



**LEGISLATIVE BRIEFING**

**Summary Critique of the Legislation Establishing the Green  
Investment Bank**

**29 May 2012**

## POLITICAL FOREWORD

The Green Investment Bank will be a world first institution fulfilling a vital public purpose – unlocking private sector investment in environmentally transformational technologies. With up to 1 trillion needed by 2030 to upgrade and decarbonise UK infrastructure,<sup>1</sup> and up to 70% of this needed in green technologies,<sup>2</sup> there is good evidence to suggest that we will not achieve our decarbonisation targets without a fully fledged GIB<sup>3</sup>. The legislation establishing the GIB has now been revealed and will soon initiate in parliament as Part 1 of the *Enterprise and Regulatory Reform Bill*. The passage of the GIB legislation is of historic importance.

Getting the legislation right is a critical test for the success of the GIB, and will affect the efficacy and credibility of the Bank long into the future. The passage of the GIB legislation occurs against the backdrop of increasing realisation of the urgent need to stimulate economic growth in the UK. The IMF has recently called on the UK to stimulate growth and lead the UK out of recession. The GIB is a natural choice for this growth engine, with the potential to be a catalytic economic actor simultaneously making large strides in environmental protection while stimulating economic growth in the green technologies and services of the future.

However, on establishment, the GIB will not be allowed to borrow. The Government has only given a flimsy conditional commitment regarding borrowing from 2015, subject to national debt falling sufficiently, and the legislation and company constitution do not provide any assurance that the GIB will ever be allowed to borrow from the capital markets in practice. Barriers include opposition from the Treasury, and the need to seek State aid clearance from the European Commission – steps the Government has still not yet taken. A bank that is not allowed to borrow cannot be described as a Bank, and investors will notice this. The legislation provides an opportunity to strengthen the commitment to borrowing and send a signal to investors across the globe that the intention is for the GIB to engage in key bank like activities soon – namely borrowing from the capital markets, so it can raise and direct funds at the scale necessary. We call for legislative amendments to commit to borrowing.

A key test for this legislation is whether or not it ensures that the Bank may only support projects that are truly ‘green.’ We have concerns that the legislative mandate is overly broad. It does not rule out the possibility of the GIB funding high carbon or other non green sectors, provided that the project merely represents gains in resource efficiency. This significantly undermines the environmental credibility of the GIB, and requires legislative amendment.

In the wake of the banking crisis, another key test was whether the legislation established highest standards of transparency and accountability to the public and stakeholders. While some of our recommendations regarding annual reporting have been met, it is of significant concern that the Government has shied away from requiring any formal or public facing review of the progress of the GIB, or consultation requirements. The monitoring that the Department (BIS) will undertake as sole shareholder is proposed to take place behind closed doors. Unless amended, this represents a barrier to stakeholder, departmental and public engagement in the future of the GIB, as well as undermining the ability to hold it to account.

## Executive Summary

1. The legislation establishing the Green Investment Bank (GIB/the Bank) has now been revealed as Part 1 of the *Enterprise and Regulatory Reform Bill 2012*. As the GIB is also being formed as a Companies Act company, its constitution and other corporate documents were revealed on formation on 14<sup>th</sup> May 2012.
2. ClientEarth is a leading European environmental law organisation. In 2010-11 we collaborated with Transform UK on demonstrating why it was essential to establish the GIB by legislation. Since then, we have undertaken extensive legal policy work on the optimum statutory design for the GIB, culminating in a parliamentary launch of model legislation in late 2011.
3. This briefing contains summary analysis of the strengths and weaknesses of legislation. We find that while the Government's draft contains a number of positive and called for elements, the legislation is overly 'light touch' and contains a number of significant deficiencies that may undermine the credibility and effectiveness of the Bank unless amended.
4. Specifically, we have identified the following top 3 concerns:
  - While the entrenchment of a legislative **green mandate** is welcome, the construction of the purposes of the GIB is overly broad, and fails to prevent the Bank from supporting high carbon or other general infrastructure provided that gains in resource efficiency are made. This undermines the environmental credibility of the Bank.
  - A key test for the legislation and company constitution was whether it provided visibility and certainty to investors that the GIB will be able to borrow from the capital markets in the near future, and enjoy a State guarantee. The legislation does contain an enabling power for State guarantee and this is welcomed. However it contains **no indication that the Bank will be ever be allowed to borrow in practice**.
  - In the wake of the banking crisis, the GIB should be required to uphold the highest standards of public **accountability and transparency**. The legislation does not contain any provision for any formal or public facing review of the progress of the Bank, and no requirements for stakeholder or public consultation. The constitution provides that the monitoring of the Bank that will be done by BIS as shareholder, will occur behind closed doors. This is unacceptable for a novel institution fulfilling a critical public purpose.

