

WRITTEN EVIDENCE FROM THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

July 2019

ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. Originally set up by the UN in 2005, the PRI is now a not-for-profit company with over 2,500 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles globally with approximately US \$89 trillion in assets under management; 366 of these signatories, representing \$9 trillion, are based in the United Kingdom.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that ESG factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

EXECUTIVE SUMMARY

Further to the PRI's Director of Climate Change Sagarika Chatterjee's testimony to the UK Treasury Select Committee on 2nd July, the PRI is pleased to provide written evidence to the Committee in its inquiry into decarbonising the UK economy.

The PRI firmly believes that climate change is a financially material issue for the UK and international investors, and the PRI welcomes HMG's commitment to achieve net zero emissions by 2050, the first major economy to do so. Interest as to how investors can reduce the associated risks as well as position themselves in the low carbon transition is growing and building a global mass. A letter¹ to

¹ Reuters. June 26, 2019 <https://www.reuters.com/article/us-climatechange-investment-letter-exclu/exclusive-investors-with-34-trillion-demand-urgent-climate-change-action-idUSKCN1TQ31X>

G20 leaders in June this year was signed by CEOs from over 400 investors representing \$34 trillion asking them to step up policy measures to avoid dangerous climate change. This is further backed up by these investors' disclosure, corporate engagement and investment strategies.

In light of the UK's bid to host COP26 in 2020, the UK government needs to showcase leadership on climate change and demonstrate to global governments that it can and will deliver on the ambitious decarbonisation target of achieving net zero emissions by 2050. The PRI welcomes Claire Perry's appointment as COP26 President and looks forward to supporting her in this role.

In addition to this submission, the PRI would be happy to provide further evidence and / or elaborate on the responses below.

RECOMMENDATIONS

The PRI recommends that, in the analysis of the cost and benefits of net zero, the UK government should consider a range of alternative scenarios such as, a sudden transition (see PRI's work on The Inevitable Policy Response²) and a failure to transition – where the UK government does not deliver policies that steadily reduce emissions in line with the 2050 goal and what the economic and social impacts of these might be.

It is the PRI's view that financing the shift to a net zero emissions economy is a strategic opportunity for UK financial services. Yet to realise this the UK government needs to introduce investor friendly policies that will deliver on UK emission reduction targets and offer clear and stable incentives for the scaling up of green and climate resilient investments. PRI's policy recommendations include:

- a) **The UK government should make green finance a strategic priority.** This includes continuing to innovate and finance the domestic energy transition as well as implementing the recommendations in the UK Green Finance Taskforce.
- b) **A more joined up approach to developing policy at HMT, and across HMG.** Policy alignment across the intermediation chain is vital if the government is to deliver successfully on net zero; net zero policy should be embedded across all levels of government, including HMT and Cabinet Office, with strong leadership from the new Prime Minister.
- c) **Government should provide further details on HMT's approach** to UK decarbonisation in the upcoming spending review and in the event of a "no deal" Brexit scenario. The upcoming spending review and economic analysis of net zero are an opportunity to reassess the economic case for an orderly transition.

² PRI, The Inevitable Policy Response 2018. <https://www.unpri.org/news-and-press/take-action-on-climate-now-or-risk-disruptive-policies-in-future/3625.article>

- d) **Greater consultation between investors, HMT ministers and officials** on the UK's low carbon commitments. We believe there are strong synergies between the growing ambition of investors to better position themselves for the energy transition and the UK's net-zero target.

- e) **An end to the chopping and changing of UK energy and climate policy**, and the provision of a clear and a stable direction, with incentives and investable rules to support the effective means of switching to low carbon technologies. Such as:
 - I. A net-zero national capital raising plan, with a granular 5-, 10- and 15-year project pipeline.
 - II. The removal of regulatory barriers, to provide a route to market for the lowest cost form of low carbon electricity generation - solar and onshore wind.
 - III. Bringing forward the sale ban on conventional ICE vehicles to 2025-2030 and detailed plans for incentivising the sales of cleaner vehicles and the build out of charging infrastructure.
 - IV. A low-carbon heat strategy and policies to improve energy efficiency in buildings.
 - V. Clarity on UK carbon pricing beyond 2021.

