this sector.
- **Planning and permitting for renewable energy infrastructure**: investors and other financial market participants commonly find that planning permission from local authorities in the UK can be a final obstacle preventing projects from moving forward, with an apparent disconnect between national government and local policy-making entities on their approach to planning for renewable energy projects. One specific issue cited was ongoing difficulties in relation to obtaining planning permission for battery storage facilities in the UK. The ban on onshore wind farms in England was another example to be addressed by policymakers through swift changes to planning rules.
- **Skills and home retrofits**: a key obstacle identified in the UK's drive to net-zero is the lack of a skilled workforce to implement certain policies. For example, a sector that has been neglected in particular by policy support for upskilling relates to the energy efficiency of homes and home retrofits in the UK. There needs to be intervention to move beyond disclosure in the housing sector and push for retrofitting to resolve the issues here. Even if action is taken, attendees commented that there is not the available workforce in the UK to carry out the necessary number of home retrofits. It was acknowledged that the government has previously set up training schemes and similar initiatives, but that the implementation and delivery of these schemes were ineffective in practice. There should be an investment in green jobs in this sector, including through government-run training schemes based on geographical demand on the installation and maintenance of heat pumps.

Attendees also highlighted that not all sectors of the economy would be able to achieve net zero, noting that harder-to-abate sectors will have residual emissions. Further consideration is required on financing mechanisms to channel capital to various sectors, whether public-private partnerships, state subsidies, or encouraging asset owners to dedicate further capital to projects. Finally, other sectors mentioned requiring further policy support included green hydrogen and the circular economy.

What further policies could form the basis of a UK government's green growth package in the Autumn Budget?

A number of suggestions were outlined by attendees for government to consider ahead of the Chancellor's Autumn Budget. These fell under the following areas:

- **Facilitating pension fund investment in the wider economy:** there should be further policy intervention to allow and better encourage pension funds to channel capital towards sustainable investments and assets, particularly should this be the preference of clients and outlined in investment mandates. Fiduciary duty was raised at length in this context, and whether clarification could better facilitate capital flows from Defined Contribution (DC) pension funds in particular. This discussion foreshadowed the Chancellor's recent Mansion House speech which addresses some of these issues. Challenges for pension schemes in investing in green and sustainable projects were considered by attendees, including: potential issues around value for money for beneficiaries (e.g. the 0.75% charge cap for auto-enrolment pension schemes), the perceived risk profile for green investments, daily liquidity requirements for certain types of funds, and the relative lack of consolidation among Defined Benefit (DB) and DC pension schemes. These various barriers to green investing by pensions schemes need to be addressed further by various actors, including policymakers.
- **Promoting behavioural change:** incentives and education can both be successful impetuses for encouraging behavioural change among the public towards more sustainable lifestyles and choices. Suggested initiatives, that would be relatively easy to implement with clear parameters, which could have a significant positive impact on the green agenda included: encouraging recycling, including charging for waste disposal, and a "right to repair" initiative, whereby zero-rated VAT would be applied on repairs on second hand products.
- **Reforms to regulators' remits:** financial and non-financial regulators' statutory objectives should be broadened to encompass climate change and sustainability considerations. This includes financial regulators, such as the Financial Conduct Authority (FCA) and Financial Reporting Council (FRC), while for examples of non-financial regulators, Ofwat has a statutory objective on climate resilience, but other non-financial regulators do not currently. One positive example cited was the new net-zero mandate for Ofgem – a key recommendation of Chris Skidmore's 'Mission Zero' Review' – and net-zero mandates for regulators could shift the way that companies invest in the wider economy.
- **Carbon pricing:** the role for carbon pricing was discussed, including the need for a clearer framework in this area, and whether a price on carbon would be a more effective area of focus for policymakers when compared with the recent emphasis on support for carbon capture, usage, and storage (CCUS) technology (e.g. the £20bn package spread out over 20 years in the UK).

How can these priorities support the development and operationalisation of the proposed "Net Zero Financial Centre framework" as set out in the 2023 Green Finance Strategy?

The government's definition of a "net-zero financial centre" in the UK was considered overly vague, and participants raised the need for government to clarify in greater detail what specific parts of the financial system and sub-sectors they are aiming to transform.

A number of sub-sectors of finance were mentioned in this respect, including green bonds, the initial public offering (IPO) market, and the role of law firms, investment consultants, and other advisory firms. Linked to this, it was agreed that the government should provide clarity on their more specific objectives and aims as part of the draft net-zero financial services framework and ensure there is no room for greenwashing by firms as one core priority in the upcoming framework. The draft framework is due to be consulted on by government (precise timings are still to be confirmed).

