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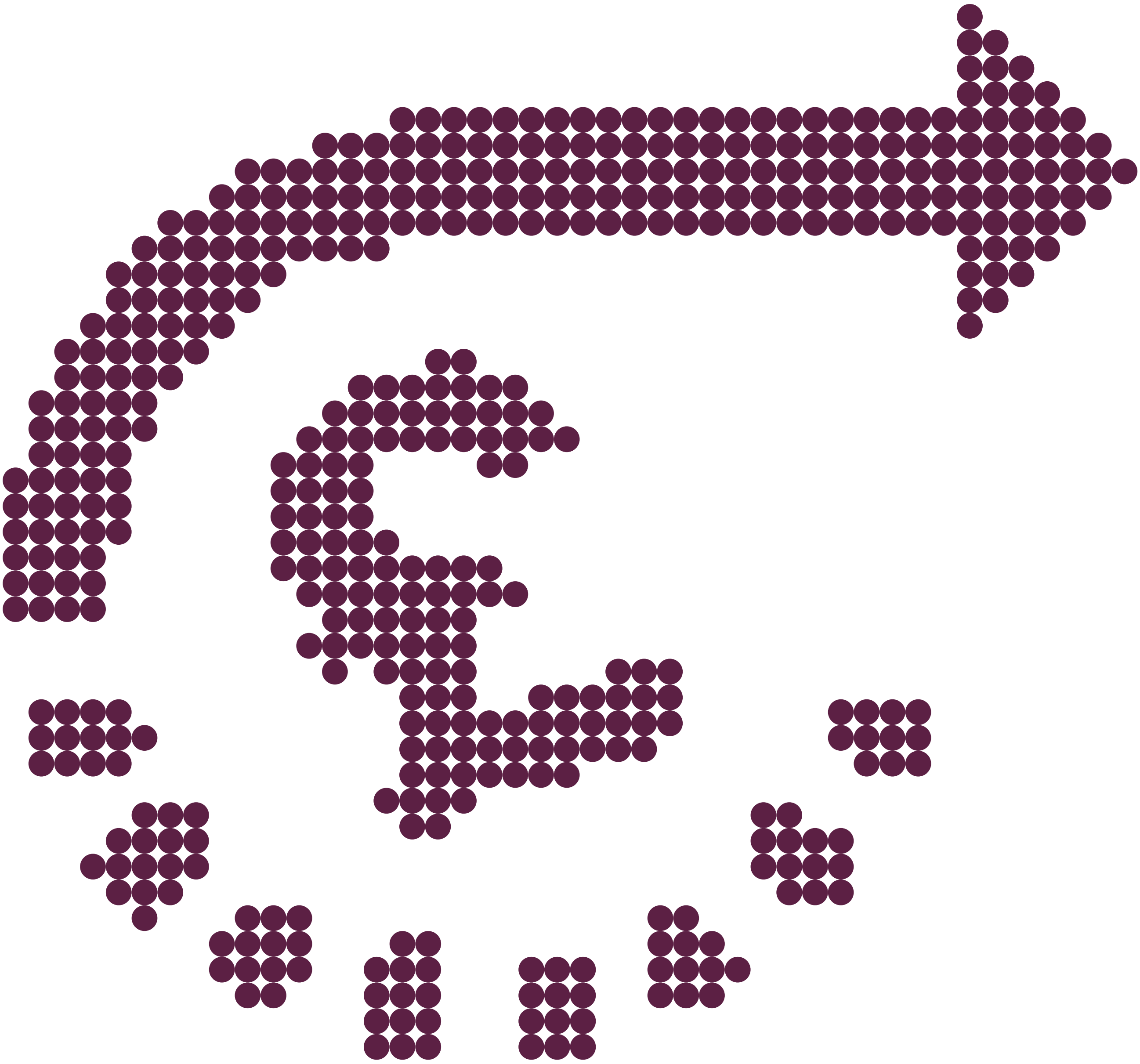

FINANCING THE FUTURE

DRIVING INVESTMENT FOR NET ZERO EMISSIONS AND NATURE RESTORATION

CONTENTS

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AUTHORS

JOSIE MURDOCH Senior Policy Officer
ANA MUSAT Head of Policy
NICK MOLHO Executive Director

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ALDERSGATE GROUP

The Aldersgate Group is a politically impartial, multi-stakeholder alliance championing a competitive and environmentally sustainable economy.

The Aldersgate Group is an alliance of major businesses, academic institutions, professional institutes, and civil society organisations driving action for a sustainable and competitive economy. Our corporate members, who have a collective turnover in excess of £550bn, believe that ambitious and stable low carbon and environmental policies make clear economic sense for the UK.

Our policy proposals are formed collaboratively and benefit from the expertise of our members who span a wide range of industry sectors and public interests. Our breadth and collegiate approach allows us to formulate progressive policy positions to benefit all organisations and individuals.

ORGANISATION MEMBERS

Recommendations made in this report cannot be attributed to any single organisation and the Aldersgate Group takes full responsibility for the views expressed.

EXECUTIVE SUMMARY

Now is the time to align economic and environmental policy

The world economy is currently facing the triple crises of climate change, mass biodiversity loss and the impacts of the COVID-19 pandemic. **From a UK perspective, tackling these crises simultaneously offers major opportunities. These include revitalising the economy, driving innovation and competitive advantages in new areas of the economy, improving economic resilience, and delivering net job creation across the country.** Despite some encouraging progress in areas such as renewable energy and a high-level commitment to a green recovery, policies announced in 2020 are only expected to deliver 26% of the additional emissions reductions necessary by 2030.[1] They are therefore not set to deliver the UK's 2050 net zero emissions target[2] nor the 25 Year Environment Plan's[3] ambition to overturn the decline of the natural environment within a generation.

As the UK economy recovers from the COVID-19 pandemic, there is mounting evidence suggesting that investing in low carbon activities can deliver greater near-term job creation benefits compared to higher carbon activities.[4] In addition, investments in areas such as home retrofits, nature restoration, electric vehicle charging infrastructure, renewable energy and low carbon industrial processes all have the benefit of providing economic opportunities that are geographically dispersed, thus supporting the government's levelling up agenda. **From both an environmental and an economic perspective, there is therefore a strong case for upcoming stimulus investments and new policy incentives to facilitate the delivery of the UK's climate and environmental goals.**

Meeting the investment challenge

Currently, the UK is seeing a major investment gap in both low carbon infrastructure and natural capital. Research from the Climate Change Committee (CCC) has estimated £50 billion of annual additional investment will be required from 2030 to 2050 to deliver net zero, in addition to the existing economy-wide investment of just under £400 billion.[5]

The largest increases are needed for building low carbon power capacity, retrofitting buildings, and the added costs of batteries and infrastructure for electric vehicles. Nature restoration alone could need as much as £4.7 billion of additional funding each year.[6]

As outlined by the CCC, **major investment from the private sector will be required to close the investment gap.** To leverage this private capital, a net zero strategy that provides short-term and long-term clarity on the regulations and market mechanisms that will be put in place across different sectors of the economy will be key to boost confidence for businesses and investors and ensure that private finance is deployed at the pace and scale required to achieve net zero emissions by 2050. Beyond policy clarity, public finance deployed strategically through the UK Infrastructure Bank and the green gilt will play an essential role in crowding in private finance, remedy market failures and de-risk investment. In addition, **an economic recovery package aligned with the UK's climate objectives could be instrumental in boosting innovation, creating good quality jobs and expanding the productive capacity of the UK economy.**

1 Green Alliance (April 2021) *Net zero policy tracker*

2 *Ibid.*

3 Natural Capital Committee (January 2020) *State of Natural Capital Annual Report 2020*

4 For further reading the Aldersgate Group recommends the following reports: Aldersgate Group (July 2020) *Rebuilding to last: how to design an inclusive, resilient and sustainable growth strategy after COVID-19*; Smith School of Enterprise and the Environment (May 2020) *Building back better: A net-zero emissions recovery*; and The IEA (June 2020) *World Energy Outlook Special Report: Sustainable Recovery*

5 The Committee on Climate Change (December 2020) *The Sixth Carbon Budget: The UK's path to Net Zero*

6 Institute for Public Policy Research (November 2020) *The road to COP26 A clean and fair recovery at home, and a leader on climate and nature abroad*

Matching financial flows with green targets: much work remains to be done

With the publication of the Green Finance Strategy (GFS) in 2019, the government set an ambition to grow private sector investment in low carbon and climate resilient infrastructure, and mobilise private capital in support of net zero. The GFS has been strengthened through further commitments such as the creation of the UK Infrastructure Bank (UKIB), the announcement of a green sovereign bond, making disclosures aligned with the Task Force fully mandatory across the economy by 2025 and the launch of the Taskforce for Nature-related Financial Disclosures (TNFD).

However, there remain areas of green finance in need of further development, such as overcoming market barriers to investing in complex low carbon infrastructure and nature restoration projects and ensuring that disclosures from businesses and investors lead to climate-positive investment decisions.

Critically, there is also significant work to be done to ensure the financial system as a whole is better governed and incentivised towards delivering net zero and restoring the natural environment. Research by PwC published in October 2020 found that although 71% of PRA-regulated banks and building societies surveyed stated that climate risk is embedded in the firm's long-term corporate strategy, **less than a third had a science based target or net zero strategy.**[7] Tackling this gap will require policies geared towards changing governance structures and decision-making, such as supporting financial institutions in adopting credible and measurable net zero emission targets and incentivising more strategic asset allocation towards environmentally sustainable assets.

Life after the EU: a unique opportunity to embed sustainability in finance

Having now left the European Union, **the UK has the unique opportunity to embed environmental sustainability into the regulatory framework governing its financial system, and in doing so, influence changes to international financial market rules and standards.** In this report, we take stock of the progress that has been made since the publication of the GFS and put forward a range of tangible policy recommendations to better embed environmental sustainability considerations across the UK's financial system and the decision-making of businesses, investors and government.

We also highlight key policy measures to overcome market barriers and accelerate private investment flows in low carbon infrastructure and nature restoration solutions where investment levels to date have been insufficient.

The Aldersgate Group has developed the contents of this report through significant engagement with a range of financial institutions, businesses, academic institutions, professional institutes, and leading civil society organisations.

7 PwC (October 2020) *Rising to the challenge: climate risk in the UK banking sector*

KEY RECOMMENDATIONS IN THE NEAR-TERM INCLUDE:

NEXT STEPS FOR CLIMATE AND NATURE DISCLOSURES

Policy Intervention	Outcome
The government should facilitate a **review of the different guidance, standards, definitions and frameworks in use with regards to climate-related disclosures, including the TCFD, upcoming TNFD and green taxonomy, and net zero frameworks.** This should include a review of the work undertaken by international initiatives, such as the Network for Greening the Financial System, to ensure climate disclosures are similar and comparable across borders to help businesses avoid having to meet different expectations in different markets.	Help businesses navigate different frameworks. Streamline the process of disclosing and reduce reporting burden. Encourage voluntary disclosures on different emissions classifications, particularly Scope 3.
Regulators should provide guidance to improve voluntary reporting of scenario analysis, with the view for mandatory scenario analysis to be introduced from 2025. This must include guidance for specific sub-sectors of the financial services industry, including, but not limited to, investment banking, retail banking, trading, capital markets, insurance, advisory professions.	Help companies build confidence and understanding of climate-related risks. Encourage an uptake of voluntary reporting for scenario analysis in the near-term.

EMBEDDING NATURE'S VALUE INTO THE ECONOMY

Policy Intervention	Outcome
The government should **align the TNFD with the TCFD** and clarify when mandatory disclosures under the TNFD will be introduced. The government should outline **how the TNFD will be used as a stepping stone towards mandatory publication of biodiversity loss mitigation and adaptation targets,** and associated transition plans.	Help to reduce reporting burden for businesses as they begin to disclose under the TNFD as well as TCFD. Encourage voluntary reporting in the near-term of plans to mitigate biodiversity loss.
The government should **set out the process for developing a more visible, accessible and applicable framework for measuring nature and identifying dependencies between business operations and biodiversity.** This should include common standards for monitoring and evaluating biodiversity investment.	Help government and businesses better understand the science of the natural environment and its contribution to economies and wellbeing. Make it easier for investors to identify dependencies between business operations and biodiversity loss.

EMBEDDING CLIMATE AND NATURE POSITIVE DECISION-MAKING INTO FINANCIAL INSTITUTIONS

Policy Intervention	Outcome
Regulators should, by the end of 2022, **publish guidance to support and encourage Financial Institutions (FIs) to voluntarily produce net zero targets and transition plans.** This must also include bespoke guidance for separate sub-sections of the financial sector, as with the previous recommendation. The government, with strategic leadership from the Bank of England, should **open a consultative process to develop a roadmap for introducing mandatory net zero targets and transition plans for FIs.** The Aldersgate Group recommends 2025 as a realistic start date for such regulation to be introduced. Part of this consultative process should involve regulators providing guidance to support and encourage FIs to publish net zero transition plans and targets on a voluntary basis, with guidance to be published no later than 2022.	Help FIs with planning and resourcing. Prepare FIs for the future introduction of a mandatory requirement to publish net zero emissions targets and plans. Such a requirement should be introduced later in the 2020s once sufficient experience and know-how have been developed.
Pension fund managers should be required to automatically enrol new beneficiaries into Paris-aligned pensions funds, and engage with existing beneficiaries to outline the benefits of transferring fund holdings into Paris-aligned funds and ESG schemes.	Close the £2.17trn “green gap” within UK pensions. Ensure pension funds are contributing to meeting the UK’s net zero and nature targets.

ACCELERATING PRIVATE INVESTMENT IN LOW CARBON INFRASTRUCTURE, GOODS AND SERVICES 1 OF 2

Policy Intervention	Outcome
The government should **publish a comprehensive net zero strategy,** providing short-term and long-term clarity on the regulations and market mechanisms that will be put in place across different sectors of the economy. The government must **set a predictable and rising carbon price escalator throughout the 2020s,** aligning it with the rate of emissions reductions required to deliver the UK’s Sixth Carbon Budget and net zero. The government should also adjust the shadow price of carbon.	Send a clear investment signal to the private sector and make low carbon business models far more investable than carbon intensive ones.
The government should take steps to improve the UK-ETS, including: - reviewing and **gradually reducing the number of free allowances and credits** available under the UK-ETS; - consulting on **including other sectors in the UK-ETS,** such agriculture, buildings, waste and surface transport; - consider the **introduction of a carbon tax** where the inclusion of a sector under the UK-ETS is not currently feasible; - **aligning the UK-ETS with the EU-ETS.**	Ensure the number of free allowances does not preclude ambitious action being taken on decarbonisation. Offer stability to businesses which have experience trading within the EU-ETS, along with other advantages associated with trading in a bigger market, including greater liquidity, price discovery, and the ability to attract abatement from across Europe rather than just the UK.

