Meeting Minutes for the APPG on Environmental, Social, and Governance

Topic: The UK as a net zero finance centre - how to build a resilient and sustainable global financial hub

Date: Wednesday, 16 March, at 10:30 (Hybrid)

Parliamentary attendees:

Alexander Stafford MP, Chair of the APPG on ESG

Guests:
Heather McKay, Policy Advisor, E3G
Eduardo Lopez, Researcher, E3G

Corporate attendees:

Christopher Carter, Senior Consultant, FTI
Nicky Conway, Senior Sustainability Manager, Severn Trent
Robbie Epsom, EMEA Head of ESG, CBRE Investment Management
Meghna Mehta, Vice President, ESG Research, MSCI Inc.
Simon Oswald, Senior Manager, Sustainability and Climate Change, PwC
Lee Perkin, Managing Director of Banking and Capital Markets, KPMG
Paul Scaping, Public Policy Specialist, The Investment Association
Kieran Sharman, Head of Lending, Lloyds Bank Corporate Markets
Claire Walls, ESG Specialist, Insig AI
Cornelia Woschek, Business Development & Sustainability Director at The Gym Group

External and industry body attendees:

Zara de Belder, MBA Candidate (ESG and Sustainability), Alliance Manchester Business School
David Cowdrey, Director of External Affairs, MCS Charitable Foundation
Cameron Stephenson, Public Affairs Advisor, Chester Zoo
Madeline Young, Associate Professor & Module Leader in Economics, Anglia Ruskin University

The meeting starts at 10:30 am.

AS: Good morning, I hope you are all well. This session is on Net Zero Finance Centres and how to build a resilient and sustainable global financial hub. Heather McKay is Sustainable Finance Policy Advisor at E3G and will be delivering a presentation on the subject.

E3G is deeply involved in the Government's net-zero ambitions, including the creation of a Net Zero Financial Centre announced by the Chancellor at COP26. It is also the co-secretariat of the Transition Plan Taskforce and sits on the Treasury's 'Green Tech Advisory Group' (GTAG) - an instrument to push the UK as a green tech thought leader.

It is appropriate that the APPG addresses what many businesses see as a new frontier in ESG - namely net zero. Members of this APPG are aware of a green taxonomy and the murky waters of green requirements on what counts as sustainable activity and what does not. There are many opportunities for greenwashing, and Heather shall address these. Once the E in ESG is anchored by an exhaustive green taxonomy, debates over greenwashing will be framed through scientific fact. I am also looking forward to the discussion on climate resilience in the City of London and mandatory regional transition plans that focus on the G and the need to integrate net zero goals into corporate structures.

In its initial phase, mandatory net zero transition plans will be limited to large financial service firms and FTSE 100 listed companies, so it is important to consider how to incorporate smaller businesses - how quickly should this happen? Should we prioritise a voluntary or sector-based approach? These are just some of the questions we could start asking. So on that note, I hand over to Heather for her presentation.

Presentation begins:

My name is Heather McKay and I lead E3G's programme of sustainable finance work. I am really pleased to be here today as this will be an important discussion. Given the public crises occurring across the world, it is important we implement a sustainable energy plan.

I think it is important to remember the S in ESG - levelling up is a critical priority of the Government and net zero isn't a way of stimying that, but about building economic productivity, saving people money, and creating good jobs. The S is engrained in E3G's thinking on green finance.

E3G is a climate policy think tank that works across Europe, America and Asia. We are all about getting the best policy and regulation from the Government and ensuring the right people are giving their ideas to help formulate both.

The amount of progressive regulation coming from the Government has been comparable to whiplash. The landscape is competitive and we are seeing the UK, US and EU compete for the position of green finance leader - and the UK is in a good place to claim that title. From 2019, the UK went from having mandatory TCFDs, to hosting COP26, establishing the framework of a green taxonomy, creating a National Infrastructure Bank with a net zero and levelling up mandate, publishing a net zero strategy, and planning the transition of the financial sector to a net zero, green future. All these culminated in the Chancellor's announcement of a Net Zero Finance Centre and mandatory transition plans for all listed companies across the UK. It is important to remember that we still have a way to go. Net zero is integral in how we build a sustainable UK economy.