## Background

5. The UK Green Investment Bank PLC (Green Investment Bank company) was formed on 14<sup>th</sup> May, established as a public limited company limited by shares, with the Department (BIS) as sole shareholder. The GIB company will be guided and constrained by its constitution – made up of the Articles of Association, and certain elements of the Shareholder Relationship Framework Document (Framework Document). The GIB company directors will also be governed by the provisions of the Companies Act 2006.
6. The GIB company constitution is in turn constrained by the GIB legislation, which has recently been published as Part 1 of the *Enterprise and Regulatory Reform Bill*. This Part comprises only 6 clauses, and is anticipated to initiate swiftly in the House of Commons. This briefing presents summary analysis of how the Government's proposal stacks up against key criteria to benchmarks its success, as set out by ClientEarth, Transform UK and other stakeholders throughout 2011-12. More detailed analysis, accompanied by recommendations for legislative amendments, will follow shortly.

## Issues –

### The Green Mandate

7. ClientEarth and Transform UK recommended a carefully defined mandate cemented in legislation. The ClientEarth model included a list of exclusions and legal prohibitions to ensure the Bank's activities were truly green, while retaining a necessary degree of flexibility to allow the Bank to respond to emerging technologies and environmental problems. We also called for legislative enshrinement of a non-exhaustive list of priority sectors to minimise policy risk for investors.
8. In the Government's model, the mandate of the GIB is located in the purpose clause (clause (1)) of the draft legislation, replicated in Article 3 of the Articles of Association. This mandate is entrenched in legislation and the GIB company cannot lawfully amend its constitution to fund projects that do not fit within the mandate. However, ClientEarth advises that the construction of this green purpose is overly broad, to the extent that it does not legally prevent the Bank from supporting projects that would not normally be considered 'green.' With priority sectors determined by BIS as sole shareholder (at least for the first chapter of the GIB's existence) this would allow for a dilution or perversion of the Bank's green mandate in practice.
9. In particular, we advise that clause (1)(1)c) significantly undermines the environmental credibility of the Bank. This enshrines the green purpose of '*advancement of efficiency in the use of natural resources.*' The Bank is only legally required to fulfill one or more of the purposes in clause 1 to satisfy the green test.<sup>4</sup> Therefore, in its current form the legislative mandate of the Bank would permit, to give a drastic example, the support of highest efficiency gas power generation, even

without any CCS component. Support of other general infrastructure projects or sectors not normally regarded as ‘green’ would also be lawful provided the investment activity met new or best practice standards for resource efficiency. This would be bad news, as it is clear that the Bank’s role must be to unlock transformational change and truly green growth. As no exclusions or legal prohibitions have been included in the legislation, the Government’s model relies largely on political pressures to hold the Bank and future Government shareholders in check regarding fulfillment of a truly ‘green’ purpose.