Policy Intervention	Outcome
Ensure that new public finance tools, such as the green gilt and the UK Infrastructure Bank, are being used to **crowd in private investment into low carbon infrastructure, nature-based solutions, green skills and climate adaptation.**	Deliver the infrastructure required to meet the UK's climate and nature goals. Build the UK's resilience to the future effects of climate change. Overcome market failures in areas of the economy which have struggled to attract private investment for decarbonisation, such as buildings and transport. Deliver net creation of good jobs across the UK, and the levelling up agenda.

ACCELERATING PRIVATE INVESTMENT INTO NATURE

Policy Intervention	Outcome
The government must **rapidly finalise the Environment Bill** and ensure it establishes a target setting framework which has **ambitious long-term targets and legally-binding interim targets.** This must include a requirement for Environmental Improvement Plans to deliver policies that can achieve these targets. The government should design **Environmental Land Management (ELM) schemes** in such a way as to make it easier for landowners, farmers, ecologists, agricultural workers, rural communities and private investors to develop public-private partnerships.	Provide a stable environment for businesses to invest in, support innovation in new green solutions and products, and provide a level playing field across the economy. Energise private sector investment in the natural environment, develop more resource efficient business models, and improve environmental performance.

THE INTERNATIONAL STAGE

Policy Intervention	Outcome
Collaborate with the EU on wider environmental policies of mutual interest such as carbon pricing and product standards to create a “race to the top” on climate and environmental issues. The COP26 Presidency should aim to **finalise the rule book for Article 6 of the Paris Agreement** in order to deliver a well-regulated and voluntary international carbon market. The rulebook must include **frameworks for using and regulating carbon offsetting.** The COP26 Presidency must build on the White House Climate Leaders Summit and continue to **drive more ambitious Nationally Determined Contributions** from all major economies. The government should **ensure upcoming COP26 and G20 negotiations lead to commitments from the highest-emitting nations with regards to green recovery packages,** using these to agree a minimum benchmark.	Help deliver climate transition savings of hundreds of billions of dollars globally. Minimise double-counting of offsetting. Send a signal that the highest-emitting economies are using the pandemic as an opportunity to pivot away from high carbon activities and towards the deep decarbonisation of industrial sectors across the economy.

Part 1 of this report sets the scene, outlining the business case for investing in net zero and nature restoration, the existing investment gap, and the role of green finance in closing it.

Part 2 looks at the next steps for greening the financial sector and how to better embed sustainability into investment decisions and company practices.

In **Part 3**, the focus is on how to grow and accelerate the financing of green projects and lower the cost of private investment into low carbon infrastructure and nature-based solutions. This includes the role of public policy signals in driving private investment, as well as the targeted contribution that public finance interventions, such as the newly created UK Infrastructure Bank and sovereign green bonds, can play in crowding in private investment in complex areas.

Part 4 outlines the UK's role on the international stage, with recommendations for delivering strong climate diplomacy ahead of COP26 and continuing to work with the European Union on areas of mutual interest.

Finally, **Part 5** gives an overview of all of the recommendations included in this report, which outline actions to be taken throughout the 2020s, divided into recommendations for government, for financial institutions andregulators. It also contains a range of recommendations where the UK government can drive positive change through the international stage, such as through the COP26, G7 and G20 summits.


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ONE SETTING THE SCENE

This section of the report outlines the benefits which can arise from ensuring the economic recovery is aligned with the UK's climate and nature targets. It also discusses the existing investment gap and the role of green finance in closing it.

1.1 The economic and environmental case for investing in net zero, nature and a green recovery

The UK is currently facing the triple crises of climate change, mass biodiversity loss and the COVID-19 pandemic. There has clearly never been a more pressing time to explore ways in which to build a more resilient and sustainable global economy. Fortunately, there is significant economic evidence that **the recovery from COVID-19 can simultaneously tackle the climate and biodiversity loss crises,** as well as create good jobs across the UK, so long as the recovery is green.

Research shows that public investment in activities and infrastructure which are both low carbon and improve the state of the natural environment can deliver significant economic benefits because they generate strong economic growth multipliers in both the near-term and long-term.[8] These multipliers consist of jobs created, knock-on spending and investment, and increased tax revenue. Crucially, they have proven to be more effective at restarting the economy than the fiscal conservatism adopted after the 2008 Global Financial Crisis (GFC), which led to low wage growth, stretched public services, stagnant productivity and rising inequality throughout the 2010s.[9]

A green economic recovery is supported by the UK public, with 77% of people seeing COVID-19 as an opportunity to change the way our society works, and 68% supporting the government's net zero goal.[10] Furthermore, given that 2021 sees the UK hosting the COP26 Presidency in November, adopting a recovery which focuses on net zero and nature can demonstrate to other major global economies, and also to developing nations, that the UK is serious about tackling these global crises.

However, early analysis suggests that global recovery packages are less green than those of 2008.[11] This is concerning; there is a risk of emissions increasing against pre-pandemic levels when nations try to recover from recessions. As of April 2021, reports have found that CO_2 levels in the atmosphere are higher than they have been at any point in the last 3.6 million years, despite ongoing international lockdowns.[12] Similarly, **current policies are only set to reduce metric tonnes of CO_2 emitted by 26% by 2030.**[13] This is significantly lower than the newly adopted commitment of meeting the CCC's Sixth Carbon Budget, which requires by law the UK to reduce emissions by **78% against 1990 levels by 2035.** The case for a green economic recovery to tackle emissions, protect nature and create jobs has never been stronger.[14]

8 Think2030 (February 2021) *Policy paper: Delivering a sustainable, durable, and inclusive recovery for Europe*

9 Aldersgate Group (July 2020) *Rebuilding to last: How to design an inclusive, resilient and sustainable growth strategy after COVID-19*

10 The Zero Carbon Commission (February 2020) *How carbon pricing can help Britain achieve net zero by 2050*

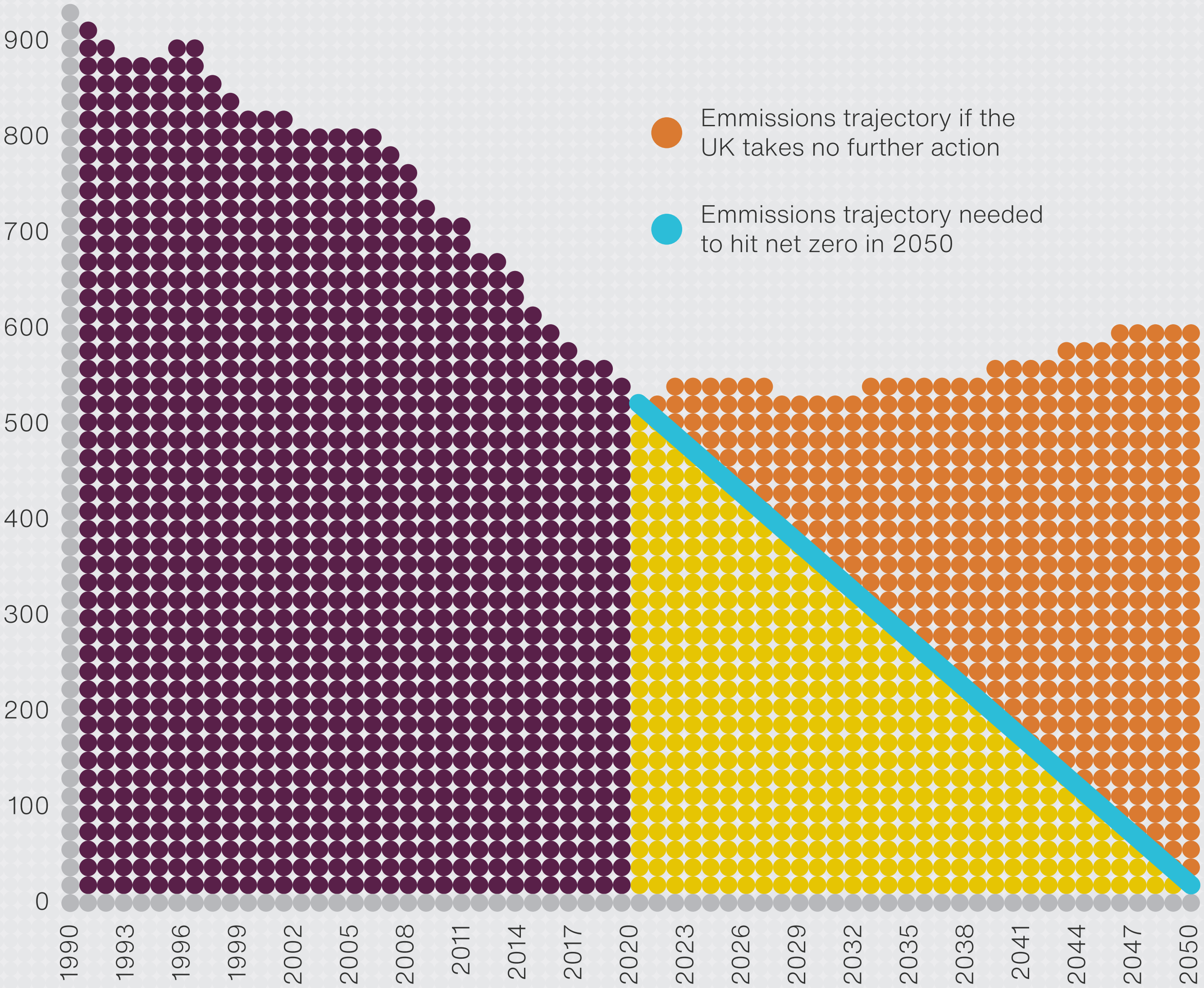
11 Vivid Economics & Finance for Biodiversity Initiative (February 2021) *Greenness of stimulus index*

12 NOAA Research News (7 April 2021) "Despite pandemic shutdowns, carbon dioxide and methane surged in 2020"

13 Green Alliance (April 2021) *Net zero policy tracker*

14 *Ibid.*

EMISSIONS ($MtCO_2e$) INCLUDING EMISSIONS FROM INTERNATIONAL AVIATION AND SHIPPING



Source: Green Alliance (April 2021) *Net zero policy tracker*

By the government's own calculations, the low carbon economy could grow by 11% per year between 2015 and 2030, four times faster than the projected growth of the economy as a whole, and offering a major international trade opportunity.[15] The prospects for job creation across a range of different sectors and regions, as well as gross value added (GVA) to the economy, are huge. For example, a recent study found that **deploying 35GW of onshore wind in the UK by 2035 could create 31,000 jobs, whilst cutting electricity costs by 7%, delivering industry productivity benefits and supporting a £360m annual export industry.**[16]

The Teesside Collective is a cluster of energy-intensive industries aiming to establish Teesside as the go-to location for future clean industrial development by creating a Carbon Capture and Storage (CCS) equipped industrial zone. This project could deliver 1000 jobs and an increase of around £85m in GVA in the UK over 2021–2024.[17] And according to calculations by the Natural Capital Committee, if woodland was planted on the periphery of major towns and cities it would deliver net economic benefits of nearly £550m per annum.[18]

At the international level, it is estimated that 9 million new jobs could be created globally between 2021 and 2023 through targeted investments in renewable electricity, grid reinforcements, electric transport, energy efficiency and an accelerated innovation programme in critical technologies such as hydrogen, batteries and carbon capture and storage.[19] Looking only at the energy sector, it was estimated that the transition to a 100% renewable energy system by 2050 could create 52 million full-time jobs globally and result in the loss of 27 million jobs across non-renewable and carbon-based energy options – a net gain of 25 million jobs.[20]

15 HM Government (October 2017) *The clean growth strategy: leading the way to a low carbon future*

16 Vivid Economics (July 2019) *Quantifying the benefits of onshore wind to the UK*

17 Teeside Collective (June 2015) *Blueprint for industrial CCS in the UK*

18 Natural Capital Committee (2015) *The state of natural capital: Protecting and improving natural capital for prosperity and wellbeing*

19 International Energy Agency (June 2020) *Special report on sustainable recovery*

20 https://bit.ly/3xwfZKp [Accessed 18 June 2021]

1.2 The net zero and nature investment gap

Research from the CCC has estimated £50 billion of additional investment will be required by 2030 to put the UK on track to deliver net zero by 2050, compared to the current economy-wide investment of nearly £400 billion.[21] The largest increases are needed for low carbon power capacity, retrofits of buildings, and the added costs of batteries and infrastructure for electric vehicles. Nature restoration could need as much as £4.7 billion of additional funding each year.[22] Crucially, there remain major areas of the economy which are still struggling to decarbonise, including construction, heavy industry and agriculture, and which cannot catch up without significant financial and technical support. **The value of assets held by UK financial institutions was valued at £22 trillion in 2019,**[23] **which means the proposition here is not about finding the capital, but rather ensuring it is invested with net zero and nature in mind.**

Research suggests that the financial sector has not yet caught up with the urgency and the immensity of the task to deliver net zero and tackle the biodiversity crisis. For example, research by PwC published in October 2020 found that although 71% of PRA-regulated banks and building societies surveyed stated that climate risk is embedded in the firm's long-term corporate strategy, less than a third had a science based target or net zero strategy.[24] Public finances such as pensions are still funding carbon intensive activities, with £10 billion invested in fossil fuels by local authority pension funds alone.[25] **Many pension scheme fiduciaries believe that their duty is to maximise short term returns,** and that taking Environment, Social and Governance (ESG) considerations into account is at odds with their duties – in a recent survey, 53% did not see climate change as a financially material risk to pensions.[26]

Similarly, financial markets will need to change the way certain climate and nature-related assets are valued. For example, in the UK, the asset value of natural capital and ecosystem services was estimated to be worth £921 billion in 2018, more than a third of which was attributable to regulating services such as pollution removal and carbon sequestration, which keep our air clean and our planet liveable.[27] This pales in comparison to the estimated value of the UK housing market at over £7.29 trillion.[28]

The price of carbon has also been too low for too long. For example, in the UK the gap between the real economic cost of climate change (for example, through damages resulting from extreme weather events) and the price of carbon is 42.2%.[29]

21 The Committee on Climate Change (December 2020) *The sixth carbon budget: The UK's path to net zero*

22 Institute for Public Policy Research (November 2020) *The road to COP 26 A clean and fair recovery at home, and a leader on climate and nature abroad*

23 https://bit.ly/3wgLzvu [Accessed 29 April 2021]

24 PwC (October 2020) *Rising to the challenge: climate risk in the UK banking sector*

25 UK Divest (February 2021) *Divesting to protect our pensions and the planet: An analysis of local government investments in coal, oil and gas*

26 Professional Pensions (24 August 2016) *"Climate change is 'overblown nonsense' and not a material risk, says industry"*

27 Office for National Statistics (November 2020) *UK natural capital accounts: 2020*

28 Savills (4 February 2019) *"Value of UK housing stock hits record high"*

29 OECD (18 September 2018) "Few countries are pricing carbon high enough to meet climate targets"

1.3 Seizing the opportunity: the crucial role of green finance

The structural barriers which exist in the financial sector and which hinder efforts to move funds towards low carbon infrastructure will need to be overcome if the investment gap for net zero and nature is to be closed. For example, the global financial market is geared towards short-term, highly liquid and large volume investments, which limits the ability or motivation to commit to the longer-term infrastructure projects needed to deliver net zero. **Crucially, the whole green finance sector, both public and private, will need to embed green thinking into all investment decision-making.**

Pivoting money away from carbon intensive activities will need to be done swiftly. A major part of this process will be about raising awareness of the risks of investing in carbon intensive activities, and developing strategies to begin moving financing towards green activities. Climate-related financial disclosures already play a key role in this process, but should really be viewed as the first step towards developing and delivering net zero-aligned strategies. This process has been named "greening finance" by the government, and will be the focus of Part II of this report.