Another thing to remember is that it isn't just pushing companies to go further and faster, but setting out exactly how public policy and investment will support the creation of new markets across the UK and helping companies get to net zero. The Government will need to work hand in hand with the private sector to truly maximise the possible opportunities out there.

I also think that given the Ukraine crisis, the resilience of the UK's financial sector has never been more important. The crisis has shown us the tangible risks of foreign fossil fuel reliance, but also the risks of corruption and a poorly regulated financial sector in taking strong positions on foreign crises. It is therefore key that we view this conversation from this standpoint. The recent Credit Suisse leak shows it is important to think about the opportunities the UK has to move further and faster to situate itself as a high-quality, well-regulated place to do business.

So what is a Net Zero Finance Centre? It is a real opportunity to position London as a place to do sustainable, well-regulated, green business. As a leading financial service hub, London should reflect these ideals.

I would first like to clarify some terminology. The Net Zero Financial Centre essentially refers to private sector financial reform, however, this is underpinned by a Government announcement to create a Net Zero Financial *System*. For us, this goes beyond private sector reform and looks at how public finance and policy can support the private sector. The Green Finance Strategy (which we are expecting by the end of 2022), is going to be the place where these concepts land, and E3G is actively working on this.

E3G, alongside the Grantham Institute and Carbon Tracker, have produced a report to just dissect what such a transition would look like across various financial sub-sectors in the UK. We aren't expecting an overnight transition, but creating a managed, transparent transition from unsustainable to sustainable. Different sectors will move at different paces. E3G is also working on another briefing (for publication at the end of the month), which aims to unpick what the Net Zero Finance Centre will look like and the policies relating to it.

We must remember that there is significant opportunity and advantage from the UK moving first on this. The City of London is one of the world's largest financial centres and we have a lot of soft power through that. We also have significant interest from financial institutions in transitioning to net zero. The Glasgow Financial Alliance for Net Zero (GFANZ) came out at COP26 and said that over £130tn in AUM (assets under management) have been committed to net zero requirements under their initiative. That's about 40% of global assets - there is significant appetite for the financial sector to be involved in the transition.

The UK has an abundance of opportunities to harness, but the UK's population is suffering from poor energy sector planning and poor investment in the sector too, with few incentives to support public and private plans to green the sector. E3G released a report that showed that investment in energy efficiency could save the poorest households up to £500 a year on their energy bills. It is a shame we haven't moved quicker on this. When we talk about finance, it isn't just GDP or the stock market, but also incomes for individual households across the country. Having a holistic plan can reduce the risk of stranded assets, lower energy costs, and can have other environmental benefits too. Institutions like Make My Money Matter are working on interesting projects such as TNFD to reduce deforestation risk from investment portfolios, and increase investment transparency to help investors understand what they are investing in.

Nature and adaptation really is the proplasm to mitigation when we talk about climate change. But the UK has made a number of commitments on a resilience front. It is one of the most critical sectors in the UK that requires investment and protection. The Net Zero Finance Centre can not only tackle reducing emissions, but also support positive outcomes such as biodiversity. However, one problem for investors, MPs, and voters is picking out the priority policies to implement this plan. There are two:

1) Providing clear definitions on what we mean by 'sustainable activities'.
2) Encouraging action, such as transition plans and the green taxonomy.

The taxonomy is something many don't want to know about. Science-based definitions are going to be crucial in maintaining integrity and trust across the market. The UN Secretary General cautioned that ambitious commitments from national actors in the private sector (the GFANZ), have also been accompanied by a deficit of credibility - there is a lack of trust between investors and consumers, and those who are making net zero commitments. This needs addressing. We need trust to move quickly.

What is the UK doing about this? It laid the foundations for a green taxonomy in 2020, and created the Green Technical Advisory Group (GTAG) that E3G sits on. The EU is also creating a taxonomy, and frankly, there are over 25 being created internationally, so there is an issue with interoperability and coherency. However, the EU was seen as the basis for many of these taxonomies. Yet, due to significant lobbying in the EU, in their second delegated act they included nuclear and gas as green sustainable activities. This is problematic as the taxonomy isn't meant to be a policy instrument allowing and denying certain things. It is more a dictionary over what science determines to be green activities and non-sustainable activities. The EU really set off a cascade of poor and weakened definitions of green economic activities.

