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Treasury Committee
House of Commons
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Dear Sir or Madam,

31st July 2019

Decarbonisation of the UK Economy and Green Finance inquiry

I am writing to respond to the Decarbonisation of the UK Economy and Green Finance inquiry on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices by pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters.

Among other activities, we work with the financial services sector to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the view of clients, beneficiaries and pension scheme members. We have experience, through our Asset Owner Disclosure Project initiative,[1] in understanding and assessing many of the issues faced by asset owners in reporting against the Taskforce on Climate-related Financial Disclosures.

Executive summary

- Climate breakdown presents a significant macroeconomic risk to the UK, and failure to alter our economic model to account for it will come at a catastrophic cost.
- Using the word 'costs' to describe decarbonisation expenditures is somewhat misleading, because these expenditures are also investments, both economically and societally.
- The Treasury should place itself at the heart of the decarbonisation agenda, coordinating the work of other departments to ensure emission reduction targets are met. This should include working with the FCA to require more effective stewardship by asset managers, and with BEIS to remove subsidies and create stronger regulation for biomass firms.
- The Treasury should also work with the Department for Work and Pensions to ensure that movement of capital is aligned with emissions reductions targets. Pension funds should be required to align their portfolios with the objectives of the Paris Agreement and report against the Taskforce for Climate-related Financial Disclosures (TCFD) framework for mitigating climate risk.
- The Treasury should prepare a Comprehensive Spending Review that is sufficiently ambitious to meet the scale of the climate crisis. This should include measures to encourage private investors to shift their capital to low-carbon products.
- The Treasury should adopt a more long-term focus, to avoid undermining investor confidence in long-term sustainability projects. The Welsh Government's Wellbeing of Future Generations Act 2015 could be used as a model.

[1] https://aodproject.net/

- There are a number of barriers preventing financial services firms from delivering green finance or investing in 'green' assets, including a fragmented approach from regulators to climate-related regulation, misaligned investment time horizons and the belief that climate-related issues are merely ethical or political.
- Asset managers should be placed under a statutory duty to safeguard the interests of investee companies and should be required by the FCA to disclose their voting records.
- The Government should enact in legislation its expectation that all listed companies and large asset owners should report against TCFD. The FCA should publish guidance on how contract-based schemes are expected to report against the TCFD recommendations.
- The PRA's review of the insurance sector should be extended to all other parts of the financial services sector. Financial regulators should create a holistic regulatory regime for firms that clearly signals that the part they need to play in the low-carbon transition.
- While consumer demand for green and sustainable financial products remains high, particularly amongst millennials, financial advisers are not generally familiar enough with the issues, and there are not enough specialist products available.

Economic opportunities

What economic costs and benefits does decarbonisation present for the UK?

1. Decarbonisation will fundamentally ensure the UK economy is sustainable for the long term. Climate breakdown presents a significant macroeconomic risk to the UK, and failure to alter the model of our economy to account for it will come at a catastrophic cost. The 2018 UN Intergovernmental Panel on Climate Change report[2] said that there are only 12 years for the world to have a chance of keeping global warming to a maximum of 1.5C, after which point even an additional half degree of warming will significantly worsen the risks of extreme weather events, heat and poverty for hundreds of millions of people. A 2019 report from the Institute for Public Policy Research compared the risks to the systemic collapse of the 2008 financial crisis, saying that, "[i]n the extreme, environmental breakdown could trigger catastrophic breakdown of human systems, driving a rapid process of 'runaway collapse' in which economic, social and political shocks cascade through the globally linked system."[3] Additionally, and on a more positive note, decarbonising the economy will mean that the UK can capitalise on the growing market for green finance and low-carbon investment opportunities, which will be a competitive advantage in global financial markets, especially post-Brexit.