10. A list of priority sectors has not been included in the legislation, but does appear in the company constitution.<sup>5</sup> While this focus for the Bank is positive, the decision to place it in the constitution alone means that in practice, it fails to provide investors with any certainty beyond electoral cycles. The next government can amend the constitution to introduce an entirely new set of priority sectors, (provided they fit within the extremely broad purposes in clause 1 of the legislation) and the Bank would be bound to adhere to such a change. On balance, the enshrinement of priority sectors, coupled with the constitutional requirement that the Bank direct at least 80% of its fund to these priorities, is certainly preferable to no enshrinement of the Bank’s focus, and is likely to go some way to bolstering the confidence of investors in these sectors. However, as a number of sectors are known with high certainty to require prioritization on decadal time spans, we still recommend placing a non exhaustive list of priority sectors in the legislation.

#### **Benchmark performance:**

- **The legislation cannot be said to ensure a truly green mandate for the Bank, or rule out high carbon investment. This significantly undermines the environmental credibility of the GIB.**
- **Neither the legislation nor the company constitution succeed in minimizing policy risk for investors beyond the next election.**

#### **Priority recommendation:**

- **Clause 1) of the legislation requires amendment. It must be tightened and/or coupled with legal exclusions ruling out the possibility of the Bank supporting high carbon projects or other environmentally harmful activities, while preserving enough flexibility to respond to emerging technologies and challenges.**

### **Enabling and signaling a real Bank**

11. Transform UK and ClientEarth called for the legislation to contain enabling powers for a State guarantee, and to provide visibility and certainty that the GIB will be allowed to borrow from the capital markets in the near future. We argued that without these features, the GIB could not be properly described as a Bank of any sort, and

would be unable to play a catalytic role in meeting decarbonisation or green growth objectives. Lack of visibility on these critical features would risk undermining investor confidence in the early years of the Bank, and may make it easier for future governments to shy away from allowing borrowing.

12. The draft legislation does contain an enabling power for State guarantee in clause 4(3)(c). This is a welcome addition and positive step in the right direction.
13. Regarding borrowing however, the legislation is silent regarding borrowing from persons other than the Secretary of State. This borrowing from the government is to be paid out of the National Loans Fund. The constitution expressly provides that the GIB shall not borrow without Treasury consent, and provides no visibility regarding if or when borrowing from the capital markets will be permitted.
14. As the GIB will almost certainly be initially classified on the public balance sheet by the ONS<sup>6</sup>, it is conventional that Treasury retains a say over the extent of the Bank's borrowing. However, the Government has missed the opportunity to use the legislation to galvanise a commitment on borrowing, and to send a signal to investors worldwide. This omission is set against the backdrop of a highly uncertain and very conditional political commitment on borrowing, and juxtaposed against increasing national and international pressure for the UK to initiate measures to stimulate economic growth. As the Government chose not to include borrowing in its original State aid application requesting permission from the European Commission to establish the bank, this represents a legal barrier that could delay possibility of borrowing beyond 2015 unless steps are taken in the near future.

#### **Benchmark performance:**

- **The legislation does contain enabling powers for a State guarantee and this is a welcome and called for addition.**
- **The legislation provides no visibility or certainty that the Bank will ever be allowed to borrow from the capital markets.**

#### **Priority Recommendation:**

- **A legislative amendment is needed to cement the commitment to borrowing as soon as possible, to provide a signal for investors and stimulate economic growth.**

### **Independence**

15. A multitude of stakeholders and commentators agreed on the necessity of providing the Bank with operational independence from Government – essential to minimize policy risk in the eyes of investors. The Government's decision to set up the Bank as a Companies Act company with the Government as sole shareholder presented significant challenges to securing operational independence in practice.