The UK has an incredible opportunity to move first to build a gold standard over what 'green' and 'sustainable' mean. The UK can play a role in setting clear standards domestically and internationally. Again, we must remember that the situation in Ukraine is putting pressure on governments, to consider energy security and market pricing due to policies like this. E3G will work closely with GTAG and energy partners to ensure the Government remembers the purpose of the green taxonomy tool - to provide clarity to the market on investment products.

Another policy that is important is the Transition Plan. This moves us beyond assessing risk and transparency, to encouraging corporations to transition towards net zero. It should include internal milestones, actionable steps, and a solid commitment. In the UK, the Chancellor announced mandatory requirements from 2023 to public transition plans. This is part of a broader push in the UK to hone down the requirements companies are being asked for under one framework - the Sustainability Disclosure Requirements Framework. This will include a number of sections and will tackle reporting fatigue and support companies of all sizes to become more energy efficient.

To support this, E3G recommends that the Transitions Plan Taskforce produces world-leading guidance on what ‘good’ looks like to help companies transition. This should also be extended to all large UK companies - how can the biggest investors ‘green’ their portfolios, when we aren’t supporting companies on the other side of the equation ‘green’ themselves?

The ISSB is reporting guidance on climate standard reporting, the GFANZ is reporting guidance for financial institutions on transition plans, and also the EU has produced a draft (Corporate Governance Directive) which is putting some pressure on the UK to produce one too. They have put a requirement on all large companies across the EU to publish transition plans that are aligned to the Paris Climate Agreement. The UK is under time pressure to deliver this, so we cannot be complacent.

Finally, I want to stress that finance really is the bridge between our ideals and delivery is crucial. We are not close to meeting our net zero targets. This will weaken trust between companies and governments and the drive towards sustainability will be complicated. It will create business risks too. Meeting net zero isn’t about penalising or punishing people, it is about creating an environment in which as many of us can prosper. As long as we have the opportunities in mind, that will support the UK and the world in getting us to net zero.

Thank you for listening, and I am happy to field questions

Discussion begins:

Question: What does the group think a green taxonomy should and shouldn’t include? Looking at Europe and the 25 other taxonomies, can we say the UK is leading the way, and which ones can the UK learn from?

HM: It's a shame the EU watered down the taxonomy they drafted. There is a recognition that the bloc hasn't gone far enough or have been ambitious enough. The EU tends to be progressive on regulation, but broadly they really have done well on corporate financial disclosure requirements and climate requirements. It's interesting to note the context in which the EU operates within, as they need to obtain approval from all member states, they are also committed to the 'just transition', and to social aspects - I think the UK could consider this more often. Other pieces of international guidance that are strong include both the Science-Based Target Initiative and the CDP.

Question: It's great to be the world's first Net Zero Financial Centre, but others need to follow in order for that to be meaningful. I'm particularly interested in the GFANZ's work around transition plans, so how do we make sure the UK leads in what it brings forward to the UK Government whilst GFANZ stakes its claim?

HM: The Transition Plan Taskforce has committed to making sure it has the right connections to international institutions and the domestic task forces. This is supported both by the commitment, and that a number of the Taskforce members sit on GFANZ and similar groups. What I would like to see is GFANZ set a minimum standard of establishing what we can expect and perhaps for UK tax enforcement to align with this. Other important things are the ISSB institutions and making sure each of the standard-setting bodies are in contact and up to speed with what the others are doing. To achieve this, it's about keeping up pressure on these alliances and institutions and emphasising the need for coherence.

Question: If you make London's financial centre net zero, there are many players who aren't from the UK who may not adhere to the regulations - how can this be enforced? Also, there is a massive challenge finding accurate data, especially across emerging markets. How can we assure the data we receive is correct?

HM: This is a Transition Plan, and we are asking companies to set out transition plans to cover their entire operations. These plans will acknowledge whether the transition will be difficult, and the guidance will provide leeway for adaptation to the transition. On the data point, the FCA is doing a lot of interesting work on setting up plug and play regulation and providing clarity to the market through technology mechanisms. We don't have enough time to wait for TCFD to be perfectly designed and rolled out, so we need to start moving and encouraging action. There is a lot of data out there, but how it is packaged can be something for regulators to monitor. Also, one thing that can support companies in feeling more confident is a commitment to transparent reporting and learning as a principle built into the system - a recognition that this is a learning process in which mistakes will be made and learnt from.

