

# SHAPING A SUSTAINABLE FINANCIAL SYSTEM

Future-proofing global finance for a net-zero, nature-positive world

## UNITED KINGDOM



# INTRODUCTION

The UK's GDP is projected to rise by

# 7%

in 2021 from 2020

When the economy contracted by

# 9.8%

following the shocks of the global pandemic<sup>1</sup>

The UK is the **17<sup>th</sup> largest emitter worldwide**, accounting for

# 1%

of total global emissions<sup>2</sup>.

**The UK is legally bound to reduce greenhouse gas (GHG) emissions by 78% by 2035<sup>3</sup>. This builds on the UK's Nationally Determined Contribution (NDC) to reduce emissions by 2030 by at least 68% compared with 1990 levels and is the highest reduction target made by a major economy to date.**

Despite alignment of high-level net-zero commitments, less than 50% of FTSE 100 companies have committed to take science-based action to align with the 1.5°C pathway<sup>4</sup>. Moreover, the loss of biodiversity is alarming: since the 1970s, 41% of all species in the UK have declined<sup>5</sup>.

Despite such loss and rising temperatures, the Bank of England estimates that loan exposures to fossil fuel producers, energy utilities and emission intensive sectors are equivalent to some 70% of the largest UK banks' regulatory capital<sup>6</sup>. UK-based financing of companies impacting nature and biodiversity loss is occurring at rapid pace, is widescale and is an international issue. In 2020, British banks provided at least £900m to over 300 major

companies involved in deforestation overseas<sup>7</sup>. UK-based financial institutions are the single largest source of international finance for six of the most harmful agribusiness companies involved in deforestation in Brazil, the Congo Basin and Papua New Guinea - critical locations for the health of our planet's ecosystem. Major UK banks, HSBC and Standard Chartered, are the 4<sup>th</sup> and 5<sup>th</sup> largest global lenders to the forest risk commodity (FRC) sector, constituting some 5% of the total lending volume worldwide<sup>8</sup>.

In the context of the climate emergency, and the UK Government's COP26 Presidency, this *modus operandi* needs to change at a much greater scale and urgency to achieve the UK's legally binding domestic target of climate neutrality by 2050.

## The role of financial institutions

Finance and insurance services is the eighth largest sector in the UK in terms of economic output, representing 6.9% of the total UK economy and with a quantitative value of £131.9 billion. The UK's financial services sector is also the ninth largest in the OECD, meaning that the UK has a significant role in shaping the rapidly evolving sustainable finance landscape<sup>9</sup>.

There has been a clear shift in the financial sector that recognises the opportunity in investing in sustainable products and services, which rely heavily upon accurate and comparable data. As such, there has been an uptake of financial services firms publishing their environmental impact.

The UK has set up a joint regulator and government Task Force on Climate-related Financial Disclosures (TCFD) taskforce and its Interim Report, and accompanying roadmap, sets out a pathway to making TCFD-aligned disclosures mandatory across the economy by 2025<sup>10</sup>. This roadmap sets out the actions that both government departments and regulators will take, and also signposts that the UK will consider endorsement of

the IFRS Foundation's Sustainability Standards<sup>11</sup>. As COP26 host, and G7 presidents, the UK can catalyse multilateral commitments to transition the global financial system in support of net-zero.

The UK Green Finance Strategy<sup>12</sup> centralizes the UK's ambition to become a global green finance hub through aligning financial investment flows towards a low-carbon transition, and strengthening the competitiveness of the UK financial sector, by:

- ▶ **Greening Finance:** current and future financial risks and opportunities from climate and environmental factors integrate into mainstream financial decision making.
- ▶ **Financing Green:** finance accelerates to support the delivery of the UK's carbon targets and clean growth, resilience and environmental ambitions.
- ▶ **Capturing the Opportunity:** UK financial services capture domestic and international commercial opportunities arising from the 'greening of finance.'

1. United Kingdom. Office for National Statistics. 2021. GDP Monthly Estimate, UK: May 2021

2. United Kingdom. UK Parliament, House of Commons. 2021. UK and global emissions and temperature trends.

3. United Kingdom. Department for Business, Energy and Industrial Strategy. 2021. UK enshrines new target in law to slash emissions by 78% by 2035.

4. Science Based Targets Initiative. 2021. Taking the Temperature: Assessing and Scaling up Climate Ambition in the G7 Business Sector.

5. United Kingdom. UK Parliament. 2021. Biodiversity in the UK: bloom or bust?

6. United Kingdom. Department for Business, Energy and Industrial Strategy. 2021. Mandating climate-related disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs): impact assessment

7. Global Witness. 2021. Cross-party support for UK Environment Bill to tackle role of UK banks in funding global deforestation, with £900m funnelled into forest-risk commodities in 2020.