- f) **Government should de-risk low-carbon investments by scaling-up the level of financing** available in both infrastructure and tech innovation funds.

- g) **Develop systematic awareness of climate-related risks and opportunities** to better connect the UK capital markets with the government's emission reduction goals. The mass adoption of the TCFD recommendations by UK investors and listed companies will play a key role in addressing awareness barriers and translating information about climate change into financial metrics.

RESPONSE TO DETAILED QUESTIONS

THE ECONOMIC OPPORTUNITY

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

1. A discussion of the cost and benefits of the UK's net zero target by 2050 needs to be set in the context that climate change presents a material financial risk to countries and investors. Both will face a combination of physical and transition risks from climate change, albeit the precise timing of when these risks will materialise and what degree of physical versus transition risks they will face is uncertain, as it hinges on how they respond to the climate problem. Therefore, also considering alternative scenarios to the UK achieving its net zero goal is recommended, otherwise there is a risk the results could become skewed and implicitly assume that a "business-as-usual" pathway is available. This is misleading as it implies there would be no adverse damages to the UK from climate change.
2. In accordance with the Bank of England's recently published insurance stress tests³, the PRI would recommend an analysis that considered:
 - An orderly transition, starting in the next 12 months steadily reducing emissions to net zero by 2050
 - A sudden transition, where emissions initially continue to rise and then are reduced abruptly to realign with the 2050 and Paris Agreement goals.
 - A failure to transition. Greenhouse gas emissions continue to accumulate in the atmosphere and the UK faces non-linear impacts from climate change.
3. For our part, we are encouraging signatories to the PRI to prepare for an abrupt tightening of climate policy. It is our view, that the longer we go without a manageable transition to a low-carbon economy the greater the policy risk investors will face, as there will be growing pressure on governments to abruptly catch up with the objectives of the Paris Agreement. PRI, together with its partners Vivid Economics and the Energy Transition Advisors, are developing an economic model that will allow investors, including those in the UK, to assess the implications of such a scenario on investment portfolios, as well as recommended actions for PRI signatories to avoid such an outcome. See the PRI's work on The Inevitable Policy Response.²

³ The Bank of England Insurance Stress Tests 2019 <https://www.bankofengland.co.uk/prudential-regulation/letter/2019/insurance-stress-test-2019>

What benefits can a growth of the Green Finance sector deliver for the UK, and does the UK hold a competitive advantage in this space?

4. The New Climate Economy estimates that some \$90 trillion⁴ will be needed between 2015 and 2030 to realise the Sustainable Development Goals and the objectives of the Paris Agreement. This will require a significant increase in global investment and is a new market opportunity for UK financial services.
5. While the UK, as a leading financial hub with deep capital markets, is well-placed to benefit, it is not alone in seeing the opportunity; the European Commission, for example, has made “sustainable finance” a strategic priority. To stay ahead of its European partners and realise the opportunities associated with the transition to a decarbonised economy, the UK should also make green finance a strategic priority. This includes continuing to innovate and finance the domestic energy transition as well as implementing the recommendations in the UK Green Finance Taskforce.
6. The PRI welcomes the establishment of the Green Finance Institute⁵, as called for in the recommendations of the UK Green Finance Taskforce. This will be an important vehicle for supporting the delivery of the Green Finance Strategy and transition to a low-carbon economy. Legislating for a target of net zero by 2050 will further strengthen the UK’s reputation as a global leader in green finance, fostering greater cooperation between the public and private sectors and creating new opportunities for investors.

How might HMT deliver a regionally balanced and ‘just’ transition across the UK?

