Principles for Responsible Investment

POLICY BRIEFING

SNAPSHOT OF KEY SUSTAINABLE FINANCE POLICY PRIORITIES FOR THE UK

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An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

SNAPSHOT OF KEY SUSTAINABLE FINANCE POLICY PRIORITIES FOR THE UK

This joint briefing by the PRI and IIGCC[1] identifies areas that the UK Government should prioritise in the short-term in 2024 to accelerate delivery of the building blocks of the UK's sustainable finance framework and support progress against the UK's net zero objectives.

1. IMPLEMENT COMPREHENSIVE SUSTAINABILITY DISCLOSURE REQUIREMENTS ACROSS THE UK ECONOMY

Barrier

Investors require standardised and decision-useful disclosures from their investees to inform capital allocation, including key data on sustainability related risks and opportunities. The operational interaction of reporting requirements across the UK is crucial: for example, comprehensive and comparable implementation of, and reporting against, climate transition plans is essential for investors to assess the credibility of companies' transition efforts, inform investment decisions, and reorient capital in line with net zero. To ensure the efficient flow of information across the investment chain, careful consideration of sequencing is key, alongside clear implementation times and further granularity.

Recommendations

- The UK government should **endorse the ISSB Standards (IFRS S1 and IFRS S2) and transpose them into UK regulatory requirements** as soon as practicable, setting up an endorsement mechanism for current and future ISSB standards to become part of UK law.2 This will help to promote comparability with wider regional and national sustainability disclosure frameworks and mitigate the risk of fragmentation and divergence.
- Relevant government departments and regulators should **swiftly rollout a comprehensive and credible transition plan disclosure regime under SDR which incorporates and builds on the TPT disclosure framework requirements.**[3] Transition plan disclosures should move from operating on a 'comply or explain' to a **mandatory basis** at the earliest possible opportunity, with adequate signposting of timelines provided. This should include the anticipated consultation on transition plans for the UK's largest companies.
- There should be clarity on how the green taxonomy, ISSB standards, and TPT disclosures will be integrated into the FCA's Sustainability Disclosure Requirements (SDR) and investment labels regime by the time they come into force. Additionally, the Government

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[1] *The information contained in this briefing is provided for informational purposes only and should not be construed as legal advice on any subject matter. Except where expressly stated otherwise, the opinions, recommendations, findings, interpretations and conclusions expressed in this report are those of the Institutional Investor Group on Climate Change and PRI Association, and do not necessarily represent the views of the contributors to the briefing or any members of the Institutional Investor Group on Climate Change or signatories to the Principles for Responsible Investment (individually or as a whole)*

[2] *See the PRI's response to call for evidence on UK Endorsement of IFRS S1 and IFRS S2, October 2023*

[3] *See IIGCC's response to the TPT's consultation on sector-neutral transition plan disclosures, February 2023*

should provide clarity on timelines for consultations on wider sustainability disclosure requirements (e.g., for listed companies) and ensure close coordination with relevant stakeholders (e.g., the FCA) to support effective implementation.

- Publication of the consultation on a **UK green taxonomy** and clarity on implementation timelines. The taxonomy should be **anchored in regulation with mandatory disclosures** and implemented as part of a broader transition finance strategy, supporting assessment of transition efforts at the activity level in a way that complements company-level transition plans.[4] Interoperability with wider international taxonomies, notably the EU's, should be prioritised to promote cross-border capital flows, although limited divergence may be required in some instances (e.g. to protect the taxonomy's scientific integrity by excluding natural gas). The recommendations of the UK Green Technical Advisory Group (GTAG) should be fully taken into account in the development and implementation of the UK taxonomy.

2. SUPPORT STRONG STEWARDSHIP

Barrier

Stewardship is often treated as an investment activity suitable only for some purposes. The lack of clear guidance on systemic stewardship has held up UK investors from effectively and collectively scaling up their stewardship practices to tackle the drivers of system-level risks and to act on sustainability outcomes.