2. The Advisory Group on the Costs and Benefits of Net Zero was set up by the Committee on Climate Change; their report this year highlighted the fact that 'the very word 'costs' to describe decarbonisation expenditures is somewhat misleading, because in a very real sense such expenditures are also investments – both in new industrial activities, and in achieving the benefits of a stable climate. What is important is that the specifics of the investments, and the policies that incentivise them, deliver the best possible economic, societal and environmental returns.' We strongly support this approach.

HMT strategy

What is HMT's current strategy, and approach to, UK decarbonisation, and is it fit for purpose?

3. The UK is not on track to meet its fourth and fifth carbon budgets. A holistic approach to decarbonisation across Whitehall is needed, with all departments working together to ensure emission reduction targets are met. The Treasury has more power than any other

[2] https://www.ipcc.ch/sr15/
[3] https://www.ippr.org/research/publications/age-of-environmental-breakdown

department to influence this and it should place itself at the heart of this work. We support Friends of the Earth's recommendations in this area, which include passing an emergency climate budget, significant investment in green infrastructure and public transport, and funding large-scale insulation schemes for homes.[4]

4. The Treasury should also work with the Department for Work and Pensions to ensure that movement of capital is aligned with emissions reductions targets. UK pension assets total $2.9 trillion – 102% of UK GDP[5] – and pension schemes therefore have a vital role to play in ensuring the UK meets its climate commitments. As the Environmental Audit Committee noted in its Green Finance inquiry,[6] ensuring that these funds manage environmental risks effectively could assist in the transition to a low carbon economy and reduce the UK's overall exposure to climate risk (as well as protect beneficiaries from the risks associated with catastrophic climate change).

5. Pension funds should therefore be required to align their portfolios with the objectives of the Paris Agreement. This would allow them a great deal of flexibility and agency in their investment decisions while still giving them the clear direction they need on managing the challenges of climate risk. This requirement would not necessarily involve disinvestment from any particular sector – it would involve trustees assessing whether the assets in their portfolios have a clear strategy for aligning their business model with the UK's emission reduction timeline and taking appropriate action. This would give companies clear incentives to develop Paris-compliant business models, making it significantly easier for the Government to achieve its own targets.

6. More long-term thinking is needed in the Treasury's strategy. The Environmental Audit Committee report in 2016 on the Treasury and sustainability noted the department's plans for environmental interventions were 'geared towards short-term priorities […] even when it could lead to higher costs to the economy in future. In part, this is because its framework does not take account of long-term benefits adequately.'[7] If the Treasury is to wield its influence effectively, it must adopt a long-term focus. Investor confidence in relation to regulatory risks is being undermined at present, reducing the likelihood that they will invest in in long-term sustainability projects.

7. The Welsh Government's Wellbeing of Future Generations Act 2015[8] provides a model for effective co-ordination of government departments, local authorities and other bodies. It places a duty on all public bodies in Wales to work towards seven goals aimed at improving the economic, social, environmental and cultural well-being of Wales. This ensures work done by government in this area is less piecemeal, and effects more comprehensive change. We would recommend that the Select Committee explores this Act as a possible model for the UK Government's work on averting the climate crisis.

How does HMT work with the Clean Growth Strategy and government departments to support decarbonisation? Is this working well?

8. The Environmental Audit Committee (EAC)'s 2016 report noted that 'the cross-government nature of carbon budgets means that the Treasury is well placed to ensure there is coordinated action across government […] we have seen no evidence that it does this effectively.'[9] The EAC commented that the Treasury's response did not make it clear whether it had considered their recommendations or whether it will do anything different as a result. We have seen little evidence since this report that the Treasury has taken the EAC's recommendations seriously.

[4] https://policy.friendsoftheearth.uk/opinion/pms-first-100-days-reimagined
[5] https://www.willistowerswatson.com/en-CA/insights/2019/02/global-pension-assets-study-2019
[6] https://publications.parliament.uk/pa/cm201719/cmselect/cmenvaud/1063/106302.htm
[7] https://publications.parliament.uk/pa/cm201617/cmselect/cmenvaud/181/181.pdf
[8] https://gweddill.gov.wales/topics/people-and-communities/people/future-generations-act/?lang=en
[9] Ibid.