8. CDP. 2019. Increasing the Transparency of Banks: The Transition to Sustainable Lending to the Forest Risk Commodity Sector.

9. United Kingdom. UK Parliament, House of Commons. 2021. Financial services: contribution to UK economy.

10. United Kingdom. Her Majesty's Treasury. 2021. A Roadmap towards mandatory climate-related disclosures.

11. <https://www.endorsement-board.uk/>

12. United Kingdom. Department for Business, Energy and Industrial Strategy. 2019. Green Finance Strategy: Transforming Finance for a Greener Future

# KEY SUSTAINABLE FINANCE POLICY ACTORS

Actor	Responsibilities and actions taken
<b>FINANCIAL REGULATORS</b>	
HER MAJESTY'S (HM) TREASURY	Oversees the UK's sustainable finance strategy, including the TCFD Roadmap, the Green Finance Strategy and future vision for financial services.
BANK OF ENGLAND (BOE)	Oversees fiscal stability, monetary policy and prudential regulation. The BoE has recently set out plans to green its corporate bond portfolio of some £20bn.
FINANCIAL CONDUCT AUTHORITY (FCA)	Regulates 58,000 financial services firms and financial markets. UK premium listed commercial companies are required by the FCA to include a statement in their financial report whether or not they are aligned with the TCFD recommendations.
PRUDENTIAL REGULATION AUTHORITY (PRA)	Regulatory body through which the BoE regulates and supervises financial firms, including stress testing on certain insurance firms.
FINANCIAL REPORTING COUNCIL (FRC)	An independent regulator in the UK and Ireland for auditors, accountants and actuaries. Home of the Financial Reporting Lab: a learning hub to support innovation in reporting.
FINANCIAL POLICY COMMITTEE (FPC)	The official committee of the BoE which identifies and monitors systemic risks.
UK EXPORT FINANCE	The operating name of the Exports Credit Guarantee Department, the UK's export credit agency. Working with the CDC (see below) to align their accounts with the TCFD recommendations.
<b>FINANCIAL INSTITUTIONS</b>	
UK INFRASTRUCTURE BANK	This bank aims to manage risk through cornerstone investments, financial tools and the development of new technologies. The Scottish National Infrastructure Bank was also founded in 2021.
CDC GROUP	The UK's development finance institution (DFI), supporting the building of businesses throughout Africa and South Asia, investing directly by providing equity, debt, mezzanine finance and guarantees.
GREEN FINANCE INSTITUTE	Government think tank working with finance practitioners, policymakers, business innovators, academics and non-profit professionals to identify the required policy, technology and financial pathways enabling the transition to a green economy.

Nb: This is not an exhaustive list of actors but key regulatory and institutional bodies in the UK's strategy on green finance.