Furthermore, **when asked what the most common barrier to investing in the infrastructure needed for net zero is, investors and project developers tend to cite not a lack of available money or willingness to invest, but a lack of opportunities to invest into.** There is therefore a need for a holistic, cross-economy policy framework which addresses this barrier by growing project pipelines in the areas of the economy most in need of decarbonisation, such as transport, buildings, agriculture and energy, and crucially in nature restoration.

This policy framework will need focus on "crowding-in" private finance as an overarching strategy,[30] as without significant levels of private investment the UK will not meet its nature and climate goals. The government can support such crowding-in by setting long-term policy certainty, developing market mechanisms, addressing market failures, and de-risking investment in clean innovation or infrastructure with long term returns. This process has been named "financing green" by the government and will be the focus of Part III of this report.

Finally, it goes without saying that climate change is a global issue and **significant sums of investment will need to be mobilised internationally to help developing countries mitigate and adapt to climate change.** With one of the biggest financial sectors in the world and historically one of the biggest donors of Overseas Development Aid, the UK has the opportunity to take the lead on climate finance diplomacy. It can do this by making a number of key policy commitments to influence the mobilisation of climate finance and to influence other countries to adopt greener stimulus measures ahead of the G20 in October and COP26 in November. Recommendations on these policies will be the focus of the final section of this report.

It is encouraging to see how the green finance landscape has evolved in the UK since the publication of the Green Finance Strategy in 2019, with announcements such as the creation of the UK Infrastructure Bank, mandatory TCFD reporting by 2025, the first UK green sovereign bond and ceasing of fossil fuel funding through UK Export Finance (UKEF). The Aldersgate Group also welcomes the government's ambitious commitment to deliver the Sixth Carbon Budget. This report will set out what we believe to be the next steps for building on the GFS and ensuring finance is working towards the new target and ensure the UK grows as a global leader on green finance.

30 The crowding in theory of change is based on the principle that rising public spending and government borrowing drives up private sector demand and spending in areas of the market which have typically been low. This can be achieved by, for example, de-risking new technologies, or "creating a market in the gap" where market failures have existed for a long time.

TWO GREENING THE FINANCE SECTOR AND PROGRESSING DISCLOSURES

This section of the report makes recommendations for greening the financial sector and ensuring sustainability is embedded into investment decisions and company practices.

This section of the report will address some of the structural, cultural and strategic barriers to mainstreaming climate and environment factors in the financial sector. Tackling these barriers requires a 'transition in thinking' a cross all levels of investment decision-making. This 'transition' was referred to as "greening finance" by the government in the 2019 Green Finance Strategy.

In recent years, the UK government has set out a number of policies, strategies and commitments to green the financial sector and position the UK as a leader in green finance. The publication of the Green Finance Strategy in July 2019 in particular set out a number of welcome objectives and initiatives to help the financial sector gear up to delivering net zero (see table overleaf).

The Aldersgate Group welcomed further announcements for green finance made in the Chancellor's Statement in November 2020 (see page 18). This section will outline what the Aldersgate Group believes to be the next steps for ensuring that net zero and nature are embedded into decision-making across the real economy and the financial system.

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THE GREEN FINANCE STRATEGY: WHERE ARE WE? 1 OF 2

COMMITMENTS MADE BY THE GOVERNMENT IN THE GREEN FINANCE STRATEGY 2019	PROGRESS MADE TO DATE	STATUS (RAG)
Setting out **expectation for all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022.**	The Chancellor has since announced the intention for disclosures to be made mandatory across the economy by 2025. Uptake on TCFD reporting has been strong in the UK and increases year-on-year.	
Establishing a **joint taskforce with UK regulators,** chaired by government, which will examine the most effective way to approach disclosures, including exploring the appropriateness of mandatory reporting.	Established as the “UK Taskforce” but no further details about who is on the taskforce or what they have delivered so far has been made publicly available. It is unclear how this initiative sits alongside, feeds into and takes into account the work of the National Central Banks and Supervisor’s Network for Greening the Financial System. Greater transparency of their work and engagement (including with regulators) is needed.	
Supporting quality disclosures through data and guidance, such as that being prepared for occupational pensions schemes by a new government and regulator sponsored working group.	Announcement of the **UK Centre for Greening Finance and Investment,** which will provide world-class data and analytics to financial institutions and services to better support their investment and business decisions, by considering the impact on the environment and climate change.	
Clarifying responsibilities for the Prudential Regulation Authority, the Financial Conduct Authority (FCA) and the Financial Policy Committee to have regard to the Paris Agreement when carrying out their duties, and including climate-related financial issues in government’s allocation letter to The Pensions Regulator.	The Chancellor of the Exchequer wrote to the Prudential Regulation Committee (PRC) and Financial Conduct Authority (FCA) in March 2021. **All regulators are now required to consider the impact of their decisions on climate change.**	

THE GREEN FINANCE STRATEGY: WHERE ARE WE? 2 OF 2

COMMITMENTS MADE BY THE GOVERNMENT IN THE GREEN FINANCE STRATEGY 2019	PROGRESS MADE TO DATE	STATUS (RAG)
Working with industry and the British Standards Institution to **develop a set of Sustainable Finance Standards,** and chairing a new International Organisation for Standardisation (ISO) Technical Committee on Sustainable Finance.	The government announced a UK taxonomy in November 2020, confirming it will take the scientific metrics in the EU taxonomy as its basis and establish a UK Green Technical Technical Advisory Group to review these metrics to ensure they are right for the UK market. A timeline for this is yet to be confirmed. The ISO Technical Committee on Sustainable Finance has been established.	
Working with the FCA and Bank of England, including through the Fair and Effective Markets Review, to consider steps that can be taken to understand the potential or actual barriers to the growth and effectiveness of green finance markets.	Government should build on the Chancellor's recent reform with the Monetary Policy Committee, Financial Policy Committee and the Financial Conduct Authority on their remit and benchmarks for net zero-aligned financial regulation. The government should also continue to engage with key financial players ahead of COP26 to identify and overcome green finance growth and effectiveness barriers.	
Working with international partners to catalyse market-led action on enhancing nature-related financial disclosures. This will complement the recently announced global review of the economics of biodiversity by Professor Sir Partha Dasgupta. Carrying out their duties, and including climate-related financial issues in government's allocation letter to The Pensions Regulator.	The Taskforce for Nature-related Financial Disclosures (TCFD) has been established; *The Economics of Biodiversity* by Professor Sir Dasgupta has been published. Domestically, **next steps involve building an institutional framework which embeds valuation of natural assets into economic reviews, and moving towards a cross-departmental framework to incorporate nature into decision-making.** Internationally, the UK must work with other nations partners on nature-related disclosures and establishing a global framework for managing nature.	

COMMITMENTS MADE SINCE THE GREEN FINANCE STRATEGY

COMMITMENT MADE SINCE THE GFS	DETAILS
Announced the Taskforce for Nature-related Financial Disclosures (TNFD).	The TNFD will mirror the Task Force on Climate-related Financial Disclosures (TCFD) and publish a framework to guide businesses in disclosing the risks resulting from biodiversity loss.
Created the UK Infrastructure Bank.	The Bank's core objectives will be to tackle climate change and support regional and economic growth. The initial capitalisation will include £12 billion of equity and debt capital. The Bank will also have the ability to issue up to £10 billion of guarantees.
Announced the UK's first Sovereign Green Bond.	To be issued in 2021, green sovereign bonds will help finance projects that will tackle climate change and deliver much-needed infrastructure investment, to create green jobs across the country.
Confirmed TCFD-aligned disclosures will become mandatory across the economy by 2025.	This will mean going beyond the 'comply or explain' approach. Many disclosures will come into force by 2023. The upcoming rules and regulations will capture a significant portion of the economy including listed commercial companies, UK-registered large private companies, banks, building societies, insurance companies, UK-authorised asset managers, life insurers, FCA-regulated pension schemes and occupational pension schemes.
Announced plans to implement a green taxonomy.	This will involve the development and publication of a common framework for determining which activities can be defined as environmentally sustainable, to improve understanding of the impact of firms' activities and investments on the environment. It will take scientific metrics in the EU taxonomy as its basis.
Joined the International Platform on Sustainable Finance (IPSF).	The IPSF is an EU initiative launched together with relevant authorities of Argentina, Canada, Chile, China, India, Kenya and Morocco. The IPSF aims to scale up the mobilisation of private investment into sustainable projects.
Launched the UK Centre for Greening Finance and Investment (CGFI).	A national centre established to accelerate the adoption and use of climate and environmental data and analytics by financial institutions internationally.

2.1 Next steps for Climate-related Financial Disclosures

The introduction of corporate reporting of climate risk under the Taskforce for Climate-Related Financial Disclosures (TCFD) – established by the Financial Stability Board – has led to a greater understanding within businesses and financial institutions of the market failures associated with non-pricing of environmental externalities.[31] Reporting has also increased the understanding of the risks climate change poses to economic activity, such as through supply chain disruption.

Globally, support for the TCFD increased by 85% from 2019 to 2020 with nearly 60% of the world's largest companies now supporting the TCFD, reporting in line with the TCFD, or both.[32] However, with the confirmation by the UK government that disclosures will be mandatory from 2025,[33] greater policy intervention is required to prepare businesses which are yet to report. Similarly, additional policies should be introduced to improve the quality of reporting and make it as useful as possible for investors to understand the risks facing businesses in different sectors. There are a number of ways to build upon the existing TCFD framework and ensure it is used to drive strong climate-related financial disclosure reporting.

Key policies to improve climate-related financial disclosures include:[34]

1 **The government should facilitate and oversee a consultation and review of the different guidance, standards, definitions and frameworks in use with regards to climate-related disclosures, to help streamline the process of disclosing and reduce reporting burden.** A number of different initiatives and frameworks exist for the private sector to refer to – including the TCFD, Streamlined Energy and Carbon Reporting, and the Carbon Disclosure Project, each with slightly different aims and objectives. These should be integrated over time, ideally under the TCFD, given this has been the most widely accepted. However, the government will need to give sufficient notice for this integration, with 2025 seen as a realistic starting date for integration by Aldersgate Group members, though this should be consulted upon.

The review should also provide clarification regarding metrics, definitions and standards for the types of climate and nature risks, and set frameworks for investing and trading, particularly around carbon offsetting, which are not currently included in the TCFD. The review should also include the upcoming TNFD and green taxonomy, was well as international initiatives such as the Network for Greening the Financial System, to align all terminology and systems. **The review should lead to publication of guidance for navigating disclosures, clarifying definitions and reporting for emissions classifications (particularly Scope 3, given its complexity), and should aim to integrate disclosure frameworks over time.**

31 UCL (September 2020) *Managing nature-related financial risks: a precautionary policy approach for central banks and financial supervisors*

32 Financial Stability Board (October 2020) *2020 Status Report: Task force on climate-related financial disclosures*

33 HM Treasury (November 2020) *Interim report of the UK's joint government-regulator TCFD taskforce*

34 For further recommendations and information see the Aldersgate Group (October 2019) policy briefing *Using TCFDs to manage climate risk: next steps for UK government, investors and businesses*

2 **Regulators should provide guidance to improve voluntary reporting of scenario analysis, with the view for mandatory scenario analysis to be introduced from 2025.** Scenario analysis plays a crucial role in helping companies develop a reasonable and objective understanding of their climate-related risks. Aldersgate Group members have found the trial-and-error process of starting with less complex scenario analysis to be useful in building confidence and understanding of risk, which can be built upon in expectation for when scenario analysis does become mandatory. 2025 has been identified by Aldersgate Group members as a reasonable starting date for mandatory scenario analysis reporting, as this will give businesses sufficient time to build capacity and understanding amongst staff. Guidance should be structured around disclosure of risks based on, first, company exposure (Value at Risk) to different events occurring, and, secondly, the probability of the event occurring under different scenarios (for example, 1.5 °C, 2°C). The guidance must include bespoke information for specific sub-sectors of the financial services industry, including, but not limited to, investment banking, retail banking, trading, capital markets, insurance, advisory professions.

3 **The government should adopt policies which will encourage greater levels of voluntary disclosures reporting for businesses which will not be required to report on a mandatory basis until 2025.** Updating procurement rules to drive demand for goods and services from companies already disclosing in line with TCFD recommendations would be one way of doing this, building on the Green Book guidance to policymakers to consider and manage down risks with low probability but high impact. It could also ensure that early movers are not unfairly penalised for being transparent about the climate-related risks faced by their business, and help to create a level playing field.

4 **Regulators should set new guidelines encouraging businesses to include heads of departments in every stage of the disclosures process, and mandating the dissemination of findings throughout their teams, from operations to procurement, to HR.** Doing so can increase understanding of climate risk in all areas of company operations and at all levels, to holistically encourage climate-positive decision making through increased understanding, even amongst staff who do not have decarbonisation explicitly included in their job remit. For example, sharing the findings with HR representatives who choose which pension funds the business defaults to could encourage greater uptake of sustainable pension funds.

5 The Aldersgate Group welcomes the creation of the UKCGFI to overcome the barrier of data access with regards to disclosing climate risk. Research conducted by PwC into uptake of disclosing climate risk found that 100% of respondents cited a lack of data about the impact of their activities as a key challenge to conducting the climate scenario analysis part of disclosures.[35] **The UKCGFI should be equipped to help businesses and financial institutions cultivate transparent and authentic reporting, and the Aldersgate Group recommends that a Corporate Reporting Lab is created to sit within the UKCGFI.** Such a Lab can in particular could particularly help industries where reporting is lagging and industries that are less regulated, as a government-convened Lab can help give structure to conversations around appropriate scenarios and ensure a level of standardisation of approach across industries.[36] Similarly, creating a strong relationship between government and businesses can create a process for identifying which areas corporates need particular guidance with, and tailor support appropriately. **The UKCGFI should also be prepared to offer technical support to small- and medium-enterprises (SMEs) who have less resource and therefore face higher reporting burdens regarding disclosures.**

THE UK CENTRE FOR GREENING FINANCE AND INVESTMENT (UKCGFI)

The UKCGFI is led by the University of Oxford and will see £10 million invested into 'a new national green finance research centre that will advise lenders, investors and insurers'.[37] The UKCGFI specifically recognises that access to scientifically robust data and analytics surrounding sustainable finance and business decisions is currently patchy and unreliable.