9. We would emphasise in particular the need for the Treasury to make overtures to the FCA about the need for more effective stewardship by asset managers to facilitate the low-carbon transition. Given their considerable influence over the business strategy of their investee companies, asset managers must be more proactive in ensuring companies have clear plans to decarbonise their business models for the long-term. Mitigation of climate change-related risk is essential to effective stewardship.

10. The FCA made clear the growing market for effective stewardship, having consulted on a number of reforms to spur greater action in this area. For example, its recent consultation on the transposition of the Shareholder Rights Directive II looked at greater transparency on how asset managers engage with investee companies. The FCA hopes that greater transparency will "encourage the emergence of a market where firms in part compete on their effective stewardship."[10] However, it took a copy-out approach to the Directive and stopped short of making voting disclosure mandatory under SRD II. We believe the FCA should require asset managers to publish voting decisions (including rationales for votes against management and for 'controversial' votes with management where a significant number of shareholders voted against or abstained). Currently, voting disclosures are often opaque and inaccessible, listing resolutions by number without setting out the actual resolution text, and lacking explanations of controversial votes. There is a concerning lack of transparency and agency. The process of giving rationales and having to publish voting records would help increase the emphasis placed on these votes by institutional investors and increase transparency for the media, civil society and individual savers.

11. ShareAction has also conducted extensive research into the climate impacts of biomass power generation. This included analysis of financial sector actors and their treatment of biomass in their policies (forestry and power). This revealed the issue remains a blind spot amongst banks and asset managers. ShareAction is concerned that biomass, in the form of wood, is incorrectly assumed to be a carbon neutral fuel. This has allowed industry to make misleading claims that biomass power generation results in substantially lower emissions than coal.[11] [12] We have worked closely with Biofuelwatch during our research and endorse their submission to this consultation. In addition we would like to make the following points:

    a. If we are to meet the goals of the Paris Agreement[13] **we urgently need to pull <u>all</u> of the following policy levers**:
        i. The Government should support and accelerate the development of Negative Emissions Technologies (NETs) such as Carbon Capture and Storage (CCS), but the **Treasury should not award Bio-energy with CCS (BECCS) subsidies to the biomass power sector since this will incentivise further growth of the industry.** Instead, incentives should be given to those companies capable of capturing carbon over the long-term. CCS should not be used as justification to continue combustion of biomass or any other fuel. Instead it should be seen as a possible, additional way to reduce CO_2 in our atmosphere, in parallel to also reducing combustion of fuels.
        ii. Support the forestry sector to maximise the carbon captured in forests and soils through protection of existing forests, afforestation and reforestation. This would require independent verification in order to receive policy support.

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[10] https://www.ipe.com/news/asset-managers/uk-regulator-adopts-rules-to-boost-stewardship-transparency/www.ipe.com/news/asset-managers/uk-regulator-adopts-rules-to-boost-stewardship-transparency/10031477.fullarticle

[11] Fortum Oyj, "Combined heat and power (CHP) – more efficient power generation," Fortum Oyj. Available online at: https://www.fortum.com/about-us/our-company/our-energy-production/ combined-heat-and-power-chp-more-efficient-power [accessed 23 November 2018].

[12] Drax, "Sustainability; Biomass supply chain emissions," Drax. Available online at: https://www. drax.com/sustainability/low-carbon/#reducing-our-carbon-emissions [accessed 8 November 2018].