# KEY SUSTAINABLE FINANCE POLICIES AND REGULATIONS

Actor	Policy/ regulation	Supervisory entity	Implementing entity	Positioning on Sustainable Finance	Year of Implementation	Addresses climate change?	Addresses protection of forests?	Addresses safeguarding water resources?
1	<b><u>A new chapter for financial services</u></b>	BoE and HM Treasury	The Department for Business, Energy & Industrial Strategy (BEIS), FCA and FRC	<p>The HM Treasury's vision builds upon the Green Finance Strategy to deliver in four key areas:</p> <ul style="list-style-type: none"> <li>▼ An open &amp; open financial hub</li> <li>▼ A sector at the forefront of technology &amp; innovation</li> <li>▼ A global centre for green finance</li> <li>▼ A competitive marketplace promoting effective use of capital</li> </ul> <p>As part of this vision, the Government will introduce new <b>Sustainability Disclosure Requirements (SDRs)</b>, which will bring together and streamline existing climate reporting requirements. The Government intends to legislate this and will set out its approach to green finance regulation ahead of COP26.</p>	2021	X	X	X
2	<b><u>Green finance strategy</u></b>	HM Treasury	BEIS	<p>The key aims of the Strategy are to align private sector investment flows with clean, environmentally sustainable and resilient growth, and strengthen the competitiveness of UK financial sector, through 3 integrated approaches:</p> <ul style="list-style-type: none"> <li>▼ <b>Greening Finance:</b> current and future financial risks and opportunities from climate and environmental factors are integrated into mainstream financial decision making.</li> <li>▼ <b>Financing Green:</b> Accelerating finance to support the delivery of the UK's carbon targets and clean growth, resilience and environmental ambitions.</li> <li>▼ <b>Capturing the Opportunity:</b> UK financial services capture domestic and international commercial opportunities arising from the 'greening of finance.'</li> </ul>	2019	X	-	-
3	<b><u>Ten-Point Plan for a Green Industrial Revolution</u></b>	Cabinet Office	BEIS	<p>The Plan aims to provide investors with a clear framework to deliver the low carbon finance needed for a net -zero economy by 2050 by:</p> <ul style="list-style-type: none"> <li>▼ Delivering clean investment through a series of issuances (e.g., 1<sup>st</sup> Green Sovereign Bond).</li> <li>▼ Harnessing international reputation to encourage private investment in supporting innovation and manage climate financial risk in line with the UK's TCFD Roadmap.</li> <li>▼ Implementing a green taxonomy.</li> </ul>	2020	X	X	X
4	<b><u>Integrated Review</u></b>	Cabinet Office	-	<p>The Review aims to tackle climate change and biodiversity loss as the UK's number one international priority, primarily through:</p> <ul style="list-style-type: none"> <li>▼ Investment in R&amp;D of green technologies.</li> <li>▼ Helping developing countries with international climate finance.</li> <li>▼ Establishing the Climate Change and Energy network as the first dedicated diplomatic green network</li> <li>▼ Ensuring UK ODA is aligned with the Paris Agreement, using a variety of financing models to tackle regional challenges of mutual interest</li> <li>▼ Investing in a 'nature-positive' economy and integrating biodiversity into economic decision-making.</li> </ul>	2021-2026	X	X	X
5	<b><u>A roadmap towards mandatory TCFD-aligned disclosure</u></b>	HM Treasury	BEIS, The Department for Work and Pensions (DWP) and the FCA.	An indicative path towards mandatory climate-related disclosures across the UK economy by 2025 aligned with the TCFD recommendations.	2025	X	-	-
6	<b><u>Proposal to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations</u></b>	FCA	FCA	The introduction of new rules in 2020 for premium-listed companies to state whether they comply with TCFD-aligned disclosure and explain non-compliance.	2021	X	-	-

Actor	Policy/ regulation	Supervisory entity	Implementing entity	Positioning on Sustainable Finance	Year of Implementation	Addresses climate change?	Addresses protection of forests?	Addresses safeguarding water resources?
7	<b>Consultation on mandatory climate-related financial disclosures by publicly quoted companies, large companies and LLPs</b>	HM Treasury	BEIS	New regulatory proposals that all listed companies and large asset disclose in line with the TCFD recommendations by 2022.	2022	X	-	-
8	<b>Enhancing climate-related disclosures by standard listed companies</b> <b>Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers</b>	FCA	FCA	These are proposals to extend scope of climate-related disclosure requirements to issuers of standard listed equity shares, asset managers, life insurers and FCA-regulated pension providers, initially on a comply or explain basis, with a view to mandate in the future, aligned with the Government's TCFD Roadmap. The FCA is also seeking views on select ESG topics in capital markets including: <ul style="list-style-type: none"> <li>▾ Issues related to green, social or sustainable debt instruments.</li> <li>▾ ESG data &amp; rating providers.</li> </ul>	2022-2024	X	-	-
9	<b>Pension scheme bill amendment</b>	TPR	DWP	In effect, the <u>Pension Schemes Act</u> introduces a range of provisions, including new climate risk-related governance and TCFD-aligned reporting requirements for pension schemes.	2022	X	-	-
10	<b>Greening the corporate bond purchasing scheme</b>	BoE	BoE	The greening of monetary policy to incentivise the transition to net-zero, including the use the balance sheet to incentivise bond issuers to support transition and encourage investors to do likewise.	2021	X	-	-
11	<b>Clean growth strategy</b>	BEIS	BEIS	The Strategy supports the growth of the green finance sector through: <ul style="list-style-type: none"> <li>▾ Working with BSI to develop a set of voluntary green and sustainable finance management standards.</li> <li>▾ Working with mortgage lenders to develop green mortgage products.</li> </ul>	2017	X	-	-
12	<b>Industrial decarbonisation strategy</b>	BEIS	BEIS	Enabling technological innovation to reduce the costs of decarbonisation through encouraging investment and finance.	2021-2030	X	-	-
13	<b>Environment Bill</b>	Parliament	Department of Environment and Rural Affairs (DEFRA)	The Bill should lead to much greater transparency on how pension schemes are addressing climate change (see below).	2021 (TBC)	X	X	-
14	<b>Due diligence on forest risk commodities</b>	DEFRA	DEFRA	Incorporated into the Environment Bill. The law would require a relatively small number of larger businesses to ensure that the 'forest risk' commodities they use have been produced legally.	2021 (TBC)		X	-
15	<b>Net-Zero Review - Interim Review</b>	HM Treasury	HM Treasury	Interim analysis of the green transition, including implications on public finance and fiscal sustainability.	2020-2021	X	X	-
16	<b>Net zero &amp; the future of green finance</b>	Parliament – House of Commons	HM Treasury	Inquiry into decarbonisation and green finance to scrutinise the role of HM Treasury, regulators and financial services in supporting the Government's climate change commitments: <ul style="list-style-type: none"> <li>▾ FCA has the appropriate remit to determine green financial funds/products to avoid greenwashing.</li> <li>▾ FCA will tackle remaining regulatory barriers to innovation in green finance products &amp; services.</li> <li>▾ The final Net Zero Review should outline clear sectoral pathways towards decarbonisation.</li> <li>▾ Government will ensure green sovereign bonds be a more expansive form of debt.</li> <li>▾ Government will encourage move from default pension funds to greener alternatives.</li> </ul>	2021	X	-	-
17	<b>The economics of biodiversity: the dasgupta review – Government response</b>	HM Treasury	-	The Government's response outlines its commitments to deliver a 'nature positive' future, reverse biodiversity loss globally by 2030 and ensure economic and financial decision-making - and the systems and institutions that underpin them - supports the delivery of that nature positive future: <ul style="list-style-type: none"> <li>▾ Improve Government guidance for embedding environmental considerations in policymaking processes.</li> <li>▾ Incorporate biodiversity into the UK Government Green Financing Framework.</li> </ul>	2021	X	X	X