7. The PRI has significant expertise on enabling a just transition, having partnered with the ITUC to commission a guide⁶ for investor action on climate change and the just transition, written by London School of Economics and Political Science (LSE) and Harvard Kennedy School.
8. The PRI recommends that HMT should, if not assessed already, develop a heatmap of sectors and regions in the UK that will be impacted by climate change. Employment figures and studies⁷ have shown that decarbonisation holds significant potential for regions like Scotland and the North of England. The latter accounts for one third of the 209,000 low carbon jobs⁸ in the UK. A combination of geological, geographic factors as well as technical expertise in hydrogen and off-shore wind means the region has further growth potential.

⁴ New Climate Economy report 2014 <https://newclimateeconomy.report/2014/>

⁵ BEIS update on Green Finance, 2019. <https://www.gov.uk/guidance/green-finance>

⁶ Climate change and the just transition: A guide for investor action, December 2018. Published by Grantham Research Institute on Climate. http://www.lse.ac.uk/GranthamInstitute/wp-content/uploads/2018/12/Climate-change-and-the-just-transition_Guide-for-investor-action.pdf
Change and the Environment.

⁷ For example “A just transition” report by IPPR, 2019 <https://www.ippr.org/research/publications/a-just-transition>

⁸ The Office of National Statistics Low Carbon and renewable energy economy report 2017 <https://www.ons.gov.uk/economy/environmentalaccounts/bulletins/finalestimates/2017>

9. The PRI recommends that HMT and the UK government publish a national capital raising plan, designed to align UK infrastructure development with delivery of the clean growth strategy, and thus bolstering the link between emission reduction and regional development. A granular 5-, 10- and 15-year pipeline developed in partnership with local authorities should also be established to give investors clear visibility of investment horizons. These were key recommendations of the UK Green Finance Taskforce, which the PRI contributed to, yet were largely absent from the government's response in the Green Finance Strategy.

HMT'S STRATEGY

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

10. The PRI welcomes the publication of the UK's Green Finance Strategy. This is an important step forward, notably regarding the consideration for UK asset owners and listed companies of a mandatory reporting requirement on climate-related disclosures. HMT co-sponsored the Strategy and the industry led Taskforce that proceeded it.
11. However, beyond the financial services team, it is unclear how the Strategy and the UK's commitment to climate reduction targets inform other functions within HMT. The roll-back of UK energy policy in 2015⁹ and reports of Chancellor Hammond's letter¹⁰ on the costs of net zero suggests a view within HMT that supporting the low carbon transition will hurt the UK economy more than it will help it.
12. Evidence from the UK's electricity sector, notably the cost innovations in off-shore wind¹¹, points to the opposite being true. The PRI recommends that the government provide further details on HMT's approach to UK decarbonisation in the upcoming spending review and in the event of a "no deal" Brexit scenario. The upcoming spending review and economic analysis of net zero are an opportunity to reassess the economic case for an orderly transition.

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

13. Policy alignment across the intermediation chain is vital if the government is to deliver successfully on net zero. A more joined up approach to developing policy on low carbon, economic growth is needed at HMT, Cabinet Office and across HMG. This should be not only at the official level, but also from ministers, notably the new Chancellor.

⁹ DECC press release: Changes to renewables subsidies. 2015. <https://www.gov.uk/government/news/changes-to-renewables-subsidies>

¹⁰ Financial Times. June 5, 2019 <https://www.ft.com/content/036a5596-87a7-11e9-a028-86cea8523dc2>

¹¹ Renewable power generation costs in 2018, IRENA 2019. <https://www.irena.org/publications/2019/May/Renewable-power-generation-costs-in-2018>

How should HMT's approach evolve to ensure the Government meets the legally binding carbon budgets (and the net-zero targets, if applicable)?

14. The PRI recommends:

- a) Greater consultation between investors, HMT ministers and officials on the UK's low-carbon commitments. We believe there are strong synergies between the growing ambition of investors to better position themselves for the energy transition and the UK's net zero target.

A study, for example, by HSBC Asset Management and the UK Green Finance Initiative of UK infrastructure opportunities for UK pension funds, found a potential £8bn of new capital available for infrastructure investment from the pooling of UK Local Government Pension Schemes¹².