[13] Climate Interactive, "En-ROADS Climate Solutions Simulator," Available online at: https://www.climateinteractive.org/tools/en-roads/ [accessed 31 July 2019].

    iii. Support the power sector to maximise genuinely low carbon sources of power, such as solar and wind, thereby supporting the transition away from combustion of coal, oil, gas and biomass.

b. **We do not have enough quantitative information** to evaluate the impact of the biomass industry on the carbon cycle through time. This would require the monitoring of the carbon density of forests, including soil, and creating maps of the quantity of carbon per unit of area measured in tonnes of carbon per hectare, for example. Therefore we should use a precautionary approach which includes the **removal of subsidies and stronger regulation**. In addition to satisfying sustainability criteria, the biomass power sector should also be expected to:
    i. Develop quantitative carbon assessment tools.
    ii. Demonstrate that they have a positive, or at least neutral, impact on the carbon stored in forests, including soils.
    iii. Employ a mitigation hierarchy approach to preserve biodiversity (which avoids, minimises, restores and offsets harm).

What role should the 2019 Comprehensive Spending Review play in UK decarbonisation?

12. Commentators agreed that, while the 2019 Spring Statement was more climate-focused than previous statements, with its proposed Future Homes Standard and mandatory end to fossil-fuel heating systems in all new homes from 2025, these measures are far too little in the context of the challenges we face. We understand that the 2019 Comprehensive Spending Review may now be delayed until 2020, given the recent change in Prime Minister and uncertainties around Brexit. We would strongly urge the Treasury to use this additional time to prepare a review that is sufficiently ambitious to meet the scale of the climate crisis. As stated above, we support Friends of the Earth's recommendations in this area, which include passing an emergency climate budget, significant investment in green infrastructure and public transport, and funding large-scale insulation schemes for homes.

13. The International Energy Agency (IEA) estimated in its 2015 Energy Technology Perspectives report[14] that $359 trillion (USD) would be needed to be invested by 2050 to implement the Paris Agreement (in areas such as decarbonised energy generation, energy efficiency of buildings and electric transportation) and keep global warming below 2°C. This is about $40 trillion more than is expected to be invested in a business-as-usual (6°C warming) scenario, which represents less than 1% of the cumulative global GDP over the period from 2016 to 2050.

14. However, as their report comments: "Governments alone will not be able to deliver the clean energy investment consistent with the [Paris] objectives; unlocking private-sector capital is essential. To leverage and direct private-sector capital flows, governments need to implement policy tools that will help address investor concerns about the inherent high financial and policy risks associated with large energy investments."

15. The most recent (2017) Energy Technology Perspectives report from the IEA[15] showed that while the global energy system is changing, transformation towards a clean energy system is still not in line with stated international policy goals. Many technology areas suffer from a lack of policy support, and this impedes their scaled-up deployment. Only a few surveyed energy technologies are on track to achieve sustainability goals and this is where policies have provided clear signals on the value of technology innovation, such as in solar photovoltaics (PV), onshore wind, electric vehicles (EVs), and energy storage.

16. The shift to a low-carbon economy is an opportunity for financial players to find new ways to invest money, shifting away from the business-as-usual mind set. However, we need an

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[14] https://www.unece.org/fileadmin/DAM/energy/se/pdfs/comm24_Open_Consultations/CSE._Cons_2015_INF7_Energy_Technology_Perspectives_2015.pdf
[15] https://www.iea.org/etp2017/

appropriate policy framework in order to fully unlock this capital. This should be coordinated by the Treasury.

Green finance

What role do UK financial services firms currently play in the decarbonisation of the economy, (for example, through stewardship, capital allocation to green projects, green financial products)? What more can they do?

17. While the UK financial services sector has taken some action on decarbonisation but much more needs to be done. The banking sector is one such example. In 2017, ShareAction surveyed European banks on how effectively their lending activities were facilitating the low-carbon transition.[16] French banks fared best in the survey, with a number of French banks providing reporting on green initiatives they had supported. UK banks were the lowest scorers in the survey, with the exception of outliers such as HSBC. The reason for this lies in the different regulatory environments in the UK and France. In 2015, the French Energy Transition Law was passed; it contained a provision required banks to report on how they are facilitating the transition. This encouraged a race to the top amongst French banks. UK banks had no such regulatory pressure to disclose this information.

