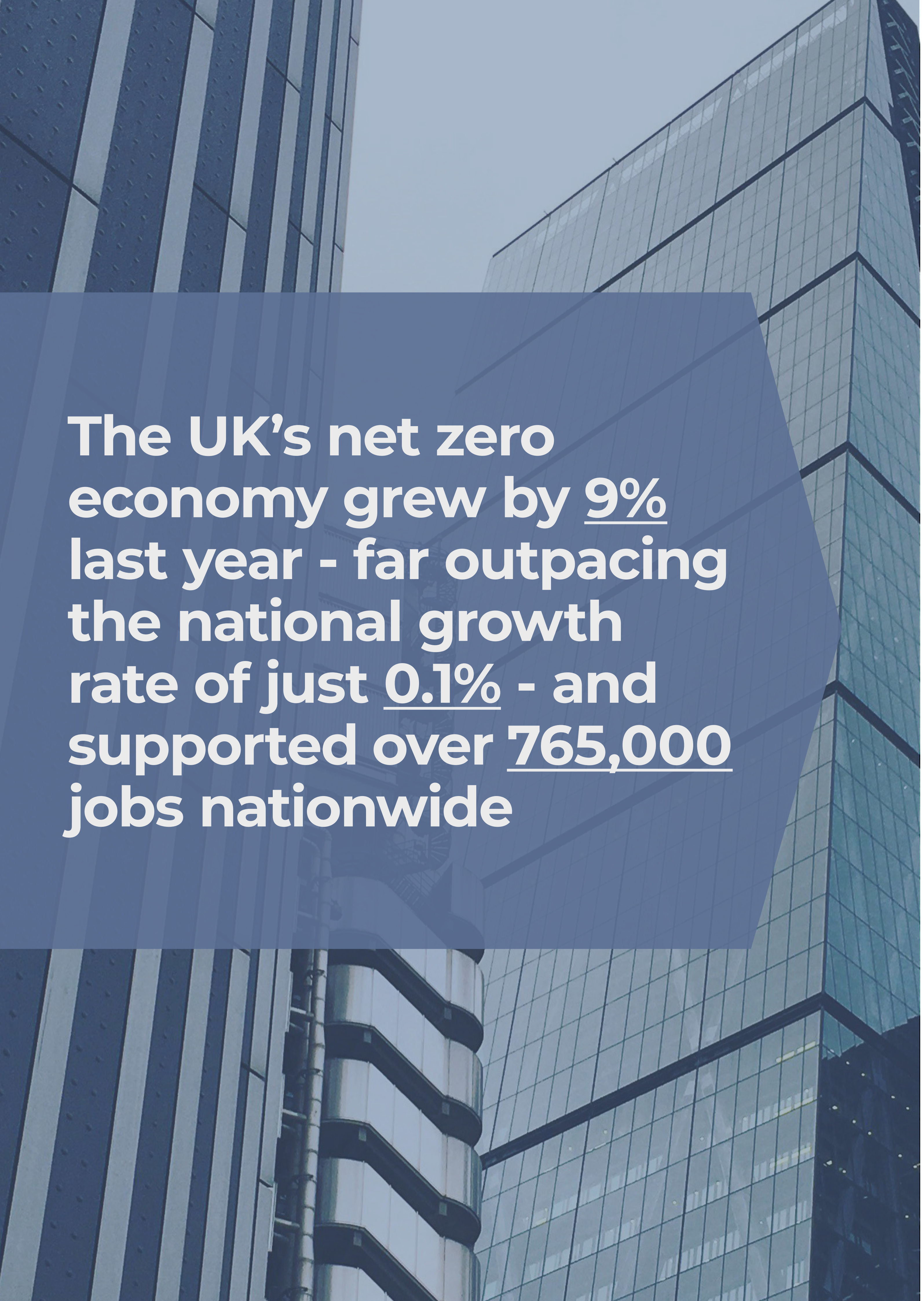
A green financial system can power sustainable economic growth.

July 2024



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Signatories

National Trust

green alliance...