The UKCGFI aims to support financial institutions shift money away from environmentally harmful and risky activities – such as coal-fired power and deforestation – towards activities like renewable energy or sustainable agriculture, and will work with finance professions, such as the Chartered Bankers Institute and Chartered Financial Analysts UK.

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35 PwC (October 2020) *Rising to the challenge: climate risk in the UK banking sector*

36 For further information see the Aldersgate Group (October 2019) policy briefing *Using TCFDs to manage climate risk: next steps for UK government, investors and businesses*

37 UKRI (15 February 2021) *"£10m research centre to spur a greener global financial system"*

2.2 Embedding climate- and nature-positive decision-making into financial institutions

Climate risk management is not the same as achieving alignment with climate-positive outcomes.[38] As the government's Green Finance Strategy notes, "disclosure is only useful if it guides decision-making".[39] Research by PwC published in October 2020 found that although 71% of PRA-regulated banks and building societies surveyed stated that climate risk is embedded in the firm's long-term corporate strategy, less than a third had a science based target or net zero strategy.[40]

In addition to disclosures, there are a number of policy levers which can be used to make climate positive outcomes a priority for financial institutions and businesses. **The Aldersgate Group recognises that a regulatory end goal of mandatory net zero targets and transition plans will be critical to benchmark the financial sector and bring all institutions up to the same standard.** Crucially, net zero delivery plans will need to include science-based targets to ensure plans are both transparent and credible for investors. However, before such a regulatory end goal can be introduced, a number of steps should be taken to prepare the sector and ensure that mandatory alignment leads to positive outcomes rather than increasing reporting burden or becoming a box-ticking exercise.

38 Responsible Investor (29 July 2020) *"With the TCFD in its fifth year, it's time to make 'net zero' mandatory for financial institutions"*

39 HM Government (July 2019) *Green Finance Strategy*

40 PwC (October 2020) *Rising to the challenge: climate risk in the UK banking sector*

Key policy recommendations for preparing financial institutions (FIs) for mandatory net zero targets and transition plans include:

1. **Regulators should publish guidance to help FIs with planning and resourcing, and encourage them to begin developing targets and plans on a voluntary basis.** Regulators should publish this guidance no later than 2022. The guidance will need to define what reaching net zero means – including both emissions reductions and the role of offsetting where appropriate. Guidance should also outline the governance and structural changes required to achieve net zero within a business. A framework for measuring and reporting on progress towards delivering net zero should be set out, to ensure consistency across the sector. Crucially, this guidance could build on the existing guidance set out by initiatives such as Science Based Targets initiative, Partnership for Carbon Accounting Financials, Paris Agreement Capital Transition Assessment and others. The guidance will ultimately need to be assessed for workability by those on the ground in the financial sector, to ensure the guidance is adopted and used effectively.

   Guidance should be designed in such as a way as to make it easy for it to be updated as and when interim targets change over time, so that transition plans and targets are consistently amended to be in line with the latest advice from the Intergovernmental Panel on Climate Change (IPCC) and the CCC. Finally, the guidance must include bespoke information for specific sub-sectors of the financial services industry, including, but not limited to, investment banking, retail banking, trading, capital markets, insurance, advisory professions.

2 **The government, ideally with strategic leadership from the Bank of England and the FCA, should open a consultative process to develop a roadmap for introducing mandatory net zero targets and transition plans for FIs throughout the 2020s.** This consultative process should follow the same kind of timeline as the TCFD consultation, of around four years, with mandatory plans and targets coming into effect around 2025. The roadmap should include clear guidance for key players in the sector, including insurers, bankers, traders, and intermediaries like credit rating agencies and auditors. The consultative process should include the establishment of a Taskforce which brings together regulators and financial institutions to agree action points and definitions. The Taskforce should be chaired by a private finance representative who understands the science of climate change and biodiversity loss. As with guidance developed by regulators, this consultative process will need to ensure that flexibility regarding targets for delivering net zero is built into the roadmap and future regulatory policies, to ensure transition plans and targets are always being developed with the recommendations of the IPCC and CCC in mind.

3 **Part of this consultative process will need to involve regulators encouraging FIs to publish net zero transition plans and targets on a voluntary basis as soon as possible.** This will enable FIs to see what their competitors are publishing and help to foster ambition and collaboration within the financial sector. It will also help FIs develop an understanding of the types of technical support which will be needed from government, regulators and carbon consultants in order for them to publish mandatory transition plans and targets.

Nudging FIs towards voluntary reporting could also include regulators incorporating impact-based reporting into disclosures, for example through the Partnership for Carbon Accounting Financials (PCAF), to begin moving disclosures away from simply the risk to investments from climate change and biodiversity, and towards risk of investments on the climate and nature. This should include not only carbon mitigation but also adaptation as an operational performance risk. This process will need to involve staff across FIs, not just accounting, to encourage a shift in investment decision-making, and prepare members of different teams for supporting preparation of net zero transition strategies.

4 **Financial institutions must take steps towards mainstreaming climate and nature knowledge across all staff working in the financial sector in the UK.** This will be vital in ensuring FIs have access to the right skills to produce net zero transition plans and set science based targets, whether through in-house staff or consultants. Embedding expertise across institutions should involve FIs recruiting new staff members with backgrounds in carbon accounting, ecology and climate risk management. Existing staff members across departments should be offered training to help them to better understand these issues – for example, through the Green Finance Education Charter, or through the CFA UK Level 4 Certificate in ESG Investing. In particular, accounting teams, which put together the annual reports in which company disclosures sit, should be supported by ensuring climate-related considerations are embedded into Professional Standards and Continuing Professional Development. This should ultimately be led by the guidance and future mandatory requirements set by regulators on net zero and nature impacts, with support for FIs to ensure they are recruiting on the right skills to enable compliance with future regulation.

MACQUARIE ASSET MANAGEMENT – NET ZERO BY 2040

In December 2020, Macquarie Asset Management (MAM), a top 50 global asset manager and the world's largest manager of infrastructure, published plans to manage its portfolio in line with net zero by 2040.[41] This is the world's first commitment by a major asset manager to meet net zero by 2040.

The steps MAM will take to deliver this plan include:

- Measuring greenhouse gas emissions of all portfolio companies;
- Identifying pathways to reduce emissions;
- Developing business plans that contribute to a net zero economy by 2040, or sooner;
- For new investments, target completion of these steps within 24 months of acquisition;
- Working with its private portfolio companies to help them produce Paris-aligned business plans by the end of 2022;
- Reporting on their progress annually.

MAM is part of Macquarie Group, which also owns the Green Investment Group (formerly the publicly owned Green Investment Bank). Macquarie has invested or arranged over A$63 billion into green energy projects since 2010, and has over 50GW of renewable energy projects in development, construction or operations. On top of its commitment to align its managed asset portfolio with net zero by 2040, Macquarie Group has also committed to reaching net zero for its operational emissions by 2025; for Green Investment Group's renewable investments by 2030[42] and to aligning all other Group financed emissions with net zero by 2050.[43]

41 Macquarie (9 December 2020) "Addressing climate change and accelerating the low carbon transition"

42 Green Investment Group (7 May 2021) "Our commitment to a net zero future"

43 Macquarie Group (7 May 2021) "Supporting the transition to a net zero economy"

Further recommendations to help embed climate-positive outcomes in the financial sector include:

1 **Building on the flexibility provided by the UK's departure from the EU and as part of integrating European legislation into UK law and policy, policy makers and regulators should move to embed environmental sustainability into the regulatory framework governing the UK's financial system.** The principles underpinning European climate and environmental policy should be incorporated into UK policy,[44] but they should be updated to reflect the UK's specific ambitious climate and environmental targets. This could be done through a review of the Financial Services and Markets Act, in which the Bank of England and other regulators were granted new powers now that the UK has left the European Union, to ensure climate and environment are included in the legislation. Alternatively it could be explored through the ongoing Future Regulatory Framework (FRF) Review. Embedding sustainability into the UK's financial services regulatory framework can crucially put the UK in a good position for influencing international rules and standards governing financial markets.

2 **UK policy makers and regulators should work together to set capital treatment for insurers and banks in such a way as to reflect the long-term risks of assets to financial stability, thereby incentivising more strategic asset allocation in environmentally sustainable assets and a transition away from high carbon or environmentally damaging investments.** This would encourage the largest investors in the world to move money in a more sustainable direction, at no cost to governments. Similar measures could be used to incentivise banks to shift their lending practices towards environmentally sustainable assets that pose a lower risk to financial stability. Furthermore, the Financial Reporting Council's (FRC) UK Stewardship Code is asking asset owners, asset managers and service provides to outline how they are embedding ESG across decision-making – not just in disclosures.[45] Similar approaches could be rolled out to include investors, asset managers and insurers. Finally, if the UK sets its own capital levels and uses the opportunity to influence international standards such as through Solvency II or Basel III.

3 **Pension fund managers should introduce measures to close the £2.17trillion "green gap" within UK pensions and ensure pension funds are delivering the UK's net zero and nature targets.[46] They should do this by automatically enrolling new beneficiaries into Paris-aligned pension funds, and engaging with existing beneficiaries to outline the benefits of transferring fund holdings into Paris-aligned funds. The government should also consult on introducing requirements for scheme managers to report on Paris-alignment, following the welcomed amendment to the Pension Schemes Act** for pension managers and trustees to report mandated climate-related financial disclosures from 2025.

The UK government and The Pensions Regulator should also offer greater support and knowledge around ESG investment to asset managers and companies outsourcing their pension management. Specifically, it should set out a clear and credible link from ESG investment to net zero goals, with advice and examples for investors, to increase understanding.

44 European climate and environmental policy is based on the principles of precaution, prevention, rectifying pollution at source, and the 'polluter pays' principle.

45 Financial Reporting Council (2020) *The UK Stewardship Code 2020*

46 The Aldersgate Group will explore the topic of pensions further with a policy briefing, to be published in autumn 2021.

4 Finally, the government should begin disclosing the impacts of biodiversity loss, climate adaptation and carbon emissions risks on its own accounts, and should report on areas of disclosures which businesses have reported to be tricky to navigate, such as Scope 3 emissions and scenario analysis. If the government begins to publish its own disclosures across all departments, and in particular Her Majesty's Treasury, it will send the right signal to the private sector and encourage them to invest in the resources and skills required to produce good disclosures, targets and transition plans.

The first publication of climate related financial disclosures by the Bank of England in June 2020 was a good start.[47] This should be rolled out across all government departments, and could involve the establishment of a cross-departmental working group on Climate-related Financial Disclosures for Government.

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All government disclosures should include reporting on areas which businesses are only required to publish on a voluntary basis currently, such as Scope 3 emissions and scenario analysis, to encourage businesses to do the same (see section 2.1 for more details).

The government should also set out how it will take learnings from the results of the Bank of England's climate stress test and inform policy making. The government must demonstrate how disclosures are leading to changes in policy making. In other words, the government must demonstrate that public money is only invested where biodiversity footprint, climate adaptation risks (for example, of infrastructure) and carbon emissions risks, have been assessed (including all Bank of England instruments and UKIB projects).

47 The Bank of England (June 2020) *The Bank of England's climate-related financial disclosure 2020*

2.3 Embedding nature's value into the economy and investment decision making[48]

Though 80% of businesses globally are reporting on sustainability, just 23% are disclosing nature-rated financial impacts in their corporate reporting.[49] A greater uptake of nature-related disclosures is needed to increase the understanding of the impact from business operations on nature risks and forecast operational risk under different biodiversity loss scenarios. The newly created Taskforce for Nature-related Financial Disclosures (TNFD) will have a huge role to play in delivering this.

Historically, the economic models have not reflected the value added by the environment. For example, the asset value of natural capital and ecosystem services was estimated to be worth £921 billion in 2018, more than a third of which was attributable to regulating services such as pollution removal and carbon sequestration, which keep our air clean and our planet liveable.[50] This is just 0.01% of the estimated value of the UK housing market in the same year, at over £7.29 trillion.[51]

48 The Aldersgate Group will be exploring this topic in a future policy briefing, to be published in the autumn of 2021.

49 KPMG Impact (December 2020) *The time has come: The KPMG survey of sustainability reporting 2020*

50 Office for National Statistics (November 2020) *UK natural capital accounts: 2020*

51 Savills (4 February 2019) "Value of UK housing stock hits record high"

The publication of the HM Treasury commissioned Dasgupta Review on the Economics of Biodiversity marks the first time a government review has been commissioned to address the valuation gap of nature-based solutions and natural capital. The Dasgupta Review should mark a sea change for incorporating nature into the economic framework, just as the Stern review did for climate change. HM Treasury has published its initial response to the Dasgupta Review, [footnote] but further work needs to be done to ensure that the recommendations are taken forward across government.[52] The Aldersgate Group believes the government must take action to transform the Review's findings into concrete policies. This should include publication of an implementation plan, which will ultimately make it easier for businesses and the government to change the way they value nature. It will also give businesses further confidence to plan, invest and collaborate on natural capital projects.

52 HM Treasury (June 2021) *The economics of biodiversity: The Dasgupta review – government response*

Policy recommendations for changing how we value nature include:

1. The Aldersgate Group would welcome a commitment from the government for the newly created Taskforce for Nature-related Financial Disclosures to be aligned with the TCFD, and clarification on how mandatory disclosures in line with the TNFD will be introduced throughout the 2020s. **The Aldersgate Group recommends that the TNFD should be used as a stepping stone towards mandatory publication of biodiversity loss mitigation and adaptation targets and transition plans.** The TNFD will also need a resource hub with open source data on natural capital and resources for businesses – including SMEs – to help identify risks, as well as free online training courses. The government should also set up a Corporate Reporting Lab within the TNFD, for corporates to share learnings.[53]

2. **The Treasury must take a leadership role on moving towards a cross-government framework for fully incorporating nature into decision-making.** The most effective mechanism for bringing this together into a coherent and sustained plan is likely to be through the cycle of Environmental Improvement Plans under the Environment Bill. The recommendations of TNFD will be critical here.

53 See sections 2.1 and 2.2 for further information about setting science-based targets and net zero transition plans, associated skills and a Corporate Reporting Lab.

3 **The government must also set out the process for developing a more visible, accessible and applicable framework for developing metrics for natural capital and identifying dependencies between business operations and biodiversity, including common standards for monitoring and evaluating biodiversity investment.** To encourage action on nature restoration in both the public and private sector, it is essential that we better understand the science of the natural environment and its contribution to economies and wellbeing. Currently, no common standards exist in the UK nor at the global level. This makes it difficult for investors to identify their impacts both domestically and across borders, and critically no universal currency has been identified for tracking investment into natural capital. Furthermore, it creates the challenge of identifying to identify dependencies between business operations and biodiversity loss. The European Commission has started work on this latter point through its programme We Value Nature, which runs up to October 2021. The outcomes of the programme could be used in the UK to set out common standards mirroring those adopted in the EU, setting a consistent approach which would streamline monitoring and evaluating for investors working in both regions (see section 4.2 for more recommendations on UK-EU collaboration).