Contribution: It's one thing to have a taxonomy that claims to adhere to the Paris Climate Agreement, but how can you get assets that can actually do the same?

HM: A taxonomy is just a dictionary. The trick to implementation is integrating the taxonomy in different policy requirements. So UK politics must underpin all the upcoming financial regulations. When thinking about green financial regulations, the taxonomy is our reference point. It's also not about asking the private sector to do everything, but forcing the Government to put its money where its mouth is, and so a taxonomy should assess public and private sector financing to set an example of the Government's commitment to transition. The EU has done this, so if the taxonomy is to be integrated it cannot just be within the private sector.

Contribution: There are three assumptions that should be tested and retested:

1) Greenwashing: In the real world, there is more ‘mudwashing’ than greenwashing and many ESG providers focus on the bad companies and deter investment in those rather than what the good companies are doing. There needs to be some measures that these companies aren’t improperly discarded from the market.
2) Geographical focus: Significant proportions of the world’s capital flows through British territories such as the Cayman Islands - this presents huge opportunities for the UK, as immediately we have extraterritorial impact. If assets are housed in these territories or countries, then it is important to get the legislation passed.
3) Taxonomy: It's good to be aspirational, but in the markets there will never be a race to the top. If you pitch it too high then businesses will be steered away.

HM: One important thing is actually showcasing examples of good private sector practice. I have assurances that this can be done, but businesses want proof it won’t.

Question: If the UK is a world leader in financial services, but one thing we have a challenge with are goods in terms of negative externalities, the production and manufacturing in the global supply chain and the negative external impacts that feed into the financing of the production of goods and services and our consumption. How are we addressing these negative externalities that we are potentially imposing on other countries that consume many goods? How is this factored into net zero?

HM: That’s a Scope 1-2-3 emissions debate, Scope 3 should be considered within all transition plans as we will never tackle the larger problem unless we understand it. One other interesting angle is on nature - we are building our understanding of carbon intensity and impact on Scope 1-2-3 levels, but we still aren’t there - hence why we still see environmental destruction by companies that are working towards net zero. Making TNFD as much of a household name as TCFD in financial institutions is important, and ensuring that when we establish guidance on transition plans, nature is considered. Finally, the taxonomy covers six environmental dimensions: Mitigation and circular economy are two of them. So when we set company and economic activities according to the taxonomy we fully assess the other impacts.

Question: The lack of net zero consistency has been a nightmare recently, so seeing the SDR and GFANZ tackle this is good. Corporations can transcend politics. It isn't clear whether Net Zero Transition Plans include climate resilience or adaptation. Should we move towards Climate Action Plans? Secondly, on data I’d agree, but would challenge how the UK can lead on this as access to accurate data is tough - can the UK be the first country in the world to make it a legal requirement to share utility data across your value chain? Thirdly, when we regulate companies we miss financial organisations as they create legal entities that sit on funds, so how can we regulate them effectively? Finally, how do we encourage organisations to be part of the transition and not to just dump assets?

HM: On transition plans, I wouldn't throw the baby out with the bath water. Nothing is perfect but we cannot let perfection be the enemy. I would agree with you. A transition plan offers a way to consider the impact on nature. Secondly, we are making progress with data, good robust reporting is critical and there is an appetite for the Government and the Transition Plan Taskforce to act as a central hub for best practice. Finally, on dumping assets, this is why stewardship guidance is critical for institutions like the Transition Plan Taskforce. We want responsible companies to do the best thing to support the companies they own whilst transitioning, and central, credible guidance is necessary for this to take place. It is important we don't penalise these companies for supporting them.

AS: We recently looked at a social taxonomy and how it would link to a green taxonomy and a governance taxonomy. How can these be linked?

HM: The EU has just published a discussion paper on the social taxonomy and it is quite highly debated, the question of whether social issues are best outlined through a taxonomy mechanism is key. I do think that we need greater transparency on the social impacts. We have seen social issues tackled through other mechanisms (a ban on child labour, human slavery commitments), and perhaps this is the best way forward? The real arguments sit on whether the issues are too critical and well known to be tackled through a disclosure mechanism and should they be tackled through regulatory mechanisms and restrictions.

AS: Thank you so much for joining us, and it was great to have someone with such knowledge join us in the room. I look forward to seeing everybody at the next meeting.