Climate Safe Lending Network

Wildlife and Countryside LINK

global witness

GREENPEACE

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NEW ECONOMICS FOUNDATION

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Introduction

The 2024 General Election made one thing clear: Britain stands at a crossroads. Leaders across every major party recognised the need to revitalise the economy and deliver sustainable growth and prosperity across our nation. However, despite growing consensus that the UK's net zero and nature-aligned transition is a 'historic opportunity'[i], the new government risks missing out if they do not take decisive action to kickstart Britain's green growth engine.

UK's net zero economy grew by 9% last year

The economic case for Net Zero is clear. Meeting the UK's 2050 net zero target alone could unlock over £266 billion for the UK economy over the next three decades.[ii] The green economy is also a major source of growth and innovation. A recent report revealed that the UK's net zero economy grew by 9% last year - far outpacing the national growth rate of just 0.1% - and supported over 765,000 jobs nationwide.[iii]

Meanwhile, our climate and natural environment are in a perilous state. Without immediate and decisive action, the ecosystems upon which human survival and prosperity depends are at risk of collapse.[1] The threat that climate change and unsustainable, nature-damaging activities pose to domestic and global financial stability cannot be overstated.[iv] Nor can the risks to families and communities across the country, still suffering from the prolonged energy price crisis, which is directly linked to our exposure and reliance on volatile fossil fuel markets.

With the Climate Change Committee estimating that the majority of investment required for the transition will come from the private sector, the next government has a clear opportunity to ensure that the UK's leading financial centre kickstarts sustainable growth at home and opens doors for British businesses worldwide. By setting out an ambitious, green, long-term and financed economic strategy, we can enable the public and private sectors to unite in solving global challenges and investing in Britain's future.

As leaders across civil society, we urge the new government to prioritise measures to green the financial system, demonstrating to the world how to finance a successful transition to net zero, whilst building a strong and prosperous economy. This joint briefing outlines the priority reforms that the government must implement to deliver on this vision.

1 The world is already overstepping at least five climate tipping points.

Sustainable Finance Policy Priorities for the Government

1. Set out an ambitious plan to invest in green growth

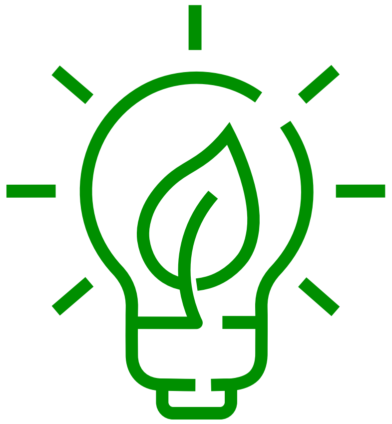
2. Leverage the power of financial sector policy to drive green investment and end unsustainable financing

3. Focus our public institutions on delivering green growth and prosperity

1. Set out an ambitious plan to invest in green growth

Annual capital investment to green the economy must rise to **£50-60bn** a year

Identifying where investment is needed and how it can be mobilised must be a central part of a credible economy- wide plan for delivering sustainable and equitable growth.



In recent decades, the UK economy has suffered chronically low levels of investment, ranking amongst the lowest in the G7 and across all 37 OECD countries relative to GDP.[v] Private sector investment, in particular, has dropped off significantly since the financial crisis and has stagnated since 2016.[vi] This represents a barrier to economic development and delivery of social, net zero and nature-related goals. To get on track to net zero, it is estimated that annual capital investment to green the economy must rise to £50-60 billion a year through the late 2020s and 2030s.[vii]

Fixing Britain's low investment cycle requires government to use multiple levers in its toolkit. Crucially, it must address the lack of confidence that market actors have in the UK's green growth trajectory. By committing to an economy-wide plan that effectively harnesses the capabilities of the UK's finance sector, the new UK Government can ensure it drives investment towards warmer homes, clean and affordable energy, and a thriving global hub for green industry. The plan should set out the long-term direction of travel for the UK economy, and how the government will use all the levers at its disposal to mobilise investment.

To leverage private sector finance, the economy-wide plan must commit to an uplift in public investment into the net zero and nature-aligned economy, alongside a clear and coherent policy package. Integrating public and private finance sources within an ambitious economy-wide plan is essential to drive green investment and deliver a just and equitable transition.[2]

2 Research estimates that an increase of public investment by around 1% GDP in tackling climate change, biodiversity and environmental destruction could lead to £77 billion in public and private investment per annum.