18. We welcome the Government's recent announcement that it was setting out its expectation for all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022. However, we urge the Select Committee to encourage the Treasury to enshrine this expectation in legislation. Financial markets need consistent and complete information in order to operate and allocate capital efficiently: it is not useful for only a select number of entities to disclose this information. Without appropriate legislative requirements and enforcement, this expectation will amount to little in real terms. We accept that in the short-term a comply-or-explain approach may be desirable to allow investors to develop their disclosure methodologies, but this should become a mandatory system in the medium-term to enable them to properly take account of climate-risks.

What steps have UK banks, asset managers, and pension funds taken to 'green' their business models, investments strategies and balance sheets, taking in to account climate and transition risks?

19. Asset managers should be placed under a statutory duty to safeguard the interests of investee companies. Section 172 of the Companies Act 2006 outlines such a duty for company directors. Legislation is needed to reflect the fact that asset managers wield considerable influence on corporate strategy, and so the same duty should apply to them. The Companies Act also contains reserve powers for the Government to force disclosure of how asset managers have used their voting shares, particularly in respect to resolutions related to low-carbon initiatives.

20. Those lower down the investment chain are also not taking sufficient action to 'green' their business models. Pension funds should report against the TCFD framework for mitigating climate risk. Our research shows great swathes of the pension sector are currently exposed to climate risk. Over 60% of global pension funds publish little or no information on how they are managing climate risk; only 20% of funds are climate scenario analysis as recommended by the TCFD.[17] The UK pension sector is not excluded from this: our survey of the UK's 16 largest automatic enrolment pension providers found their default funds were effectively subject to a 'climate lottery', with great variance as to how well their investments

[16] ShareAction, Banking on a Low-Carbon Future - https://shareaction.org/wp-content/uploads/2017/12/BankingRanking2017.pdf.
[17] ShareAction, Pensions in a Changing Climate - https://shareaction.org/wp-content/uploads/2018/12/AODP-PensionsChangingClimate.pdf

were protected from climate risk.[18] As stated above, pension funds should also be required to align their portfolios with the objectives of the Paris Agreement.

21. The insurance sector is also failing to adequately factor in climate risk. Our survey of the world's 80 largest insurers found just a third said their approach to investing was climate-aware.[19]

Are there any barriers (regulatory or otherwise) preventing financial services firms from delivering green finance or investing in 'green' assets?

22. We conducted a study of 22 leading asset owners to explore best practice in developing climate strategies, our *Winning Climate Strategies* research. This identified a range of barriers to the growth of green financial services. [20] These include areas where FCA action, including more joined up thinking with other financial regulators through the risk forum, can help the sector overcome such barriers, such as:

   a. **Regulation and policy**
      i. Uncertainty around investors' fiduciary duty;
      ii. Uncertainty around climate-related investment approaches;
      iii. A fragmented approach from regulators to climate-related regulation.

   b. **Misaligned time horizons**
      i. Varying timelines across the range of climate related risks and opportunities;
      ii. Shorter-term time horizons of fund managers with the expected physical impacts of climate change;
      iii. Contrasting time-horizons between the asset management, investment consultation and pension fund sectors (this can be overcome through more joined up thinking by regulators).

   c. **The prevalence of traditional mind sets**
      i. The belief that ESG and financial performance are mutually exclusive;
      ii. The belief that climate-related issues are ethical or political.

23. One obstacle to climate risk mitigation by investors is the misconception that engagement with companies on sustainability issues is only relevant to equity investors. Engaging on climate issues should be the responsibility of debt as well as equity holders. Fiduciary duties are a universal responsibility – where engagement with companies is a successful tool it makes no sense to limit that engagement to a single asset class.