RSPB'S NATURE RESTORATION INVESTMENT – WALLASEA ISLAND WILD COAST PROJECT

The RSPB's Wallasea Island Wild Coast Project used more than three million tonnes of earth tunnelled from beneath London's streets to build Crossrail, to help transform Wallasea Island into the largest habitat creation project of its type in Europe. The project has created a haven for thousands of migratory birds, but also reduces pressure on seawalls elsewhere on the estuary, sequesters carbon at a rate of about 4 tonnes of carbon per ha per year, and provides nursery areas for commercially important fish species, providing a number of nature-based solutions which provide financial benefits across the economy.


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THREE ACCELERATING AND LOWERING THE COST OF PRIVATE INVESTMENT

Think sections explores how to grow and accelerate the financing of green projects and lower the cost of private investment into low carbon infrastructure and nature-based solutions.

The CCC outlines in the Sixth Carbon Budget that private investment will need to do most of the heavy lifting to close the investment gap into low carbon infrastructure to deliver net zero and also into nature restoration, as outlined in section 1.2. It is therefore crucial that the government makes it easier for real economy businesses and investors to finance these areas. This will require clear policy frameworks to drive private investment at the necessary pace and scale, and at the lowest possible cost, given the high investment gap.

This section will outline the policies which the Aldersgate Group believes will be vital to include in such a framework, specifically through a net zero strategy, and accompanying carbon pricing and markets to drive investment towards low carbon infrastructure.

3.1 Government-led tools for crowding in private finance

3.1.1 A net zero strategy

Significant investment is required to ensure the infrastructure needed to reach net zero in 30 years is rolled out. As outlined by the National Infrastructure Commission, some of these challenges include preparing for 100% electric vehicle sales by 2030, decarbonising the energy sector without increasing prices to consumers, and improving energy efficiency of buildings.[54] The Aldersgate Group also recognises the need for investment to support delivery of net zero in sectors which are harder to decarbonise, such as heavy industry. This will require significant investment into emerging technologies and innovation, for example into CCUS and green hydrogen.

Barriers to private investment into net zero, as outlined in section 1.2, include prioritisation of short term returns and traditional investments which are seen as having a lower risk profile than emerging technologies or market failures, which restrict money from flowing towards low carbon infrastructure projects which require patient capital. Strategies for moving the financial system away from this model are outlined in Part II of this report, but there are a number of actions which can be taken in the nearer term to crowd-in private investment into the types of projects needed to meet the government's climate goals.

The CCC recommends the government publish sector-specific strategies whilst also utilising system-wide instruments to enable market innovation in private finance.[55] **To support this, the government must publish a net zero strategy ahead of COP26.**[56] The strategy needs to **set out sufficient policy detail on a sector-by-sector basis towards net zero and include a clear timeline for policy decisions over the next five to ten years.** This will provide investors with clarity regarding which net zero pathway the government is adopting, enabling them to begin driving funding to the decarbonisation technologies required.

54 National Infrastructure Commission (July 2018) *National infrastructure assessment*

55 The Climate Change Committee (December 2020) *The Sixth Carbon Budget: The UK's path to net zero*

56 For further recommendations on delivering a net zero economy, please see the Aldersgate Group (October 2020) report *Building a net zero emissions economy*

The strategy also needs to outline **how it will be overseen by all key government departments,** with regular reviews on progress against the timeline. The creation of a net zero delivery body could be valuable here. **The strategy will need to set out the detailed policy measures and market mechanisms which will be used to drive cost-effective private investment into low carbon technologies and services.** These policy measures will need to match the pace and scale of investment required by the CCC's Sixth Carbon Budget and will be particularly important in areas such as buildings, power, heavy industry, transport and land use.

Publishing such a plan will ensure businesses working across the economy have stability to begin growing the parts of their businesses most needed for decarbonisation, rather than continuing to operate under business-as-usual. It will also help to grow the pipeline of projects needed to match the capital available to invest in low carbon infrastructure to deliver net zero. Ideally this plan should also be should receive input from all parties and legislated to set long-term stability for businesses.

Key recommendations for a net zero strategy include:

1 **Set out the key policy interventions that the government will adopt over the next five years on a sector-by-sector basis, to give clear guidance to the private sector.** This will need to outline policies to address the infrastructure needs for each sector individually, in turn creating investable project pipelines across all sectors of the economy. This should include setting the **regulatory policies and market mechanisms** which will be put in place to enable the delivery of these sectoral pathways, by making it more attractive to invest in low carbon than carbon intensive activities, **to begin mobilising supply chains and finance in the long term.**

Government policy must support an industrial strategy that trials critical technologies at scale (such as carbon capture and low carbon hydrogen production), supports low carbon skills development, and delivers essential infrastructure investments. For example, in the construction sector this could involve setting a minimum energy efficiency standard of EPC band C by 2030 and announcing a phaseout of gas boilers from 2025, both of which will send a strong signal to investors and construction businesses.

2 **Ensuring a joined up approach to regulatory policies across different sectors.** Taking a holistic view of the economy will be crucial to ensure policies are designed with interdependencies in mind. For example, setting planning regulation which requires charging points to be installed in new homes will encourage the purchase of electric vehicles and reduce the need for fast charging points to be installed in petrol stations, generating a cost-saving on infrastructure upgrades at different sites. Such a plan would also create jobs across building and transport construction. This approach will also require the government to set out how different departments will join up to deliver key projects, ensuring that delivering the net zero strategy is at the core of policy and spending decisions across government.

3 **The strategy should also include a range of fiscal policy interventions to attract money to sectors which have seen market failures regarding delivery of net zero.** This could include, for example: (i) binding regulatory drivers, such as setting a minimum energy efficiency rating of C for buildings; (ii) setting **revenue guarantee mechanisms,** such as Contract for Difference schemes for green hydrogen; (iii) greater clarity on **carbon pricing trajectory** (see the next section for further details); and (iv) **fiscal incentives.**

3.1.2 Driving low carbon investment through meaningful carbon pricing

Currently, the price of carbon in the economy is far too low. In the UK, the gap between the real economic cost of climate change and the price of carbon is 42.2%.[57] However, setting a meaningful and evidence-based carbon price can shift a change in investor behaviour by penalising high carbon activities, driving innovation and creating opportunities for decision-useful investing over long timescales.[58]

The Aldersgate Group acknowledges there are many options for pricing carbon in the economy, including an Emissions Trading Scheme (ETS) and a carbon tax. Presently, the Aldersgate Group believes that ensuring the new UK-ETS has a price trajectory aligned with the net zero target and equipped with a gradually increasing carbon price floor is the most effective way of genuinely driving down emissions across a range of sectors.[59] However, the Group also recognises the UK-ETS needs to be strengthened through pricing and regulatory adjustments, and that there may be opportunities for a carbon tax to be introduced as a complementary interim measure in some areas of the economy.

Key policy recommendations for strengthening carbon pricing domestically:[60]

1 First and foremost, **the government must set a predictable and rising carbon price escalator throughout the 2020s,** aligning it with the rate of emissions reductions required to deliver the UK's Sixth Carbon Budget and net zero. **The government should also adjust the shadow price of carbon** – the price it uses internally to guide public sector decisions – which could serve as an exemplar for the private sector to use for their own international considerations. A shadow price that is consistent with net-zero could start at £50 (with a range of £40–100) per tonne of carbon dioxide (tCO_2) from 2021, increasing to £75 (£60–140) in 2030 and £160 (£125–300) per tCO_2 in 2050, which reflects the likely cost of negative emissions technologies.[61]

2 **The UK will need to review and gradually reduce the number of free allowances and credits available under the UK-ETS.** the EU is currently reviewing this, and could provide a strong signal to heavy industry for example, where the number of free allowances has, in some cases, precluded ambitious action being taken on decarbonisation. This will need to be managed carefully, to avoid undermining business competitiveness and leading to offshoring of industry. **One way to do this is to allow a grace period to enable businesses to prepare for the phase out of free allowances.** This would be particularly beneficial if a Carbon Border Adjustment Mechanism (see section 4.2 for more details) were to be introduced, as a grace period could also allow for the phase in of such a levy simultaneously, to give businesses an adjustment period during which to move from one system to another.

57 OECD (18 September 2018) "Few countries are pricing carbon high enough to meet climate targets"

58 The Zero Carbon Commission (February 2020) *How carbon pricing can help Britain achieve net zero by 2050*

59 For background on the research which into this view please see the Aldersgate Group (October 2020) position paper *The future of UK carbon pricing*

60 For recommendations for strengthening carbon pricing internationally, please see section 4.2.

61 LSE Grantham Research Institute on Climate Change and the Environment (May 2019) *How to price carbon to reach net-zero emissions in the UK*

3 **The government should launch a consultation on including other sectors into the UK-ETS,[62] including agriculture, buildings and surface transport.** The government could also set emissions caps under the UK-ETS on a sector-by-sector basis, setting lower caps for sectors which are easier to decarbonise, and apply a similar approach to the domestic carbon tax, known as the Carbon Price Support. An interim carbon tax should also be introduced for sectors not currently within the scope of the ETS, with a view to gradually extending the ETS to cover the whole economy.

4 **The UK-ETS should be aligned with the EU-ETS.** The EU-ETS is the largest scheme in the world and the advantages of linkage are clear in terms of liquidity, price discovery, and the ability to attract abatement from across Europe rather than just the UK. Modelling by the Environment Defence Fund (EDF) found that the biggest opportunities for emissions savings and reduction of mitigation costs from carbon markets occur when countries can trade in international carbon markets.[63] Furthermore, aligning the UK-ETS with the EU-ETS will offer stability to businesses which have experience trading within the EU-ETS. However, it is crucial that linkage is based on the aforementioned reformations to improve the credibility of both schemes. For further recommendations on UK-EU alignment, including on a carbon border adjustment mechanism, see section 4.1.

5 **The government should publish guidance regarding domestic offsetting regulation and allowances for UK businesses, which should be developed in partnership with climate scientists to ensure offsetting does not lead to unintended emissions increases.** This guidance could follow the framework published by the Science-Based Targets Initiative, which states offsetting must be additional and that businesses must also take steps to bring down their emissions, to send a signal to all market participants on the role of offsetting in delivering net zero. The guidance should clarify whether caps apply to the amount which can be offset, which registries can be used by UK businesses, what action should take place if a company's purchased offsets are shown not to have been additional. It should also clarify whether offsets must be carbon negative, or whether avoided emissions count.[64] Finally, it will be important for the UK government to work with international partners on this guidance once the rulebook for an international voluntary offsetting market has been established under Article 6 of the Paris Agreement (see section 4.2 for further information). This will help to ensure domestic regulation around offsetting is consistent at the international level.

62 https://bit.ly/3cCU5gm [Accessed 29 April 2021]

63 EDF (December 2019) *How carbon markets can increase climate ambition*

64 University of Oxford (September 2020) *The Oxford principles for net zero aligned carbon offsetting*

ABOUT CARBON OFFSETTING

The offsetting market started in 1970 but has picked up since the 2000s and grew again in 2020.[65] Forestry and land use initiatives remain by far the largest sector of the market in dollar terms – for example, with carbon stored in trees – but offsetting is priced at very different rates in different countries for what is essentially the same service.[66] Whilst offsetting grows and the price of carbon remains low, there is a risk that offsetting – which is cheaper than investing into technological developments to bring down emissions at the source – will grow in popularity as an alternative to investment into innovation and R&D, and as such will not tackle the root of the problem. For example, easyJet announced it is to be the first net zero airline with no changes to planes or fuel used, or the amount of emissions it will produce, but with a significant surge in offsetting investment.[67]

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3.2 Accelerating private investment through clear policy signals: nature and biodiversity

Investment into restoring nature has been slower than anticipated in recent years. In the UK, there has only been a 2.2% increase in restoring protected sites to favourable condition since 2013; the total amount of restored protected sites stands at 38.9% against a 25 Year Environment Plan target of 75%.[68] Whilst the government has set out plans to restore nature and protect biodiversity using public money, such as through the Environment Bill and the Environment Land Manage scheme (ELMs), there is already a significant gap in the levels of public investment in nature which is needed and delivered, with a shortfall of £1.8 billion.[69]

It is therefore vital that a policy and regulatory framework is established to attract private investment to close the investment gap for nature. Crucially, all new frameworks and governance practices must be established based on the crowding-in theory of change, with public investment into nature leading to increased investment from the private sector, to begin moving away from the historical model in which investment into biodiversity and ecosystems was largely done through public financing only.[70]

65 Financial Times (29 September 2020) "Carbon offset market progresses during coronavirus"

66 *Ibid.*

67 https://bit.ly/3gyFfdk [Accessed 29 April 2021]

68 Natural Capital Committee (January 2020) *State of natural capital annual report 2020*

69 RSPB (March 2018) *Bridging the finance gap: How do we increase financing for conservation?*

70 HM Treasury (February 2021) *The Economics of Biodiversity: The Dasgupta Review*

Key policy recommendations include:[71]

1 **The most effective way to establish such a framework is by rapidly finalising the Environment Bill.** Businesses fully support the strong enforcement of environmental law and the protection of the natural environment. When well-designed and properly enforced, ambitious environmental regulations provide a stable environment for businesses to invest in, support innovation in new green solutions and products, and provide a level playing field across the economy. If the Environment Bill is designed and implemented correctly, it will energise private sector investment in the natural environment, develop more resource efficient business models, and improve environmental performance.

2 **The Environment Bill needs to establish a target setting framework which has ambitious long term targets and robust interim targets.** Having the combination of long term and interim targets in all priority areas identified in the Bill will support businesses in providing a clear direction of travel. Ambitious targets can also create a regime whereby businesses are incentivised to go above and beyond minimal compliance baselines. To achieve this, there needs to be a clear overarching vision for the target setting process which brings together the governance framework, the target setting process and the policy objectives in the Bill.

Additionally, interim targets need to be strengthened to give businesses more confidence regarding near-term delivery, to encourage them to drive investments towards nature. For long term targets to be seen as credible and investible by business, there needs to be certainty that successive governments will take sustained, regular action to deliver these targets. The positive impact of robust interim measures can be noted by the success of the Carbon Budgets established under the Climate Change Act, which helps drive short term progress on emission reductions.

3 **Public funding for the natural environment should be structured in a way which will enable a blend with private investment.** The outcomes that public funding and regulatory compliance are designed to achieve must be clear so that business can contribute to these outcomes and drive up standards further. This will increase the amount of funding that is available to nature projects and enable action across the private and public sectors.[72] Other public financing mechanisms such as government-backed guarantees and using long term contracts should also be explored to create genuine revenue certainty for investors. The government could also consider creating a creating a Big Environment Capital fund (based on Big Society Capital) using some of the funds proposed in the Dormant Assets Bill.