Recommendation

- The UK government and regulators should continue to showcase global leadership on stewardship through the review of the **UK Stewardship Code**. The review should ensure that the regulatory framework encourages informed and engaged stewardship leadership practices, with stronger coherency between regulators. Clear guidance on **reporting metrics** for systemic stewardship will provide holistic insights for clients and regulators to monitor progress in addressing system-level risks.[5]

3. CLARIFY FIDUCIARY DUTY THROUGH SUSTAINABILITY GUIDANCE FOR PENSION SCHEMES

Barrier

UK investors remain hesitant to change their established practices and pursue sustainability impact goals, even when this is required to achieve financial objectives. It is also still not commonplace to proactively incorporate the preferences of beneficiaries in their strategy or decision-making and there is often a lack of engagement from beneficiaries with their pension savings.

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[4] Guidance from the Green Technical Advisory Group should be integrated into UK Green Taxonomy development. The two-year voluntary window for the taxonomy should allow for the market to acclimatise to the new requirements and provide government with an opportunity to develop a progressive taxonomy.

[5] *Further guidance in the* How policy makers can implement reforms for a sustainable financial system: stewardship

Recommendations

- The UK government should offer **clarity to interpretations of fiduciary duty and develop further guidance on the application of the relevant duties.** The guidance should include how sustainability goals relate to financial goals and duties, how pensions funds can set and pursue these goals, and how they can assess sustainability risks and impacts.[6] This should be informed by the outcome of the Financial Markets and Law Committee's (FMLC) working group on Fiduciary Duties and Pension Trustees in the Context of Sustainability in Finance
- **Non-mandatory guidance should be provided by DWP** on how schemes can engage with their beneficiaries to better understand and incorporate member preferences into investment decisions.[7]

4. MOBILISE PRIVATE FINANCE TO SUPPORT THE TRANSITION TO A NET ZERO ECONOMY

Barrier

To meet the UK's legally binding climate commitments, an additional £50- 60 billion of capital will be needed each year. Private finance will make up the bulk of this capital, but the Government needs to crowd-in this finance by introducing supportive policies that can help create a pipeline of investible projects and boost supply. While the Autumn Statement provided some welcome commitments to increasing investment in the UK's transition, accompanied by targeted subsidies and public investment, the amounts pledged continue to fall far short of what is needed, particularly in the context of the US Inflation Reduction Act and the EU's Net Zero Industry Plan.

Recommendations

- The outcomes of the **Transition Finance Market Review** should provide clarity on the policy interventions needed to scale transition-focused capital raising and put forward recommendations for how the UK financial and professional services ecosystem can become a leading provider of transition finance services and innovative instruments. Following the publication of the Terms of Reference for the Review in December, further **clarity on the nature of the planned outreach programme for engagement with industry stakeholders** would be a useful next step. The focus on **developing innovative financial solutions, tools and products to facilitate transition finance flows** will also be critical.
- The UK government should improve **strategic public investment and capitalisation** of public finance institutions through the **UK Infrastructure Bank and the British Business Bank.** This will require strategic coordination, better integration and stronger governance structures between central government funding programmes and the programmes of public finance institutions, using blended finance structures and identifying areas where blended finance models could be further deployed.
- The UK government should **leverage the role of export credit** in supporting companies transition to net zero and shift financial flows through **UK Export Finance**. Greater access to financing for companies across the globe also provides a key supply chain opportunity for the

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[6] *Further guidance in* A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry.

[7] *Further guidance in* *Understanding and aligning with beneficiaries' sustainability preferences*

UK. The government should also seek to unlock investment to scale innovation in climate solutions through **Innovate UK**, ensuring that net zero opportunities can be de-risked, supported, and visible to wider financing options.