Recommendations

1. **Commit in the first 100 days to establish a Net Zero Investment Plan (NZIP) setting out exactly how public and private investment will be unlocked to achieve an economy-wide decarbonisation plan**. The NZIP, informed by independent financial flow tracking, will outline sector-by-sector policies, regulations, and public investments. These measures will provide the clear signals and certainty needed to leverage large-scale private sector investment across the UK in critical sectors and regions. The NZIP will create a dynamic feedback loop between businesses, private finance, and government policy, enlisting private capital to achieve nationwide decarbonisation.

2. **Drive a programme of strategic public investment to catalyse growth of green industries and mobilise private investment**. Ensuring public finance is strategically deployed as part of an economy-wide plan will help boost sustainable economic growth, facilitate the just transition, and increase public revenue.[viii] Public investment is a powerful tool to drive innovation, crowd in private finance and fully achieve the UK's Net Zero Target

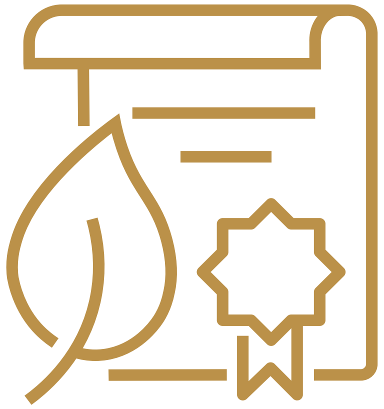
3. **Commit to develop a nature-positive strategy for the UK**. Just as the UK requires a financed economy-wide plan to meet Climate Change Act targets, it also needs a nature-positive strategy to fulfil the legally binding targets of the Environment Act 2021 and international nature agreements.[3] This strategy would guide the incorporation of nature-related factors into economic sectors, and should be integrated into the broader economy-wide plan. This is essential for driving investment in nature recovery and resilience alongside the net zero transition.

4. **Reform the pensions system to boost savings rates and incentivise long-term green investment**. There is widespread agreement that pension savings rates must be significantly higher in order to ensure decent retirement savings for all. Alongside reform of the pensions system - including changes to fiduciary duty - this would help drive more sustainable investment generally, and significantly increase long-term green investment in the UK.[4]

3 Such as the Kunming-Montreal Global Biodiversity Framework
4 Changes to the UK pension industry could see £0.8-1.2 trillion flowing into UK climate solutions between now and 2035.

2. Leverage the power of financial sector policy to drive green investment and end unsustainable financing

Key policy and regulatory levers must be utilised to unlock a future-fit, sustainably growing UK economy.



For many years, the UK has taken steps to develop regulatory frameworks and policies aimed at promoting green finance. A robust regulatory framework provides the foundation for a stable, resilient, and successful financial sector by setting clear guidelines, standards, and incentives. Unfortunately, progress has faltered. The Environmental Audit Committee highlights frustrating delays in policy implementation and conflicting signals from the government as core reasons for this.[x] Such setbacks have undermined investor confidence and risk squandering the potential for the UK to be the world's leading international green finance hub.

Amidst unprecedented growth in capital flows for net zero, with the ESG market forecast to reach $30 trillion by 2030,[xi] the UK must reestablish its position as a pioneering, world leading setter of global norms and standards on climate and nature. This will unlock a wide range of emerging green financial services, including climate-focused reinsurance, sustainability-linked instruments, and transition finance, all of which present opportunities for the UK to direct capital towards sustainable projects, companies and technologies.

The UK's global leadership position also hinges on shaping a regulatory environment that actively incentivises the transition away from unsustainable financing, notably fossil fuel expansion and deforestation. Finance into these areas is destroying our ecosystems, undermining globally agreed-upon warming limits, and representing substantial market and transition risk for the UK financial sector and economy. For example, some scenarios for net zero estimate a halving of the value of the world's fossil fuel assets by 2036[xii], with the US and UK displaying much larger financial losses than other countries.[xiii]