71 For more recommendations on improving the Environment Bill, see the Aldersgate Group's (February 2020) *Briefing for the second reading of the Environment Bill*

72 Broadway Initiative & Aldersgate Group (April 2021) *Dasgupta Review: How the Government's response can help business invest in nature*

4 **The government must design ELM schemes in such a way as to make it easier for landowners, farmers, ecologists, agricultural workers, rural communities and private investors to bridge public-private partnerships,** for example with large estates like the National Trust and the Crown Estate. This approach can help with aggregating and de-risking projects to make investment more appealing. Further opportunities exist between universities, NGOs and businesses, like the Ignition Project in Greater Manchester, which aims to develop a model enabling large scale investment into environmental projects to boost climate resilience.[73] For ELMs to be as effective as possible, it will also be vital that government clarifies how the funding for ELMs will operate alongside other payments and support for the farming and land use sector and ensure farmers, agricultural workers and rural communities are involved in projects, such as biodiversity net gain. The government should also clarify how ELMs will sit alongside new policy mechanisms, such as biodiversity net gain. This will strengthen the development of further public-private partnerships and deliver environmental improvements.

5 **The government should introduce Environmental Investment Tax Relief (EITR) to incentivise individual taxpayer investment into nature.** This could be based on the existing Social Investment Tax Relief (SITR) scheme,[74] but with modifications to increase take-up. An EITR could be introduced in the near term and can help with funding for more and bigger pilot nature-based solutions projects, like those being carried out by the Environment Agency and Triodos Bank (see below), to help grow the project pipeline for private sector investment.

6 **The government should create a publicly available database of the types of nature-based solution projects available for investment.** Doing so can help businesses identify which nature-based solutions fit with their business operations. The database should include the co-benefits of each project – for example, tree planting which helps with flood mitigation. **The government should also ensure all government data on natural capital is open source.** Data has a crucial role to play in building an understanding of the science of the natural environment and its contribution to economics and wellbeing in both the public and private sector. The government and others already invest £100 million each year into environmental data collection,[75] but it is not currently used in a strategic way, and much of the government's data exists behind pay walls.[76]

73 https://bit.ly/3geqlcb [Accessed 29 April 2021]

74 https://bit.ly/3gcKbEs [Accessed 6 May 2021]

75 Broadway Initiative & Aldersgate Group (April 2021) *Dasgupta Review: How the Government's response can help business invest in nature*

76 https://bit.ly/3cTClYT [Accessed 29 April 2021]

USING PUBLIC AND PRIVATE SECTOR EXPERTISE AND INVESTMENT TO TACKLE CLIMATE CHANGE AND RESTORE NATURE

Defra, the Environment Agency (EA), Esmée Fairbairn Foundation (EFF) and Triodos Bank UK have formed an innovative collaboration to support environmental projects to create sustainable funding models.

Four initial projects have been selected to receive funding in a pilot scheme to encourage sustainable private sector investment in our natural environment, which will protect and restore valuable habitats.

Having been sourced and evaluated by Triodos Bank UK, the projects have received grant funding from Defra, the EA and EFF to support their development, complete business plans to attract private sector investment, deliver long term environmental benefits and sustainable financial returns:

- The Devon Wildlife Trust's restoration of the Caen wetlands;
- The Rivers Trust's work on natural flood management in the Wyre catchment in Lancashire;
- The National Farmer's Union's work to reduce nitrate pollution in Poole Harbour;
- The Moors for the Future Partnership's restoration and conservation of peatlands in the Pennines.

The government's 25 Year Environment Plan made clear that while the public sector will continue to be an important source of funding for the natural environment, it is critical that this is alongside more private sector investment to protect and enhance our environment.

"We have invested over two years of our resources and expertise into finding viable financial projects in this new area and were delighted to bring these first UK investments together. We believe that connecting economic outcomes to investment in environmental restoration is possible and can deliver benefits, in terms of carbon storage, air quality, flood management and human health, as well as enhancing biodiversity and wildlife habitats."

DR BEVIS WATTS, CHIEF EXECUTIVE OF TRIODOS BANK UK

3.3 The role of public finance to crowd in private sector investment

Ensuring public money is supporting delivery of the UK's climate and nature goals is good not only for the environment but also for society. The links between social resilience and the environment have been long documented. Furthermore, as will be outlined in this section, there are many examples of how patient public-funded capital with steady returns deliver long term innovation and projects have wide benefits for the economy and society through innovation and creation of new markets. As such, there is a clear opportunity as part of the economic recovery to COVID-19 to deliver public money for public goods.

The UK Infrastructure Bank

The Aldersgate Group welcomes the creation of the UK Infrastructure Bank (UKIB). National and state banks have historically played a role in successful reconstruction post-crisis, for example after the Second World War or the 2008 Global Financial Crisis. The UKIB clearly has a major role to play in delivering a green economic recovery from the COVID-19 crisis. The UKIB will also be essential now that the UK has left the EU, replacing the European Investment Bank as a key source of patient capital for businesses and infrastructure projects – which financed £7 billion of projects in 2016 alone.[77]

The Group therefore welcomes the commitment from the government that the new bank will be instrumentalin delivering on the UK's net zero commitments and levelling up across the country, mirroring the approach taken by other state banks, For example, sustainability is one of the primary business targets of the German national bank Kreditanstalt für Wiederaufbau (KfW). Crucially, KfW has a public side of the bank which finances projects which aren't commercial yet (for example, energy efficiency grants for households) and a private arm that makes commercial investments alongside the private sector. It therefore has the flexibility to fill gaps in the markets and nudge sectors towards becoming commercial more quickly. KfW also funds green jobs and skills, and biodiversity. To be most effective, the UKIB should play a similar role in the UK economy.

77 Future Economies (November 2018) *What we really mean when we talk about industrial strategy*

Key recommendations for an effective UKIB include:[78]

1 **Mission-driven mandate:** The Aldersgate Group welcomes the UKIB's existing mandate to tackle climate change and support regional and local economic growth. **The Bank will need to have mitigation and resilience goals as the key drivers for supporting recovery, fairness, and a just transition.** The Group also welcomes the commitments in the UKIB's Policy Design that the Bank will focus in particular on scaling early-stage technologies that have moved through the research and development phase, to provide additionality to make projects happen that would not have happened otherwise, and to bring projects forward to meet net zero or regional and local growth objectives.

Nature restoration and adaptation must also be a key part of the Bank's mandate, financing and supporting development of projects at both the national and local levels. The Bank can have a big impact when it lowers policy risks for emerging technologies, and creates markets where there are gaps, such as with historic market failures.

The UKIB should also support the delivery of green skills for the green industrial revolution. This could include supporting universities and schools so they can update curricula to embed sustainability across all subjects, or providing funding to help businesses and educators create partnerships for climate-related programmes, such as emerging and riskier technologies which the UKIB will fund projects for. The UKIB could also offer support to individuals looking to access training in sustainability.

It is important that the mandate has flexibility built in, so the Bank can respond to changing decarbonisation needs and market conditions over time; what is currently considered a climate changed-related market failure – for example, buildings decarbonisation – should not be a market failure in ten years' time. The Bank will therefore need a broad investment scope to fund a wide variety of projects, in terms of locality, size, and their stage in the pipeline.

2 **Governance: The Bank should be an independent and enduring institution with full banking and borrowing powers.** It is important that the Bank is led by a private banker with the skill set and cultural experience required to bridge the gap between the public and private sector, and build strong partnerships. It is also vital that the UKIB is governed by a board which is diverse and representative of the whole UK, and features representation from areas of the economy and sectors with which the Bank will interact.

3 **Capitalisation: The institution's capitalisation level should be appropriate to its mission and functions.** The UKIB will need a higher risk tolerance than the private sector to send signals to the market of the Bank's long term credibility and impact. The institution should be able to access capital markets for both debt and equity. Crucially, the Bank will need to operate on the crowding in theory of change, to draw in private finance and ensure the Bank's capitalisation is in line with the market failures and size of the investment challenge that we face. It should be prepared to have low returns in its infancy, and will ideally commit returns to being redirected into UKIB projects only.

78 This section of the report builds on the briefing note *National Infrastructure Bank Design: Building a public bank fit for the future* which was developed in collaboration with, and published by, E3G. The note is available **here**.

4 **A future-fit definition of infrastructure: The Bank should employ an active strategic mission to crowd-in private investment, mobilising the markets by virtue of its demonstration effect.** A broad investment scope is needed for the Bank to fund a wide variety of projects, in terms of locality, size, and their stage in the pipeline. The types of oven ready projects which will deliver quick returns and grow the Bank's capitalisation swiftly are well known and outlined in the table on pages 41–42. A complementary patient capital approach will be required to de-risk new technologies such as carbon capture & storage (CCUS) and green hydrogen production, the latter of which is at a similar level of maturity now as offshore wind and solar were in 2009.[79]

It is also **vital that the UKIB brings adaptation into project development and design,** and not just mitigation, to ensure infrastructure is future-fit. For example, retrofitting buildings will require mitigation through installing clean energy and insultation to bring down energy use-associated emissions, but will also require buildings to be resilient to higher temperatures in the summer months through innovate smart design for ventilation and cooling measures. Similarly, there are interdependencies between different types of infrastructure which can be exacerbated by climate change. For example, flooding affects several types of infrastructures, so even if a factory is not directly affected, its workers may not be able to get to work, or a company may not be able to transport its products. These 'cascading' and 'dependent' risks do not neatly fall within a single sector and therefore risk being neglected. The UKIB must ensure they are a priority and could do so by analysing the projects it invests to see how it incorporates and addresses adaptation to direct and interdependency risks.

5 **Local authorities: The UKIB must consult local authorities (LAs) on UKIB projects** – particularly areas identified as priorities for local funding such as transport, heat, energy efficiency and nature – to harness local knowledge and understanding of citizens' needs, and deliver climate and place-based improvements simultaneously. The UKIB should play a convening role to identify LA pioneers of net zero delivery and bring together different LAs, to share learnings and build networks.

79 The IEA (June 2020) *Green stimulus after the 2008 crisis*

6 **Measuring success: The UKIB should aim to not to measure its success through its financial returns but instead through other KPIs linked to green activities and levelling up, such as emissions reduced, targets for nature restoration achieved, and green jobs created** – as was the case with the Green Investment Bank.[80] A good balance of mitigation and adaptation could also be built in as an additional KPI for projects (see point 4 on future-fit infrastructure). KPIs will need to be attributed to projects **ex ante (before the fact) and some KPIs may need to be dynamic and flexible,** in particular with regards to nature restoration and adaptation, because these will be more susceptible to external factors year-on-year.

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When it comes to the types of the projects the UKIB should fund, the Aldersgate Group recommends the Bank focus both on de-risking emerging technologies, such as CCUS and green hydrogen, and playing a role in "creating a market in the gap" in mature technologies which have seen consistent market failures, such as nature restoration, energy efficiency retrofits for homes, and installing EV charging points at scale.

The Aldersgate Group recommends starting by focusing on four key areas of investment which straddle these two areas of focus, as recommended by the Green Finance Institute: clean energy infrastructure, decarbonising UK transport, the built environment and nature-based solutions.[81] **A summary of some specific project and financing tool recommendations per sector can be found in the table overleaf.**

The UKIB will need to support the growth of the technical knowledge and expertise required to deliver such projects, through investment in skills and supporting businesses and local authorities to develop business models. Taking this approach can create new domestic and exportable markets, drive net growth of jobs across the UK, deliver a green economic recovery and a just transition.

80 Green Investment Bank (November 2014) *Our green investment principles*

81 Green Finance Institute (December 2020) *The role of a UK national infrastructure bank in a green recovery*

SUMMARY OF PROJECTS THE UKIB SHOULD INVEST IN THE NEAR-TERM, BY SECTOR[82] 1 OF 2

SECTOR	FINANCING TOOL	PROJECT
Clean Energy Infrastructure	Loan	Infrastructure for commercial-scale green hydrogen production and CCS.
	Co-investing	Energy storage technology (e.g. gigafactories and battery R&D) and supply chain.
	Loan	Development capital and technical assistance for smart grid infrastructure in local areas.
	Co-investing + pension fund management	A new National District Heat Fund – similar to the GIB offshore wind fund.
Decarbonising UK Transport	Equity funding	Developing UK battery supply chain, through funding gigafactory battery production.
	Project aggregation	EV on-street charging infrastructure.
	Loan (KPI-linked)	Support to LAs for upgrading public transport.

82 *Ibid.*

SUMMARY OF PROJECTS THE UKIB SHOULD INVEST IN THE NEAR-TERM, BY SECTOR ⪼ 2 OF 2

SECTOR	FINANCING TOOL	PROJECT
Nature-based solutions	Co-investment or guarantees	Transition land to provide sustainable and regenerative agriculture, peatland restoration and sustainable forestry.
	Loan	Lending to Local Authorities to develop and demonstrate urban green infrastructure.
	Loan	Providing finance for natural flood management, water quality improvement, carbon storage and green coastal resilience projects.
The Built Environment	Credit guarantees	Social housing retrofits.
	Technical assistance and loan	Aggregate energy efficiency and heat decarbonisation projects.
	Loan	Initial capital and delivery mechanism for UK Property Assessed Clean Energy schemes.

THE ROLE OF A GREEN SOVEREIGN BOND

"A Green+ Gilt that combines green investment with clear social and economic benefits will reinforce the UK's reputation as a centre for financial innovation, while mobilising capital that will benefit both people and planet. As well as being a clear signal of commitment to building back better it will catalyse wider green+ bond issuance ahead of COP 26."

DAME ELIZABETH CORLEY
CHAIR, IMPACT INVESTING INSTITUTE AND BOARD MEMBER, GREEN FINANCE INSTITUTE[83]

Green Gilt

The Aldersgate Group welcomes the announcement of a green+ gilt, or green sovereign bond. Currently, less than 3% of the global green, social and sustainable bond market is denominated in Sterling, so the issuance of the UK's first green sovereign bond marks a significant step in the right direction.

Green bonds are a cost-effective way to crowd in the private financing required to deliver green and climate focused projects, and engage the public in financing net zero during the economic recovery to COVID-19. **Green sovereign bonds tend to have a low risk profile, and are therefore complementary to the UKIB, which will need to have a high risk profile so it can de-risk new technologies and drive funding to market failures.** The green sovereign bond can help to deliver a sustainable recovery from COVID-19 which will deliver multiple goals for the UK such as tackling regional inequality, and generate growth of a new type of financing tool for risk-averse funders across the country.[84]

83 LSE Grantham Research Institute on Climate Change and the Environment, Green Finance Institute & Impact Investing Institute (October 2020) *The Green+ Gilt: How the UK could issue sovereign bonds that deliver climate action and social renewal*

84 *Ibid.*

Key policy recommendations include:

1 **The Aldersgate Group would welcome publication of the UK's sovereign green bond (green gilt) framework as soon as possible,** ideally well ahead of COP26. This framework should include a commitment that revenue raised through the projects funded by green bonds to be reinvested into green projects, for example by directing the interest into the UKIB.