One area noted that could be illustrated more clearly in government's definition is the UK's global leadership role, and work enabling interoperability and to influence standards across the world; for example, in regards to green taxonomies under development. Finally, in terms of operationalising the UK's draft net-zero financial centre framework, the recently established Net-Zero Council was highlighted as a vehicle for this (this is chaired by DESNZ Minister, Graham Stuart).

THE ROLE OF FIDUCIARY DUTY IN ADDRESSING SYSTEMIC RISKS AND OUTCOMES

The second session of the UK Sustainable Finance Policy event discussed the topic of fiduciary duty. The session started with a short overview of the 2023 Green Finance Strategy, which acknowledges the need for a review of fiduciary duty and to align finance flows with a climate resilient economy. The strategy highlights that the Department for Work and Pensions (DWP) "will examine the extent their Stewardship Guidance is being followed in late 2023. Government will engage with interested stakeholders on how we can continue to clarify fiduciary duty through a series of roundtables and a working group of the Financial Markets and Law Committee."[1] (FMLC)

This was followed by a presentation on A Legal Framework for Impact (LFI) report commissioned by the PRI, UNEP FI, and the Generation Foundation, and authored by Freshfields Bruckhaus Deringer. Attendees heard about the difference between integrating ESG into portfolios and investing for sustainability impact, and how investors can achieve their goals by pursuing sustainability outcomes as this addresses the cause of portfolio risk. The findings of the October 2022 report A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry were also outlined, including key recommendations for policymakers.

The questions that the roundtables were asked to consider were:

1. Are you pursuing sustainability impacts/outcomes intended to contribute to efforts to mitigate the risks resulting from system-level sustainability threats? How and on what basis have you decided to do so?
2. If you are not pursuing sustainability impacts, why is that? What barriers or challenges limit your ability to do so?
3. In order to improve your confidence/ability to pursue sustainability impact goals and so manage sustainability risks, what legal or policy guidance or other types of guidance would you like to see and from whom?

MAIN TAKEAWAYS FROM THE ROUNDTABLE DISCUSSIONS

Are you pursuing sustainability impacts/outcomes intended to contribute to efforts to mitigate the risks resulting from system-level sustainability threats? How and on what basis have you decided to do so?

- **Pension funds:** Pension funds seem to be growing more comfortable in considering sustainability factors. However, there is limited evidence of an associated shift in practices from investment managers. Asset owners with pension fund clients also noted that Local Government Pension Schemes in particular seem to be more comfortable with the concept of pursuing sustainability impacts compared to private sector schemes.
- **Transition Plans:** Transition plans were discussed as a solution to enable investors to pursue sustainability impacts and if applied systematically would help better align financial flows. They provide a way to assess and measure real world impacts, and are needed at all levels – company, sectoral, and economy wide.

[1] For further details see the 2023 Green Finance Strategy pg. 56

If you are not pursuing sustainability impacts, why is that? What barriers or challenges limit your ability to do so?

- **Conservative perspectives:** traditional (and somewhat conservative) interpretation of the law and fiduciary duty within legal and investment communities is a prevailing issue. Many lawyers are cautious, preferring to focus solely on maximising return and not considering explicitly the benefits of pursuing sustainability outcomes.
- **Negative sustainability impacts:** there is considerable discretion in how assets are invested which enables investments with negative sustainability impacts as long as a proper decision-making process has been undertaken. This causes misalignment between financial flows and the stated ambition to become a Net Zero-aligned Financial Centre.
- **Performance perception:** there is a behavioural issue with many investors concerned about the optics of poor returns, with the potential perception that these performance issues could be blamed on sustainability-related policies and therefore imply of a breach of fiduciary duties. However, it was emphasised there is actually a legal obligation to consider pursuing sustainability outcomes in cases where it will help achieve financial objectives. Additionally, the law offers strong protections if proper decision-making processes are followed.
- **Wider context and influence:** asset owners feel they do not have significant influence in the context of large investment managers. This is particularly an issue with investment managers based in the US, as a lot of centralised decision-making results in US-centric risk management and anti-ESG sentiment preventing impact investing occurring more readily. Investment managers are also facing the challenge of triangulating what is happening across different jurisdiction, as well as navigating unclear mandates from some asset owners.
- **Data accuracy and availability:** measuring fund manager performance can be a challenge: asset owners noted having issues relating to underlying data, particularly in private asset classes, and their strong reliance on fund managers to provide the necessary information.