What is the Financial Conduct Authority and the Prudential Regulation Authority doing to support decarbonisation and a 'greening' of the financial system?

24. We welcome the setting up of the Climate Financial Risk Forum, although we are concerned to learn that the Pensions Regulator and the Financial Reporting Council have not been invited to join the forum. All appropriate regulators with standard-setting functions should be involved in the forum and an MoU should be publicly disclosed.
25. We also welcome the recent consultations by the FCA on the transposition of the Shareholder Rights Directive II and clarified duties for IGCs. However, we regard the FCA's approach to the former as insufficient, in that it has taken a 'copy-out' approach to the EU legislation. It needs to go beyond the original legislation to ensure active engagement by asset managers to mitigate climate risk, including making voting disclosure mandatory (for the reasons outlined above in our answer to question 1).

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[18] ShareAction, the Engagement Deficit - https://shareaction.org/wp-content/uploads/2018/06/TheEngagementDeficit.pdf

[19] ShareAction, Got It Covered? Insurance in a Changing Climate - https://shareaction.org/wp-content/uploads/2018/06/AODP-GotItCovered.pdf

[20] ShareAction, Winning Climate Strategies - https://aodproject.net/wp-content/uploads/2018/06/AODP-WinningStrategiesReport.pdf

26. The Government's recent Green Finance Strategy committed to TCFD reporting by large asset owners by 2022. The FCA should therefore publish guidance on how contract-based schemes are expected to report against the TCFD recommendations. While we welcomed the FCA's DP 18/8 paper on climate change and green finance, we were disappointed to see TCFD not given prominence in this paper.

What expectations do (and should) they place on regulated firms about their role in the transition through their policy and supervisory activities?

27. The UKLA should undertake a review of different sectors of the economy, how they need to decarbonise, and putting in place requirements to do so. The PRA has already undertaken an effective review of the insurance sector; a review of this kind is needed of other parts of the financial services sector. This should be followed by the creation of a holistic regulatory regime for regulated firms that clearly signals that firms need to play their part in the low-carbon transition.

What is the consumer demand for 'green' financial products?

28. Consumer demand for green and sustainable financial products remains high, particularly amongst millennials. According to polling by Rathbone Greenbank Investments, 18% of people surveyed wanted more ethical investments in their pension pots while 23% said they would not like to invest in companies with whose business or conduct they disagreed with.[21] There is a stark contrast in demand from different age groups – while 28% of millennials said using shareholder engagement to bring about positive change was the best way of using "money for good", only 5% of over 45s agreed this was the case.

29. Polling from Good Money Week has also shown a steady rise in those wanting a fossil fuel free pension product: 40% of all people surveyed agreed, up from 35% and 32% in the preceding two years. Again, the generational divide was clear with 57% of investors under 24 wanting fossil fuel free fund options from financial advisers, compared with 34% of over 45s.[22]

30. One of the key barriers to increased capital flows into these retail funds was identified by the Green Finance Taskforce which found that 'the suite of savings products available to the average retail investor is limited. Financial advisers… are not general familiar with the issues, nor are specialist products available. Despite growing evidence that funds geared towards sustainability can actually perform better, advisors continue to focus on financial returns and conventional diversified portfolios without asking for their clients' preference.[23]

We would be interested in meeting or offering oral evidence to discuss this response, the work of the Treasury in this area and our research into the approach by some of the world's biggest investors to taking account of climate risk.

Yours sincerely,

Rachel Haworth

Policy Manager

[21] https://www.ftadviser.com/investments/2017/10/12/clients-increasingly-seeking-ethical-investments/
[22] Good Money Week 2017 polling report http://uksif.org/wp-content/uploads/2018/01/GMW-Public-Polling-report-2017.pdf
[23] Green Finance Taskforce, *Accelerating Green Finance*, 2017 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/703816/green-finance-taskforce-accelerating-green-finance-report.pdf