2 **The government should outline how the green gilt will sit alongside the UKIB to ensure there is a joined-up strategy to deliver low carbon and environmental projects.** As the UKIB will be leading on the government's investments into domestic low carbon infrastructure, integrating these financing initiatives can ensure decision-making does not become siloed. Publishing a framework to link the two will be crucial to overcoming this, and its execution will need to be supported by a cross-departmental working group. **Ideally, the green sovereign bond would be folded into the UKIB's fund management, with the UKIB responsible for holding and disbursing the debt capital raised through the issuance of green bonds.**

3 **The government should ensure that social co-benefits are identified through *ex ante* (before the fact) allocation reporting and include biodiversity conservation, adaptation and future-fit as co-benefits, in addition to jobs created and local growth.** Allocation reporting must be completed during the project's development and planning phase, rather than waiting to include it during annual reports, to ensure appropriate budgets are allocated to delivering identified co-benefits from the outset. All social co-benefits will need well-defined social metrics to ensure accuracy of measurement in impact and allocation reporting. The government must also ensure that *ex post* (after the fact) reporting on project benefits delivered is to a high quality, to encourage other nations to publish similarly detailed reports on their own green gilts. Doing so can help to increase international competitiveness and improve the quality of projects funded by green gilts over time.

4 **To further crowd in financing for nature and natural capital in particular, we encourage the UK government to issue a nature performance sovereign bond.** Current estimates suggest that only 4% of green bonds are used to fund biodiversity conservation.[85] Such a bond could be used to finance further trials of nature-based solutions, such as those carried out recently by the Environment Agency, to provide new learning and models which can be scaled up across public and private sectors. The bond could also support the work of the Taskforce for Nature-based Financial Disclosures, and help to deliver policies which are in accordance with the findings of the Dasgupta Review (see section 3.2 for further information about investing in nature and the Environment Agency trials).

85 HM Treasury (February 2021) *The Economics of Biodiversity: The Dasgupta Review*

FOUR THE INTERNATIONAL STAGE

This section explores the UK's role on the international stage, with recommendations for delivering strong climate diplomacy ahead of COP26 and continuing to work with the European Union on areas of mutual interest.

4.1 Working with the European Union

Whilst the exit of Britain from the European Union offers many opportunities for the UK to collaborate at an international scale, it is important to ensure that a good working relationship remains between the UK and EU on matters of climate and environmental policy. Many business members of the Aldersgate Group operate both within the UK and the EU, with manufacturing, supply chains and offices in different nations. As the UK establishes its own policies around green finance, which offer opportunities for improvement, these members are calling for consistency, where possible, between new UK policies and former EU ones, to enable them to continue their operations as close to business as usual as possible in the near term.

Areas of interest to business for collaboration between the UK and EU include:

- **power sector decarbonisation** – with the grid in the UK linked to mainland Europe – and the development of a renewable energy hub in the North Sea;
- regulatory approaches to **accelerate the shift to low emissions transport** and smart mobility;
- the future of **product standards and environmental standards** in accelerating the shift to net zero emissions, greater resource efficiency and nature restoration; and
- **green finance taxonomies and disclosure requirements.**

Given the leadership shown by the EU and the UK on the green finance agenda to date, a degree of collaboration on areas such as disclosure requirements, the development of sustainable financial product definitions, green bond issuances, and rules on capital allocation levels, would be beneficial.

Key policy recommendations include:

1 **The UK should collaborate with the EU on wider environmental policies regarding carbon pricing and product standards, such as plastic taxation and resource efficiency, as this would promote a "race to the top" on climate and environmental issues.** This includes aligning the future trajectory of carbon pricing under the UK and EU Emissions Trading Schemes (as outlined in section 3.1), as this linkage can increase liquidity and strengthen the investment signal provided by both schemes. It is also important that the UK collaborates closely with the EU to protect the competitiveness of low carbon industries through measures such as carbon border adjustments, an update to public procurement rules and product standards driving down the levels of embodied carbon and resource use in industrial products.[86]

2 **The UK should continue to work with the EU on global climate diplomacy.** Given their history of joint climate diplomacy in the run up to and during major climate summits, it would be highly beneficial for the UK and the EU to collaborate and join up negotiation approaches ahead of COP26 (the presidency of which the UK is sharing with Italy), as well as other relevant events such as the Convention on Biological Diversity in China and the G20 summit. This in particular would be beneficial ahead of COP26, as the UK and the EU have increasingly recognised the importance of global cooperation on climate adaptation in recent years and are both supportive of building international coalitions in this area, and could therefore work together to establish working groups on key areas of interest for the negotiations, such as green finance and nature.

86 For more information see Aldersgate Group (October 2020) report *Building a net zero emissions economy: Next steps for government and business*

4.2 Climate diplomacy and COP26

Through the hosting of the COP26 in 2021, a crucial year for tackling climate change and recovering from COVID-19, the UK holds a unique opportunity to drive global change. The UK has already made a number of big announcements of international relevance for the future of green finance, including changes to what UK Export Finance will fund, a revised Nationally Determined Contribution (NDC), the announcement at the Biden Climate Summit to deliver the Sixth Carbon Budget by 2035, and widening the scope of mandatory reporting within the TCFD.

However, climate change is an international issue, and so international collaboration is needed to ensure that vulnerable countries are supported during the transition to net zero, and to align COVID-19 recovery packages with the goals of the Paris Agreement. The UK must therefore demonstrate its commitment to a global effort to tackling climate change through domestic policy. **This should include the publication of a net zero strategy ahead of COP26** (for more details please see section 3.1) **and maintaining the historical commitment of 0.7% of Gross National Income on overseas aid, ensuring this is net zero and climate adaptation aligned.** Taking these steps will send a strong signal of the ambitions of the Presidency to both developed and developing nations, and help to make the negotiations more dynamic and productive.

Priority progress areas for the COP26 Presidency include:

1. **The COP26 Presidency must secure a post-2025 agreement which provides adequate climate finance to support vulnerable nations.** The existing funding gap between the committed US$100 billion per year from 2020 and the actual level of climate finance mobilised – estimated at US$67 billion in 2020 – must also be addressed.[87] The Aldersgate Group supports the finance priorities set out by the Presidency in January 2021, which include mobilising private climate finance, increasing the allocation of finance – in particular grants – to the poorest and most vulnerable, and providing greater levels of finance for adaptation and resilience.[88] It is critical that deals are secured on these issues at COP26.

2. The UK's current policies are not sufficient for reducing emissions in line with the Paris Agreement, and instead put the UK in line with delivering between 2°C and 3°C of warming.[89] Though the UK recently committed to delivering the CCC's Sixth Carbon Budget, the policies to get us there are yet to be confirmed. **The UK will need to outline its plans to deliver its NDC ahead of COP26, to send the right signal to developing countries, and encourage other developed nations to do the same,** in particular by working with the new Biden administration in the US.

87 OECD (October 2016) *2020 Projections of climate finance towards the USD 100 billion goal technical note*

88 COP26 Presidency (January 2021) *Priorities for public climate finance in the year ahead*

89 https://bit.ly/3iSqpjd [Accessed 30 April 2021]

3 **The COP Presidency must address the international adaptation funding gap.** Historically, adaptation funding has been a major negotiation point for developing countries at COP, with the Paris Agreement delivering a huge piece of progress by encouraging all developed nations to commit to supporting developing nations with significant adaptation funding.

However, the majority of climate finance still flows towards mitigation projects, which have a clearer investment revenue and returns stream, and as such a large adaptation funding gap remains, with the OECD reporting that just over one fifth of climate finance was spent on adaptation in 2019.[90] This adaptation funding gap is likely to be a major focus for developing nations at the negotiations, and if the UK can set out its domestic policies on adaptation-related financing – such as by clarifying how the TNFD will be used as a stepping stone towards mandatory publication of biodiversity loss mitigation and adaptation targets and transition plans (see section 2.3 for more information) – these will provide positive starting points for negotiations.

4 **Whilst developing the UK's own green taxonomy, green bond standards and climate- and nature-related financial disclosure requirements, the government should seek to foster greater international harmonisation of approaches.** It should pursue active and ongoing dialogue with all the jurisdictions leading the global regulatory developments on these policy areas. For example, in November 2020, the Chancellor announced that the UK will create a new green investment taxonomy – a framework for determining which activities can be defined as environmentally sustainable – which will take the scientific metrics in the EU taxonomy as its basis. As the European Commission (EC) is in the process of redefining its Taxonomy – and there have been hints that the Taxonomy will be adopted by the US under the new Biden administration, which would align US and European sustainability standards[91] – the Aldersgate Group recommends that the UK government continues to engage with the Platform on Sustainable Finance established by the EC to advise them on the technical screening criteria for the EU taxonomy, and engages with the US and other jurisdictions on the same topic. Doing so will ensure that green finance policy is compatible at the international level.

5 **Finally, it is vital that the COP26 Presidency and the UNFCCC ensure that a regulated international voluntary carbon market is established through the creation of Article 6 "rulebook" and finalising the Paris Agreement, and that the rulebook includes frameworks for using and regulating carbon offsetting.** Delivering the rulebook for an international carbon market has the potential to significantly raise climate ambition and reduce decarbonisation and transition costs, as well as protect and restore nature around the world.[92]

However, the offsetting industry is growing but is currently unregulated. The current draft Article 6 rulebook does not explicitly refer to offsetting. Significant investment into offsetting without an established carbon market could lead to problems such as double-counting the same emissions reduction mechanisms – for example, the same trees could be listed as sequestering double the amount of carbon as intended. This could invalidate a business or individual's investment and potentially lead to increased emissions as businesses produce emissions under the assumption they are reducing emissions through offsetting.

90 Climate Change News (6 November 2020) "OECD: One-fifth of climate finance goes to adaptation as share of loans grows"

91 Euractiv (10 March 2021) "France proposes common US-EU rules for green finance"

92 Carbon Trust (29 November 2019) "In-depth Q&A: How 'Article 6' carbon markets could 'make or break' the Paris Agreement"

A further problem could arise from the fact that developing countries are now asked to provide a Nationally Determined Contribution and are therefore disincentivised from selling carbon offsets to businesses in favour of counting carbon reductions towards their own NDC progress. Without an Article 6 rulebook there is a risk that the market for offsets will be squeezed and cause spikes in carbon prices which would undermine recent investment into offsets.

WHAT IS ARTICLE 6?

The Paris Agreement has a section – Article 6 – which sets out initial guidelines for creating an international carbon market which is regulated to ensure its efficiency. As part of the UK's hosting of COP26 in November 2021, it is part of the Presidency's responsibility to create an Article 6 "rulebook" which would thereby complete the Paris Agreement. It has been argued that the success of the Paris Agreement hinges on Article 6,[93] with some estimates placing the potential climate transition savings from a globally integrated carbon market under Article 6 at hundreds of billions of dollars each year,[94] making its finalisation a key priority in the negotiations for the COP26 Presidency.

This is the last part of the Paris Agreement to be agreed upon by UNFCCC members, and has proven difficult to negotiate, which led to a delay in 2019 at COP25 in Madrid. One of the major sticking points is around whether carbon credits already in the market under the Clean Development Mechanism (CDM) of the Kyoto Protocol – which have historically had such a low carbon price that they have been effectively worthless, at close to US$0.2/t$CO_2$e[95] – should be transferred to the new Article 6 System. If they are transferred there is a risk that the new carbon market will once again be flooded with credits and the price of carbon will stay low. If they are not transferred, countries with existing major CDM projects – which are overwhelmingly in developing countries, such as Brazil and India[96] – could be negatively impacted by losses resulting from the transition.

93 *Ibid.*

94 IETA & Carbon Pricing Leadership Coalition (September 2019) *The economic potential of Article 6 of the Paris Agreement and implementation challenges*

95 Carbon Brief (19 November 2019) "In-depth Q&A: How 'Article 6' carbon markets could 'make or break' the Paris Agreement"

96 https://bit.ly/3pHCvNN [Accessed 29 April 2021]


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2 **Finally, the COP Presidency and the G20 Presidency could, ahead of COP in November, establish working groups between nation delegates on key focus areas of interest.** For example, it could establish a Nature Investment Coalition and bring in nations which have demonstrated a key interest in investment in nature, such as Costa Rica, to share their learnings with those which have struggled. Such knowledge sharing can lead to greater relationship building and overall global progression towards the UN Sustainable Development Goals.

Key initiatives for the UK to co-launch ahead of COP26:

1 **The government should set a key aim for the G20 negotiations to deliver more green recovery packages from COVID-19 than were committed after the 2008 financial crisis.** Early analysis by Vivid Economics published in their Greenness of Stimulus Index 2021 report suggests that global recovery packages are less green than those of 2008.[97] The government should encourage all nations at the G20 summit to agree to a minimum commitment policy, a benchmark which could be developed during the negotiations. Doing so would signal to developing countries that the highest-emitting economies are using the pandemic as an opportunity to pivot away from industrial activities which are carbon-intensive and towards low carbon industrial overhauls, in line with the UK government's Green Industrial Revolution objectives. Such a pivot would have major implications for a trickle-down effect across the globe, by making emerging technologies and nature-restoration markets a major growth area for international exports.

97 Vivid Economics & Finance for Biodiversity Initiative (February 2021) *Greenness of stimulus index*

FIVE SUMMARY OF ALL POLICY RECOMMENDATIONS

This section gives an overview of all of the recommendations included in this report, which outline actions to be taken throughout the 2020s.

This overview is divided into recommendations for government, for financial institutions and regulators. It also contains a range of recommendations where the UK government can drive positive change through the international stage, such as through the upcoming COP26 and G20 summits.

5.1 For government

Next steps for Climate-related Financial Disclosures

1. Carry out **a consultation to review the different guidance, standards, definitions and frameworks in use with regards to climate-related disclosures**, to help streamline the process of disclosing and reduce reporting burden. The review should lead to the publication of guidance for navigating disclosures, clarifying definitions and reporting for emissions classifications (particularly Scope 3), and should aim to integrate different existing ways of reporting into the Taskforce for Climate-related Financial Disclosures (TCFDs) framework over time.

2. The government should **adopt policies which will encourage greater levels of voluntary disclosures reporting for businesses which will not be required to report on a mandatory basis until 2023.** This should include updating procurement rules to drive demand for goods and services from companies already disclosing in line with TCFD recommendations, building on the Green Book guidance to policymakers.

3. Ensure the **UK Centre for Greening Finance and Investment (UKCGFI) is equipped to help businesses and financial institutions cultivate transparent and authentic reporting, with a Corporate Reporting Lab** to support laggard industries and enable companies to share learnings created to sit within the UKCGFI. The UKCGFI must also support SMEs.