Recommendations

1

Fast track the delivery of a coherent package of sustainable and credible finance reporting reforms to drive green investment and incentivise market transition away from fossil fuels and deforestation. These reforms should be embedded within the Sustainability Disclosure Requirements regime, building on the commitments outlined in the Green Finance Strategy (2023), including:

a) **A science-based and world-leading UK Green Taxonomy**, which excludes gas, sets out credible Do No Significant Harm principles, and is interoperable with other global taxonomies. The UK is lagging significantly in this important area.[5]

b) **Mandatory disclosure of science-based transition plans with accompanying regulatory measures for accountability and enforcement to ensure those plans align with 1.5°C**. This should be pursued via legislation or regulatory rules, extend to all large private companies within the UK including the financial sector and fully integrate nature considerations to pave the way for holistic climate and nature-positive company transition plans.

c) **Introduce mandatory reporting against the Taskforce for Nature-related Financial Disclosures (TNFD) framework**[xiv], aligned with global nature preservation and restoration targets, including mandating key sectors to disclose their impacts on nature.

d) **Introduce mandatory due diligence for the UK financial sector to halt the financing of deforestation** and urgently implement an improved scheme to provide due diligence of forest risk commodities, as required by the Environment Act 2021.[6]

e) **Adopt the International Sustainability Standards Board (ISSB) standards into the UK's regulatory framework** to support global consistency in disclosure measures.

2

Embed accountability into private sector decision making by **giving all financial regulators an explicit statutory objective on climate change, nature and biodiversity**. This change - expanding upon existing powers[7] - would ensure that all financial regulators[8] prioritise the UK's net zero target within their remit and meet Britain's commitment to halt and reverse biodiversity loss by 2030 and broader environmental goals.[9]

3

Ensure the Bank of England more deeply integrates sustainability considerations into monetary policy, supervisory rule making and its existing capital framework. The Bank of England should reform these functions to ensure the UK financial system is resilient to the financial stability, safety and soundness risks arising from climate change and nature destruction, including the risk of severe-but-plausible near-term climate scenarios. It should also ensure its activities are fit-for-purpose to support the net zero economic transition. Such measures include:

a) **Implementing dual interest rates via a green term funding scheme** to reduce the cost of financing green and environmentally friendly projects.

b) **Adopt a precautionary approach to climate-related financial risks**, for example, by reviewing and adjusting the current capital regime to ensure it is suitable for a net zero transition and adequately covers systemic risks arising from climate change and nature loss.

c) **Greening its collateral framework** to remove the benefit currently given to environmentally damaging companies, ensuring they are no longer eligible for use as collateral at the Banks' lending facilities.

d) **Commit to publishing a nature-related financial risk supervisory statement** recognising the materiality of nature-related risks, such as biodiversity loss and environmental degradation, and the need to integrate these considerations into supervisory practices.[xv]

5 Since the UK first announced its plans to introduce a green taxonomy, an additional 21 taxonomies have been announced or come into force globally.
6 Halting deforestation was a 'top priority' in the government's Net Zero Strategy (2022).
7 The Financial Services and Markets Bill (2023) introduced a regulatory principle to consider the need to contribute towards commitments made to address both climate change and biodiversity loss.
8 FCA, PRA, BoE, the Pensions Regulator and the Financial Reporting Council.
9 Environment Act, the G7 Nature Compact and the Kunming-Montreal Global Biodiversity Framework.

3. Focus our public institutions on delivering green growth and prosperity

To maximise green growth and ensure effective delivery of climate and nature goals, net zero and nature must be central to the mission of key government, public finance and regulatory institutions.

The UK has put in place some important architecture for supporting institutional delivery on climate change. This includes committing to legally binding carbon budgets in the Climate Change Act (2008) and being the first major economy to legislate net zero emissions by 2050. However, the Climate Change Committee (CCC) reports that the UK is not on track to meet its climate targets and investment is not flowing fast enough into the green economy.

To address this, existing institutions must be empowered with clear mandates, adequate resources, and robust accountability mechanisms to accelerate delivery and ensure long-term policy success. The UK can maximise green growth by strengthening delivery capabilities in key areas, and drive progress towards net zero and nature goals.