16. For this reason, ClientEarth called for legal measures to ring fence the role of Government. We recommended using the legislation as an opportunity to qualify or limit one or two of the standard rights of shareholders provided in the Companies Act 2006, including the ability for Government as sole shareholder to dismiss a director without reason. We argued that if these sorts of measures were not established in legislation, then it would be essential to pursue new arrangements under Companies Act structures to help secure operational independence.<sup>7</sup>
17. ClientEarth considers that independence is one of the more positive aspects of the Government's final proposal, but by no means as strong as it could have been. The Government's proposal goes further in advancing the *perception* of independence than it does in providing any legal measures that are enforceable by the Bank against the Government in practice, at least until other shareholders are introduced.
18. The mechanism the Government has chosen involves a written 'independence undertaking' (Annex 1 of the Framework Document) whereby the Government shareholder essentially promises to adhere to a number of positive and essential independence principles. These include that the Government shareholder will not interfere with the day to day running of the Bank, or request the Bank to act in any particular way regarding any investment decision or category of investment decisions. While this document is not part of the constitution, it is linked with a legislative duty in clause 2(3) requiring the making of the independence undertaking, and that any amendment or revocation of it, must be laid before Parliament as long as the Crown maintains more than 50% shareholding in the GIB (clause 6(3)). In practice this will improve the perception of independence for investors. It can also be expected to further the objectives of real independence in so far as any significant or sustained breach of this undertaking may be expected to result in a Director resigning or otherwise leaking and shaming the Government. Minor breaches however may go unchecked as the undertaking is not legally enforceable against the Government shareholder.
19. Stronger approaches would have involved creating legally enforceable independence principles crafted as statutory duties in the legislation. It would also have been beneficial to limit the ability of the Government shareholder to dismiss a Director without reason. As an alternative approach, the Government could have chosen to improve real independence utilizing Companies Act structures – such as by including a minority shareholder (or non-shareholding voting member) and making the independence undertaking part of the company constitution. In this scenario, a non-government member would be introduced as guardian of the constitution with the legal power to hold the Government shareholder to account regarding the independence undertaking.
20. Other weaknesses include the provision of a power for the independence undertaking to be revoked entirely (clause 6(3)a)ii). Presumably, this has been included to preserve the ability for the Government to seize more control over the Bank if ever

necessary. The use of this power will likely be held in check by political pressures and the requirement to account to parliament.

**Benchmark performance:**

- **The legislation does require the Government to lay before parliament an ‘independence undertaking.’ The contents of this undertaking are sound and this will improve perceived and real operational independence.**
- **However, the independence undertaking is not legally enforceable against the Government in practice.**

**Recommendation:**

- **As soon as a minority shareholder is introduced, it will be essential to amend the Framework Document to make the independence undertaking part of the constitution and enforceable against the Government.**
- **The Government should consider amendments to enshrine the independence principles in the legislation.**

## **Transparency and Accountability**

### *Lack of transparent review or stakeholder consultation*

21. The most significant weakness regarding accountability is that neither the legislation nor the GIB company constitution require any kind of formal or public facing review into the practices of the bank, or its progress in attaining its mission. Of course, this does not prevent the Department from running consultations or publishing review documents from time to time, but it is unacceptable that this has not been included.
22. ClientEarth and Transform UK, as well as the GIB Commission, called for the creation of an independent advisory committee charged with independent statutory review, and independent advice. We recommended the review process be informed by public consultation requirements, as is appropriate for a publicly funded institution fulfilling a new and vital public purpose. Public consultation should also be required prior to setting of a new Business Plan.
23. In the Government’s model, not only is there no independent review of the Bank, but even the monitoring that the Department (BIS) proposes to undertake will take place behind closed doors. Paragraph 6.6 of the Framework Document provides that the Shareholder will regularly monitor the GIB’s performance in a series of meetings. It may also require the GIB to provide the Government with reports allowing for the assessment of the delivery of the green impact. There is no requirement for these

reports to be published. More broadly, there is no requirement for the Government to publish any public report into the performance of the Bank.

24. It is significant that no requirements for consultation have been included. We consider this represents a barrier to broader stakeholder and societal engagement with the practices of the Bank, which may result in shallow review and make it harder for other departments (such as DECC), stakeholders and the public to have their voice heard, or to hold the bank to account. The risk is that the future of the Bank will be left largely to the Department for Business alone. It is unacceptable to rely only on the assessments of BIS.
25. We understand that the Government's view is that statutory review is not necessary because Parliamentary committees are likely to conduct enquiries into the Bank. We do not consider that it is sufficient to rely on the ad hoc work of parliamentary committees for a public institution of such importance.