Embedding climate- and nature-positive decision-making into financial institutions

4. The government, with strategic leadership from the Bank of England, should **open a consultative process to develop a roadmap for introducing mandatory net zero targets and transition plans for financial institutions (FIs) throughout the 2020s**. The Aldersgate Group recommends 2025 as a realistic start date for introducing such regulation. Part of this consultative process should involve **regulators providing guidance to support and encourage FIs to publish net zero transition plans and targets** on a voluntary basis no later than 2022.

5. The government should **begin to disclose the impacts of biodiversity loss, climate adaptation and carbon emissions risks on its own accounts,** and should report on voluntary areas of disclosures which businesses have reported to be tricky to navigate, such as Scope 3 emissions and scenario analysis.

Embedding nature's value into economic and investment decision-making

6 The government should commit for **the newly created Taskforce for Nature-related Financial Disclosures (TNFD) to be aligned with the TCFD,** and clarification on how mandatory disclosures in line with the TNFD will be introduced throughout the 2020s. Ensure that the TNFD is used as a stepping stone towards mandatory publication of biodiversity loss mitigation and adaptation targets, and associated transition plans.

7 Following publication of the Dasgupta Review, **HM Treasury must take a leadership role on developing a cross-government framework for fully incorporating nature into economic policy decision-making.** The first steps towards achieving this are to clearly outline nature-related spending in the Budget and forthcoming Comprehensive Spending Review, and to incorporate these issues into the Green Book.

8 **Set out the process for developing a more visible, accessible and applicable framework for measuring nature and identifying dependencies between business operations and biodiversity**, including common standards for monitoring and evaluating biodiversity investment.

Accelerating private investment through clear policy signals: low carbon infrastructure, goods and services

9 Publish ahead of COP26 **a comprehensive and well joined-up net zero strategy which sets out the key policy interventions that will be adopted over the next five to ten years on a sector-by-sector basis**, with interdependencies between sectors clearly highlighted.

10 The Strategy should **include regulatory drivers, market mechanisms and fiscal policy interventions to attract investment to sectors where market failures are particularly pronounced** and currently hampering the transition to net zero emissions. This could include, for example:

- binding regulatory standards and tax rebates to drive investment in **energy efficiency and low carbon heat** in existing buildings;
- revenue guarantee mechanisms, such as Contract for Difference schemes for **green/low carbon hydrogen production;**
- **product standards and green public procurement criteria** to grow the demand for low carbon industrial products; and
- greater clarity on the future **carbon pricing trajectory** in the UK (see point 11).

11 Set a predictable and rising carbon price escalator throughout the 2020s, by **consulting on next steps for aligning the UK ETS with net zero and continue revising the minimum price for carbon allowances** so that it increases gradually. The government should also adjust the shadow price of carbon.

12 In support of providing a predictable and meaningful carbon price trajectory, **the government should take steps to strengthen the UK-ETS.** This should include reviewing and gradually reducing the number of free allowances and credits available under the UK-ETS, **consulting on how best to include other sectors under the UK-ETS** (such as agriculture, buildings and surface transport) and **considering the introduction of a carbon tax** in sectors where the inclusion of a sector in the UK-ETS may not currently be feasible.

The UK-ETS should also be aligned with the EU-ETS to offer stability to businesses which have experience trading within the EU-ETS, along with other advantages associated with trading in a bigger market, including greater liquidity, price discovery, and the ability to attract abatement from across Europe rather than just the UK.

13 Publish **guidance regarding domestic offsetting regulation and allowances** for UK businesses, which should be developed in partnership with climate scientists to ensure offsetting does not lead to unintended emissions increases.

Directing finance to protect biodiversity and ecosystems: natural capital and nature based solutions

14 Rapidly **finalise the Environment Bill and ensure it establishes a target setting framework which has ambitious long term targets and interim targets.** This should be complemented by a clear requirement for the government to produce Environmental Improvement Plans, setting out clear policies to achieve these targets

15 Explore opportunities for **co-financing nature restoration projects with actors in the private sector,** including through the use of public financing mechanisms such as guarantees and long term contracts to help create revenue certainty for investors.

16 Design Environmental Land Management **(ELM) schemes** in such a way as to make it easier for landowners, ecologists and private investors to develop public-private partnerships.

17 Introduce **Environmental Investment Tax Relief** to incentivise individual taxpayer investment into nature, building on the example of the existing Social Investment Tax Relief (SITR) scheme, but with modifications to increase take-up.

18 The government should create **a publicly available database of the types of nature-based solutions projects available for investment,** to help businesses identify which nature-based solutions fit with their business operations. The government should also ensure all government data on natural capital is open source.

Crowding in private investment through the UK Infrastructure Bank

19 The Aldersgate Group welcomes the UKIB's existing mandate to tackle climate change and support regional and local economic growth. Given the UK's broader environmental and levelling up commitments, **the UKIB should have a legal mandate to achieve the levelling up agenda and the UK's climate change mitigation and resilience goals** as the key driver for supporting recovery, fairness, and a just transition. **The mandate will also need to have flexibility built in,** so the Bank can respond to changing market failures and infrastructure needs over time.

20 **Ensure the Bank is independent, with full banking and borrowing powers.** The Bank should be led by a private banker, accompanied by a board which is multi-skilled, diverse and representative of the UK.

21 The institution's **capitalisation level should be appropriate to its mission and functions,** to send the right signal to the private sector, and must be able to access capital markets for both debt and equity. Although the Bank's capitalisation should increase over time, the initial amount committed is a good start. The Bank should not focus on returns.

22 The Bank should employ an **active strategic mission to crowd-in private investment, mobilising the markets by virtue of its demonstration effect.** The Bank should also bring adaptation into project development and design, and not just mitigation, to ensure infrastructure is future-fit.

23 **The UKIB must consult local authorities (LAs) on UKIB projects,** to harness local knowledge and facilitate collaboration between local players and central government in the implementation of UK's climate and environmental strategies.

24 The Bank should aim to **measure its success through not only financial returns but also through other KPIs** linked to green activities and levelling up, such as emissions reduced, targets for nature restoration achieved, and green jobs created.

Crowding in private investment through the UK's first green sovereign bond

25 Outline **how the green sovereign bond (green gilt) will sit alongside the UKIB** to ensure there is a joined up strategy to deliver low carbon and environmental projects.

26 Ensure that **social co-benefits are identified through ex ante (before the fact) allocation reporting** and include biodiversity conservation, adaptation and "future fit" as co-benefits, in addition to jobs created and local growth.

27 Crowd in financing for nature and natural capital in particular by **issuing a nature performance sovereign bond.**

Working with the European Union on taxonomies, disclosures and areas of mutual interest

28 **Collaborate with the EU on wider environmental policies of mutual interest such as carbon pricing and product standards** to create a "race to the top" on climate and environmental issues.

29 Continue to **work with the EU on global climate diplomacy** to grow the number of countries adopting net zero emissions and nature restoration targets and secure global collaboration for a green economic recovery following the COVID-19 crisis.

5.2 For financial regulators and institutions

Next steps for Climate-related Financial Disclosures

30 **Regulators should provide guidance to improve the voluntary reporting of scenario analysis, with the view for mandatory scenario analysis to be introduced from 2025.** Guidance should be structured around disclosure of risks based on, first, company exposure (Value at Risk) to different events occurring, and, secondly, the probability of the event occurring under different scenarios (for example, 1.5°C, 2°C).

31 Regulators should **set new guidelines encouraging businesses to include heads of departments in every stage of the disclosures process,** and mandating the dissemination of findings throughout their teams, from operations to procurement to HR.

Embedding climate- and nature-positive decision-making into financial institutions

32 Regulators should, by the end of 2022, **publish guidance to support and encourage Financial Institutions (FIs) to voluntarily produce net zero targets and transition plans.**

33 Building on the flexibility provided by the UK's departure from the EU and as part of integrating European legislation into UK law and policy, **policy makers and regulators should move to embed environmental sustainability into the regulatory framework governing the UK's financial system.** This current Future Regulatory Framework (FRF) Review provides a live opportunity to do this and to amend the Financial Services and Markets Act accordingly.

34 UK policy makers and regulators should work together to **set capital treatment for insurers and banks in such a way as to reflect the long term risks of assets , thereby incentivising more strategic asset allocation in environmentally sustainable assets** and a transition away from high carbon or environmentally damaging investments.

35 Financial institutions must take steps towards **mainstreaming climate and nature knowledge across all staff working in the financial sector** in the UK. This should involve recruiting new staff members with backgrounds in carbon accounting, ecology and climate risk management. Training for existing staff should also be encouraged, for example through the Green Finance Education Charter, or through the CFA UK Level 4 Certificate in ESG Investing.

36 **Pension fund managers should introduce measures to close the £2.17trillion "green gap" within UK pensions by automatically enrolling new beneficiaries into Environment, Social and Governance (ESG) schemes for pension funds and engaging with existing beneficiaries to outline the benefits of transferring fund holdings into ESG schemes**. The UK government and The Pensions Regulator should also offer greater support and knowledge around ESG investment to asset managers and companies outsourcing their pension management.

5.3 The international stage

The COP26 Presidency's priorities at COP26:

37 The COP26 Presidency must **secure a post-2025 agreement which provides adequate climate finance to support vulnerable nations** and addresses the adaptation funding gap.

38 **Outline the UK's plans to deliver its NDC and long term net zero target ahead of COP26,** to send the right signal to other countries and encourage other developed nations to do the same.

39 Build on the White House Climate Leaders Summit and **continue to drive more ambitious NDCs from all major economies.**

40 **Whilst developing the UK's own green taxonomy, standards and disclosure requirements, the government should seek to foster greater international harmonisation of approaches.** It should pursue active and ongoing dialogue with the all the jurisdictions leading the global regulatory developments on these policy areas.

41 The COP26 Presidency must **finalise the rule book for Article 6 of the Paris Agreement in order to deliver a well-regulated and voluntary international carbon market.** The rulebook must include frameworks for using and regulating carbon offsetting, as significant investment into offsetting without an established carbon market could lead to problems such as double-counting the same emissions reduction mechanisms.

Key initiatives for the UK to co-launch ahead of COP26:

42 **The UK should ensure G20 negotiations lead to a commitment from high-emitting nations to a green economic recovery by ensuring recovery packages are greener than those committed after the 2008 financial crisis and commit to collaborating on green economic recovery approaches.** This will send a signal to other nations that the highest-emitting economies are using the pandemic as an opportunity to pivot away from high-carbon activities and towards the deep decarbonisation of industrial sectors across the economy. This could be delivered by encouraging all nations at the G20 summit to agree to a minimum commitment policy, a benchmark which could be developed during the negotiations.

43 The COP26 Presidency should, ahead of COP in November, **establish working groups between nation delegates on key focus areas of interest**, for example by establishing a Nature Investment Coalition and bring in nations which have demonstrated a key interest in investment in nature, such as Costa Rica, to share their learnings with those which have struggled.

44 In addition to publishing a detailed net zero strategy at COP26, the UK government would maximise its influence at the summit and beyond by **maintaining the historical commitment of 0.7% of overseas development assistance,** which must be aligned with commitments on net zero and climate adaptation.

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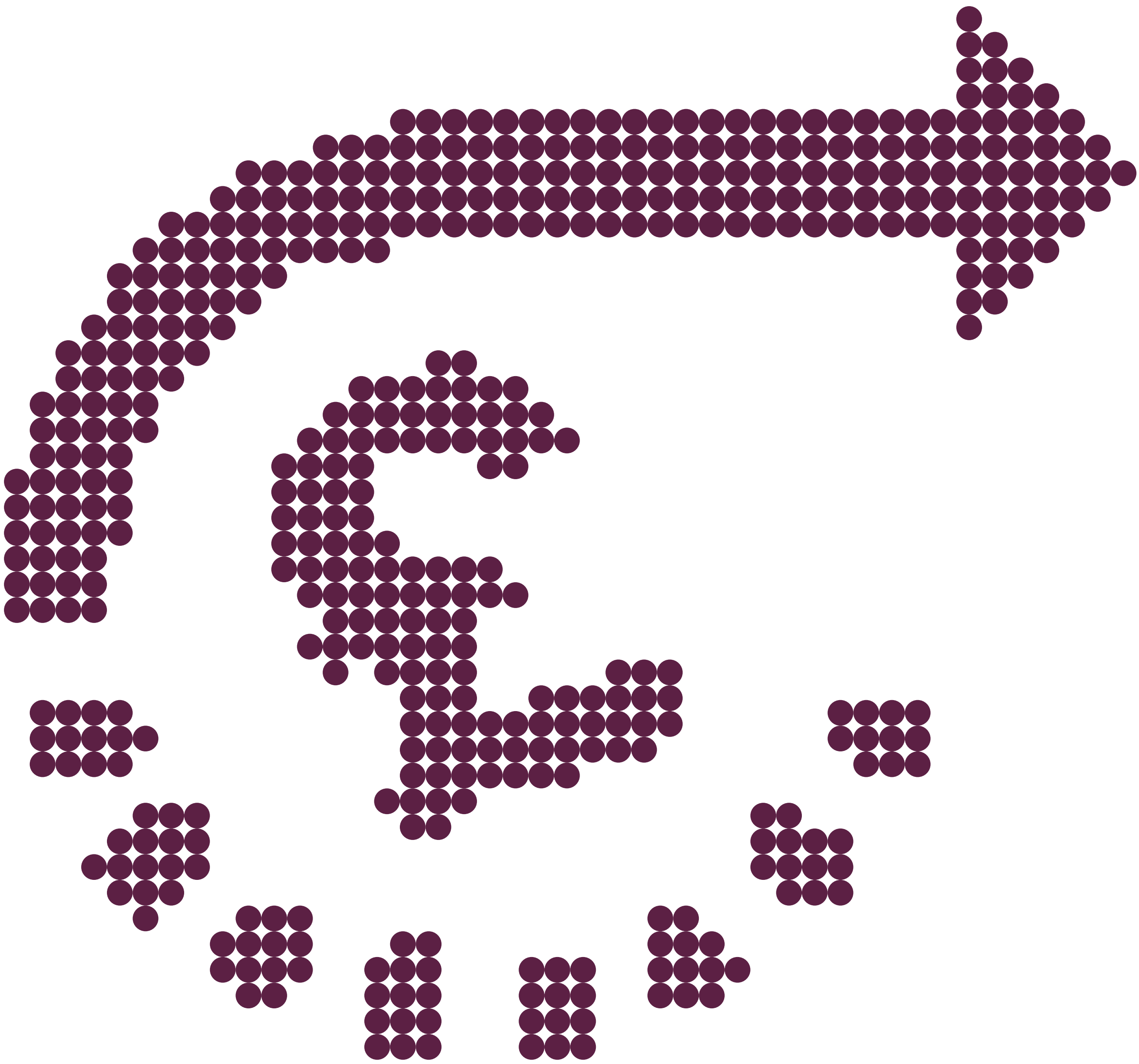

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