UK climate goals aside, increasing investments in low carbon infrastructure also offer portfolio diversification benefits in the form of uncorrelated risk-adjusted returns with public equity and bond markets for UK pension schemes. By international standards, as the Law Commission and others have noted, the UK pension market lags behind its OECD peers in the allocation to alternative asset classes like infrastructure. In 2016 the UK defined contribution pension market invested less than 5% in real asset classes compared to 24% globally.¹³

- b) Net-zero policy embedded across all levels of government, including HMT and Cabinet Office, with strong leadership from the new Prime Minister.
- c) Policies to reduce UK emissions are investor-friendly. An end to the chopping and changing of UK energy and climate policy, and the provision of a clear and a stable direction, with incentives and investable rules to support the effective means of switching to low carbon technologies. Such as:
 - I. A net-zero national capital raising plan, with a granular 5-, 10- and 15-year project pipeline.
 - II. The removal of regulatory barriers, such as a route to market for the lowest cost form of low-carbon electricity generation - solar and on-shore wind - through their inclusion in Contracts for Difference and / or subsidy free power purchase agreements.
 - III. Bringing forward the sale ban on conventional ICE vehicles to 2025-2030 and detailed plans for incentivising the sales of cleaner vehicles and the build-out of charging infrastructure.

¹² The Renewable Energy Infrastructure Investment Opportunity for UK Pension Funds report, December 2017, published by the UK Green Finance Initiative. <http://greenfinanceinitiative.org/the-renewable-energy-infrastructure-investment-opportunity-for-uk-pension-funds/>

¹³ UK Law Commission Report Pension Funds and Social Investment 2017, page 74. <https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/>

IV. A low-carbon heat strategy and policies to improve energy efficiency in buildings. Zero carbon building standards for new homes beyond 2025.

V. Clarity on UK carbon pricing beyond 2021.

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?

15. Private and public finance institutions have played a key role in the UK decarbonisation efforts to date:

a) Infrastructure funding. Financing the UK's Industrial Strategy and the transition to net zero will require the mobilisation of a large amount of private sector funding for infrastructure, which according to one estimate will need to be £693 billion by 2031.¹⁴ Public institutions, such as the former Green Investment Bank and the European Investment Bank, have played a pivotal role in financing the low-carbon infrastructure in the UK. The former GIB invested £3.4 billion and attracted £3 of private sector finance for every £1 invested. The EIB has also contributed significantly, investing £1.2 billion in 2016 alone – almost double the GIB's £700m total. Both institutions specialised in early project development, which would then be sold on as operational assets to insurance and pension funds.

The PRI recommends the government develop contingency plans to maintain investment from the private sector the UK, this should include safeguarding the role the former GIB and EIB have played in the direct financing of and the de-risking green infrastructure investment in the UK.

b) Technological innovation. European institutions have also played a key role in funding early stage green technology in the UK. The European Investment Fund (EIF) has been a cornerstone investor in UK venture capital funds, investing £500m across the UK, including £100m into clean tech.¹⁵ Whilst the government has announced a £20m clean growth venture capital fund, it is an order of magnitude smaller than what was previously provided.

16. In both innovation and infrastructure financing the UK is facing reduced access to public sector investment as it looks to meet a more challenging emission reduction target. The PRI recommends that the UK government scale-up the level of financing available to investors through infrastructure and tech innovation funds.

¹⁴ Aldersgate Group "Financing UK's low carbon transition" 2018 <http://www.aldersgategroup.org.uk/our-reports>

¹⁵ UK Green Finance Taskforce, 2018, page 50

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/703816/green-finance-taskforce-accelerating-green-finance-report.pdf