### *Reporting and disclosure requirements*

26. At minimum ClientEarth recommended the GIB be subject to the more stringent annual reporting and publication requirements contained in Parts 15 and 16 of the Companies Act, equal to the same standard as publically listed commercial banks. For the GIB, we also recommended legislative requirements for the GIB's annual reports to be laid before parliament to enhance parliamentary scrutiny. These recommendations have been answered in clause 5 and clause 6(2) of the legislation and are welcome.
27. However, in the wake of the banking crisis, the GIB legislation was an opportunity to go beyond this and set the highest standards of transparency and accountability for the GIB. We recommended enhanced narrative reporting requirements allowing for meaning assessment of how the Bank is being managed and its success in fulfilling its green mandate. We also recommended the application of the Freedom of Information Act 2000, coupled with positive duties to disclose and publish all key operational documents, with necessary exceptions for commercially sensitive data. These recommendations have not been followed.

### *Corporate Governance*

28. ClientEarth and Transform UK recommended the UK Corporate Governance Code be applied to the GIB, a relevant best practice code for corporate governance. This recommendation has been taken up in paragraph 6.1 of the Framework Document, this element being designated part of the Constitution for the purposes of the Companies Act 2006, and therefore readily enforceable against the Directors of the GIB company.

### **Benchmark Performance:**

- **The legislation contains no requirements for public facing review of the Bank’s performance and no requirements for stakeholder, departmental or public consultation. This undermines the accountability of the GIB.**
- **The legislation applies to the GIB the same standard of reporting as publically listed companies, and requires these to be laid before Parliament. However, it falls short of establishing the highest standards of transparency or disclosure.**

### **Priority Recommendation:**

- **The legislation requires amendment in the form of a new clause requiring periodic statutory review, informed by stakeholder and public consultation.**

### **NOTES:**

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<sup>1</sup> HM Treasury, Infrastructure UK (2010) ‘Strategy for National Infrastructure’ p. 1

<sup>2</sup>E3G analysis based on Holmes, I. Mabey, N. (2010) ‘Accelerating the transition to a low carbon economy: The case for a Green Infrastructure Bank’ p.9

<sup>3</sup> Ernst and Young, ‘Capitalising the Green Investment Bank’ (October 2010).

<sup>4</sup> The elements of clause 1 (1) are not cumulative, as confirmed in section 2 (2).

<sup>5</sup> Paragraph 4 of the Shareholder Relationship Framework Document. The priority sectors until 2015 are: offshore wind power generation; commercial and industrial waste processing and recycling; energy from waste generation, including gasification, pyrolysis and anaerobic digestion for the production of heat and/or power; and non-domestic energy efficiency, including onsite renewable energy generation and heat. A 5<sup>th</sup> priority is included on a conditional basis – measures in support of the Green deal.

<sup>6</sup> It is worth noting that if the Bank was allowed to borrow and was raising enough of its own funds proportionately, then this would be a material factor that may alter whether or not, or the extent to which, the GIB was classified as on or off the public balance sheet.

<sup>7</sup> For example, introducing a non-government minority shareholder, or non shareholder voting member introduced as guardian of the GIB company constitution containing independence principles. The government could then retain a ‘golden share’ with special rights attached as necessary. As a matter of company law, the constitution is also regarded as a type of contract between its members. Members can bring an action in court to enforce their own rights, or a derivative action on behalf of the company to see the constitution enforced.

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Contact:

**David Holyoake**

Law and Policy Advisor

[dholyoake@clientearth.org](mailto:dholyoake@clientearth.org)

**Brussels**

4ème Etage

36 Avenue de Tervueren

Bruxelles 1040

Belgium

**London**

274 Richmond Road

London E8 3QW

UK

**Warsaw**

Aleje Ujazdowskie 39/4

00-540 Warszawa

Poland

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