Recommendations

1 **Strengthen the mandate, capabilities and capacity of all public financial institutions for net zero and nature-aligned outcomes**. Public financial institutions will play a critical role in driving and delivering net zero, including by investing in key projects and technologies that do not yet align with the private sector's appetite for risk and return, and where the risk-bearing capacity of public finance is needed to kick-start innovation and crowd-in private investment. Key changes include:

a) **Powering up the UK Infrastructure Bank** by removing or reducing the financial return expectation to ensure it can offer concessional financing to critical sectors[10]; providing long-term certainty of funding; and, in time, giving it full banking powers alongside taking its debt off the public balance sheet (as is the case with other European public banks).

b) **Aligning all existing forms of public financing[11] with net zero and nature goals**, supported by any necessary update of their mandates and related accountability measures. The UK Export Finance (UKEF) climate mission and capitalisation provides a good example of this change.

c) **Scaling up technical assistance and pipeline development** support for green projects across public financing institutions.

2 **Give all relevant non-financial UK regulators[13] a mandate for net zero and nature preservation**. This will ensure that regulation across the economy prioritises and implements the necessary changes in coordination with financial sector regulatory reform.

3 **Introduce clear accountability and delivery mechanisms to accelerate action.** Embedding climate and resilience in departmental decision making will complement and reinforce other recommendations outlined above, giving much needed confidence to businesses, investors and the broader public that the government is serious about delivery. Key measures include:

a) **Ensure all government departments have a mandate to deliver net zero and nature targets**, including updating HM Treasury's organisational responsibilities at the highest level, as seen US and other countries.[14]

b) **Introduce a 'Net Zero Test'** for fiscal events to ensure each overall tax and spending package is aligned with the UK's climate and nature commitments, helping ensure energy security and resilient growth.[15]

c) **Require Government departments and public bodies to bring forward significant new Bills**, announcements and public procurement exercises that quantify impacts and enhance the delivery of net zero and environment protection.

10 Such as the built environment and nature preservation and conservation. The financial return target, which most other successful national banks do not have (e.g., KfW), limits the bank's ability to intervene in nascent, high potential sectors, and increases the risk of crowding out private investment.
11 As recommended by the CCC's Finance Advisory Group (2021).
12 This includes rolling out the UK Infrastructure Bank's Advisory Function to as many Local Authorities as possible and integrating this service with the UK's Net Zero Hubs.
13 Including other economic, environmental and energy-related regulators.
14 For further details on measures to green the Treasury see Aviva's Policy White Paper.
15 The Test should assess the overall impact of tax and spending decisions on delivery of net zero and nature goals and be applied before the fiscal event is presented to Parliament. This will allow it to add value beyond the current Green Book methodology, helping decision-makers to identify opportunities to 'green' neutral tax and spending line items to crowd in further private investment and to seize the immense opportunities of the transition to build a more resilient, productive economy.

End notes

i Net Zero Review (2023) Net Zero Review: UK could do more to reap economic benefits of green growth

ii HM Government (2021) Impact Assessment for the sixth carbon budget

iii Energy & Climate Intelligence Unit (2024) The UK's net zero economy

iv Financial Stability Board (2022) Supervisory and Regulatory Approaches to Climate-related Risks

v IPPR (2023) Now is the time to confront UK's investment-phobia

vi London School of Economic (LSE) Britain can promote private investment and economic growth. Here's how

vii HM Government (2021) Net Zero Strategy: Build Back Greener

viii IPPR (2022) Increased investment in net zero an 'economic, environmental and political necessity' says new report

ix Finance Innovation Lab & ShareAction & Make My Money Matter (2024) Better pensions for all and a sustainable, productive, economy: proposals for reform

x Carbon Brief (2023) In-depth Q&A: What do Rishi Sunak's U-turns mean for UK climate policy? and UK Parliament, EAC (2024) Government encouraged to engage fully with EAC recommendations for boosting financial sector's role in achieving net zero

xi Broadridge (2023) ESG and sustainable investment outlook: $30 trillion by 2030 on the way to net zero

xii Nature (2021) Reframing incentives for climate policy action

xiii Nature (2022) Stranded fossil-fuel assets translate to major losses for investors in advanced economies

xiv ShareAction (2024) From Policy to Preservation: Why the UK Government should introduce mandatory reporting against the Taskforce on Nature-related Financial Disclosures

xv Network for Greening the Financial System (2023) Nature-related Financial Risks: a Conceptual Framework to guide Action by Central Banks and Supervisors