- The UK Government needs to ensure that the policy signals it sends provides investors with confidence and certainty to invest in the growth of sectors that will drive the UK's transition. While the UK may not be able to compete with the US and EU in terms of scale, it can compete strategically. The UK's response to initiatives such as the Inflation Reduction Act and Net Zero Industry Act **should focus on additional targeted policy incentives and subsidies for sectors where the UK has a clear competitive advantage**.

5. DEVELOP AND IMPLEMENT CREDIBLE, COMPREHENSIVE SECTORAL DECARBONISATION PATHWAYS

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Despite the emissions reductions targets set through Carbon Budgets and the UK NDC, there is a lack of detail and clarity on how key sectors of the UK economy will decarbonise (and by when). **Sectoral policies** are needed to send price signals to markets and increase the pipeline of targeted investable opportunities in key industries are currently insufficient.[8] The UK government has also sent **mixed signals on key sectors that will need to transition**: for example, based on the latest Climate Change Committee, International Energy Agency and Intergovernmental Panel on Climate Change's findings, new fossil fuel infrastructure build in the UK broadly contradicts net zero objectives. This reduces the capacity of industry to plan ahead and make investments that will drive down the costs of adopting low-carbon technologies.[9]

Recommendations

- The UK government should produce **comprehensive sector roadmaps** (aligned with the UK's legally binding short, medium and long-term targets) to provide investors with the necessary detail as to how **key sectors of the UK economy will transition**, by when, and the policy tools and levers available to support and accelerate their transition. While the Government has produced a number of technology-specific roadmaps, these pathways need to set out more detail on the decarbonisation trajectories across key sectors economy (e.g., a transition pathway for financial services, which was originally signposted by the government in 2021). These pathways should set out the investment roadmaps required to unlock private investment, and associated tax, spending and regulatory/policy commitments to incentivise demand.
- The UK Government should swiftly deliver on **energy efficiency measures** and pursue **power sector decarbonisation and renewables integration at pace as a priority**,[8] including measures to encourage new opportunities in clean investment.

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[8] *Climate Change Committee (CCC) (2023)* 2023 Progress Report to Parliament*, International Energy Agency (IEA) (2023)* The Oil and Gas Industry in Net Zero Transitions*, Intergovernmental Panel on Climate Change (IPCC) (2023)* Sixth Assessment Report

[9] *IIGCC, PRI, UKSIF (2023)* Letter to the UK Government regarding the Prime Minister's backtrack on vital net zero policies.

- The acceleration of investment in renewables goes hand in hand with a gradual phaseout of fossil fuel, including through **the elimination of all subsidies for fossil fuel exploration and coal production**, and an **end to public financing of fossil fuels and related infrastructure**, in line with credible 1.5°C pathways.
- To support the transition to a fully decarbonised electricity system by 2035, the UK Government needs to **speed up approvals and reduce the time it takes for new clean energy projects to connect to the grid**, as acknowledged in the response to the Winser review.[10]

6. PROTECT THE UK'S REPUTATION FOR STRONG CORPORATE GOVERNANCE

Barrier

Draft legislations for planned audit reforms were not introduced as legislative proposals in the Autumn Statement. Many of the recently proposed changes to the UK Corporate Governance code will not be pursued. The FCA proposed a more permissive approach on dual class share structures (DCSS) while removing some mandatory shareholder votes on transactions such as acquisitions for companies. Taken together, these barriers signal that UK leadership on corporate governance is weakening.

Recommendation

- The UK government should fully implement audit reforms and ensure the rights and interests of shareholders are protected when dual class share structures are introduced. This includes ensuring that the UK Corporate Governance code reflects evolving best practice on corporate governance. These measures will ensure the UK remains a leading standard in sound corporate governance and achieve the government's ultimate objective of "restoring trust in audit and corporate governance".[11]

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of the UK Government in achieving the UK's net zero commitments and accelerating the transition.

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org

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[10] *As set out in the Government's* response to the Electricity Network Commissioner's report *and the* Connections Action Plan.

[11] *Further guidance in the FRC's Restoring trust in Audit and Corporate Governance*