17. Other areas where more could be done include:

- Encouraging increased allocation by UK defined contribution pension funds to real assets, including infrastructure. As noted above, this is low by international standards. Scaling up investments in real assets, desirable from a portfolio diversification perspective, faces a number of barriers. Such as i) the expectation, which is *not* legally required, that DC schemes offer daily liquidity to their beneficiaries and as a result DC pension schemes struggle to allocate assets to alternative investments, which are typically illiquid in nature¹⁶, ii) pension trustees are required to specifically justify any allocation made to non-publicly traded asset, which can add to the difficulty for DC schemes to invest in UK infrastructure. To address this, the UK government could work together with industry bodies to publish guidance on what can be integrated into the default pension fund.
- The development of systematic awareness of climate-related risks and opportunities to better connect the UK capital markets with the government's emission reduction goals. The mass adoption of the TCFD recommendations by UK investors and listed companies will play a key role in addressing awareness barriers and translating information about climate change into financial metrics
- The need for a common classification of what assets and financial products constitute being "green / low carbon". In this regard, the PRI was pleased to note in the UK Green Finance Strategy that the government retains the option of onshoring the EU taxonomy into UK law.¹⁷

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?

18. UK financial institutions have led the adoption of climate-related disclosures. The UK saw more responses to the draft recommendations from the Taskforce on Climate-related Financial Disclosures from the UK than any other market back in 2017. Another measure of this has been the responses by investor signatories to the PRI to introduction of TCFD-based indicator questions in its annual reporting framework. Whilst voluntary to report against in 2019, almost 600 investors with more than \$45 trillion of assets opted to do so. In absolute terms the number of investors reporting from the UK – 100 in total – was more than any of the other 50 markets that the PRI operates in. Analysis of these responses will be published by the PRI in September this year.

19. Examples of low-carbon investments by UK investors includes:

- **University Superannuation Scheme** (asset owner). USS has in excess of £700m in committed financing to UK renewables. USS owns direct equity interests in several offshore wind farms sold by the UK government of the Green Investment Bank.

¹⁶ For further details see the Law Commission's 2019 page 82

¹⁷ UK Green Finance Strategy, 2019, page 26

- **Railways Pension Trustee Company** (asset owner). Railpen has allocated 34% of its infrastructure portfolio to the refinancing of a portfolio of solar power assets situated in the UK.
- **Environment Agency Pension Fund** (asset owner) has set targets of at least 25% of its investments in low carbon by 2020 and decarbonising investments in coal by 90% and oil & gas by 50% by the same date.
- **Legal & General Investment Management** (asset manager) pioneered the development of low-cost low carbon index the Future World Fund, which has become the default equity pension scheme for HSBC's pension fund. LGIM, published a TCFD report in 2019, and has invested £1bn in UK renewable infrastructure
- **AVIVA** (insurer and asset manager) published a TCFD report, including climate scenario analysis, in 2019 and invested £3bn in low carbon infrastructure since 2015.

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

20. Please see our response to the first question in this section.

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

21. Financial regulators can play an important role in raising awareness and helping to address market information failures. In response to the FCA's consultation earlier this year about climate change and green finance, the PRI recommended:

a) A two-step approach to implementing the TCFD recommendations

In the UK Green Finance Taskforce¹⁸, representatives from the UK financial sector, including the PRI, provided a two-step approach on how these recommendations should be implemented.

- I. Official guidance from UK financial regulators, including the FCA, that climate change is a material financial risk and thereby publicly reporting against it is mandatory under existing UK law.

¹⁸ The UK Green Finance Task Force report 2017, pages 37 – 39.

- II. The FCA, together with other UK financial regulators, should integrate the TCFD recommendations throughout the existing corporate governance and stewardship reporting frameworks.

- b) **A comply or explain approach is avoided.** The government should set a clear date for the introduction of mandatory disclosure in line with the TCFD recommendations. The heightened global risks of a disorderly low-carbon transition means that firmer action by governments and financial regulators is now needed to address market information failures and help ensure investors and companies incorporate climate related-risk systematically in their view of the future.

- c) **Seek to reduce the costs and burden** for issuers of these extensions to existing UK law by implementing them over a two-year period, leveraging the FCA and PRA Climate Risk Forum to build capacity through annual conferences and facilitating a leading group of users and preparers to accelerate the maturity and standardisation of the reporting and TCFD implementation process.

Any questions or comments can be sent to:

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