In order to improve your confidence/ability to pursue sustainability impact goals and so manage sustainability risks, what legal or policy guidance or other types of guidance would you like to see and from whom?

- **Education:** to shift conservative interpretations of law, more education and socialisation of reports and analysis which highlight the compatibility between fiduciary duty and investing for sustainability impact is needed. Trustees also require support interpreting their fiduciary duties and re-skilling to better understand sustainability-related subjects.
- **"Relevant" sustainability factors:** to reduce negative sustainability impacts policymakers might consider intervening in the discretion that funds have, such as mandating that particular sustainability factors are defined as "relevant" and therefore taken into consideration by default.
- **Improving performance perception:** the potential for poor optics can be addressed through better communication with beneficiaries, enabling them to understand the long-term benefits of addressing system risks. Policymakers could also look into ways to extend the time horizon of investments, so they are no longer linked to quarterly performance, reducing the pressure fund managers face to achieve short-term returns.
- **Transparency of data**: one way to ease difficulties in presenting poor returns and communicating the benefits of addressing systemic risks is through increased availability of

data. Policymakers should work with the industry to develop an appropriate reporting and disclosure regime, providing investors with all necessary data.

- **Clear guidance**: the need for more guidance on creating and implementing transition plans was raised by a number of stakeholders. Investors are unsure as to how to set targets that are achievable, and do not create conflicts for key outcomes. Policymakers also need dispel myths about acting in concert by providing guidance on competition law and when collaborative engagement and action is permitted.

TRANSITION FINANCE AND THE DECARBONISATION OF THE REAL ECONOMY

This session centred on how the UK government's sustainable finance policy framework can promote a supportive environment to facilitate transition finance flows at pace and scale. The session included a presentation from the Head of Transition Finance at the Department for Energy Security, who provided an overview of the Government's priorities in this area. Participants heard more information about the government's plans for a Transition Finance Market Review, to be led by an external expert, which will explore how the UK's financial services ecosystem can become a leading provider of transition finance services and instruments. Next steps on the review are due to be announced shortly. Attendees heard how the review will leverage and align with the work of the Transition Plan Taskforce (TPT), which is due to finalise its sector-neutral framework for transition plan disclosures later this summer. We also received an update on the UK government's commitments to consult on requiring the largest UK companies to disclose transition plans, on a comply or explain basis, with work underway to prepare a consultation for Autumn/Winter 2023.

As part of the roundtable, attendees discussed three key questions:

1. How can existing and proposed sustainable finance regulations support transition finance flows? What are the key policy barriers that need to be addressed? What is missing from the existing framework?
2. Which sectoral policies need to be prioritised to send the right price signals to the markets / incentivise the reorientation of capital in line with the transition?
3. How can we ensure a 'joined-up' approach between sustainable finance and real economy/sectoral policies?

MAIN TAKEAWAYS FROM THE ROUNDTABLE DISCUSSIONS

How can existing and proposed sustainable finance regulations support transition finance flows? What are the key policy barriers that need to be addressed? What is missing from the existing framework?

- **Definition of transition finance:** a common theme across the discussion tables was the need to have a clear understanding of what transition finance means in practice. While the UK government has set out a high-level definition for transition finance, it will be important to ensure this concept is applied consistently and coherently across regulations.[2] The forthcoming Green Technical Advisory Group (GTAG) paper on policy links was welcomed in this regard, with some attendees suggesting that this could help to increase transparency over how various policy tools can be used to boost transition finance flows.
- **Economy-wide roll-out:** there was general agreement on the need for comprehensive transition plan disclosures to be rolled out across the UK economy and a high degree of support for the approach established by the TPT. Integrating these frameworks into the UK's disclosure architecture and striving for maximum interoperability to support global comparability of reporting, were flagged as key priorities.

[2] HM Government, Mobilising Green Investment: 2023 Green Finance Strategy, (March 2023) See definition of transition finance, page 29.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1149690/mobilising-green-investment-2023-green-finance-strategy.pdf

- **Incentives:** while these plans and disclosures were seen as a 'key ingredient' to enable assessment of the credibility of corporate transition efforts, a number of attendees highlighted that more needed to be done to incentivise investment through stronger sectoral policy initiatives. A lack of price signals from policymakers (e.g. those created by the US Inflation Reduction Act or the EU Net Zero Industry Act) were seen as key barriers to catalysing transition finance flows. Attendees suggested that helpful policy signals could include anchoring transition plans in sector pathways or financing roadmaps, which would provide a means of benchmarking company- and activity-level transition (e.g. through TPT and the taxonomy) against sectoral and economy-wide milestones.
- **Key performance indicators (KPIs):** linked to the TPT framework, attendees also emphasised the need for robust KPIs to measure transition progress and avoid greenwashing or ('transition washing'). The taxonomy could be helpful in this regard, but it was noted that the framework is more focused on financing 'green' rather than the transition, with one attendee highlighting the ongoing divide about the inclusion of nuclear as a 'sustainable' energy source as an example of the politicised debate in this area.
- **FCA's Sustainability Disclosure Requirements (SDR):** the FCA's proposed "sustainable improver" label was seen as a potentially welcome mechanism for "legitimising" transition-focused investment strategies, but needed to be underpinned by clear, timebound and measurable criteria to be credible. The role of stewardship was also highlighted in this context – engagement will be a key tool at investors' disposal to drive progress across their holdings and should form a component of the improvers label, although accurately measuring success was noted as a key challenge, as well as a focus on volume of engagement rather than outcomes.
- **Credible escalation strategies**: a need for credible escalation strategies (with divestment as a last resort) was cited across several tables. Additionally, more prescriptive guidance from regulators and policymakers in this area would be welcomed, with the upcoming review of the UK's regulatory framework for stewardship cited as a good opportunity to introduce clarifications.

Which sectoral policies need to be prioritised to send the right price signals to the markets / incentivise the reorientation of capital in line with the transition?

- **Sectoral pathways and financing roadmaps**: attendees reiterated the need for sectoral pathways and financing roadmaps to set out how much investment is needed (and by when) across key sectors of the UK economy. This could increase transparency over investment gaps and opportunities and presents an opportunity to track both public and private finance flows towards the transition.
- **Carbon markets**: several discussions centred on robust carbon markets in pricing negative externalities, and the role this could play in reorienting capital towards the transition and away from harmful investments. Revenues generated from the UK's Emissions Trading System could then be reinvested in transitioning carbon-intensive and hard-to-abate sectors. One attendee noted that case studies on how the UK's carbon pricing works, with clear links to investment could be useful.
- **Sectoral policies:** overall, a consensus emerged on the need for sectoral policies to catalyse progress by focusing on the areas where the financial sector alone wouldn't be able to shift the dial, echoing previous discussions around the need for a robust response to the US IRA

and EU NZIA. In particular, attendees cited the need to prioritise the energy sector as the key to effective sectoral transition across the UK. One attendee noted that we will need five times the amount of electricity we use today to power the future UK economy, and ensuring we are able to decarbonise our energy sources needs to be a central focus for policymakers.

How can we ensure a ‘joined-up’ approach between sustainable finance and real economy/sectoral policies?

- **Disclosures:** high quality, decision-useful disclosures, combined with policies that send price signals and catalyse investments in the sectors of the UK economy whose transition will have the greatest impact on emissions reductions, were seen as key to a joined-up approach.
- **Prioritise key sectors:** attendees noted that government should focus on the key sectors of the economy that need to transition, what the financing gaps are for these sectors, and ensure investors and market participants have the information they need to inform decisions.
- **Incentives:** incentives once again came up as a crucial lever – whether through the ETS, planning permissions, subsidies and other channels. It was noted that the US and the EU were taking this approach, and companies were starting to act, offshoring renewables manufacturing and production to the jurisdictions that were incentivising it, with investor capital following hot on the trail.
- **Certainty and clarity**: to provide companies and investors with the policy certainty and clarity they needed to invest with confidence over the long-term, a number of attendees also flagged the merits of a dedicated, arms-length UK Office for Net Zero Delivery, which could be tasked with developing policy tools, outlast the electoral cycle and gain broad cross-party support.

BACKGROUND ON IIGCC, PRI, AND UKSIF

PRI

The Principles for Responsible Investment (PRI) is the world’s leading proponent of responsible investment. Supported by the United Nations, it works to understand the investment implications of environmental, social and governance (ESG) factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole. Launched in New York in 2006, the PRI has grown to more than 5,000 signatories, managing over US 121 trillion.

UKSIF

The UK Sustainable Investment and Finance Association (UKSIF) is a membership organization for those in financial services committed to the growth of sustainable and responsible finance in the UK. Our 290+ members include investment managers, pension funds, banks, financial advisers, research providers, NGOs, among others, representing over £10 trillion in assets under management.

IIGCC

The Institutional Investors Group on Climate Change (IIGCC) is the European membership body for investor collaboration on climate change and the voice of investors taking action for a prosperous, low carbon future. IIGCC has over 365 members, mainly pension funds and asset managers, across 23 countries, with over €51 trillion in assets under management.