Of major UK policies and/or regulation related to sustainable finance,



**94%**

cover climate-related financial impacts

Of these, only the upcoming UK Environment Bill provides specific measures to require larger businesses by law to consider the protection of forests by ensuring their commodities have been produced legally. The safeguarding of water resources is not yet embedded in UK financial regulation.

The UK has taken a “climate-first” approach to embedding environmental concerns into sustainable finance policy and regulation. The TCFD is the standard and baseline towards



**44%**

cover forest-related impacts and a further

mandatory reporting across the UK economy, beginning with the climate-related financial impacts and bringing into scope listed companies, asset managers, life insurers and pension providers in a phased approach by 2025. There is a regulatory roadmap in place for banks, building societies, occupational pension schemes, premium and non-premium listed companies. Currently, such requirements only apply to larger companies, so there is room for other companies to be brought into scope, as we have seen in other key jurisdictions.



**25%**

on broader water-related impacts

## Analysis (including governance challenges)

**The UK Government has made significant strides on green finance in the past few years, mainstreaming international frameworks including the TCFD into corporate reporting, with the ambition of becoming a world leading centre for green finance. But what next? It's crucial that the UK Government tackles climate change hand in hand with nature.**

The risks of climate change will be felt through water-related impacts and climate change cannot be tackled without urgently addressing deforestation. As the UK Government forges ahead with its renewed green finance strategy, it will be crucial to work together with global actors and ensure clarity and coherence with other international regimes and standards. Finally, with the eagerly awaited Net-Zero Strategy due to be published later this year, it's important that this is focussed on not just innovative ways to fund green activity, but on what is urgently needed to transition to net-zero, including rapidly phasing out fossil fuel subsidies.

As such, the main challenges currently identified relate to:

### ▼ **Ambition in sustainability-related reporting.**

The upcoming sustainability disclosure requirements (SDRs) will require businesses to report on their broader environmental impact beyond climate-related financial risks: a significant

milestone mirroring ambition seen in other key jurisdictions, such as the establishment of the European single access point (ESAP). CDP's longstanding history and expertise in driving corporate action towards high-quality reporting means that it is well positioned to give steer to the implementation of broader sustainability-related requirements of investors' portfolios that will cover the “E” in ESG.

### ▼ **Policy coherence on mandatory disclosure.**

The UK has demonstrated clear intent to set an international precedent and implement economy-wide climate-related financial disclosure requirements. However, it will be important to ensure that the measures outlined in the TCFD Roadmap and the upcoming SDRs are coherent, compatible and robust. Clear and aligned disclosure requirements will bring much-needed clarity and confidence to the financial actors that are driving activity towards a low-carbon economic transition.

## Way Forward

- ▼ **Ensure that the new SDR regime requires companies to disclose their impacts on water security and forest stewardship, building upon the baseline of TCFD-aligned disclosure.** Policymakers must ensure that upcoming regulations go beyond climate-related financial disclosure to capture the broader and interrelated environmental impact of financial actors, on a mandatory basis.
- ▼ **Champion international net zero commitments under the COP presidency.** As hosts of COP26, the UK should drive further commitments to 1.5°C aligned Science-based Targets by UK and international companies through establishing an international mandate with other key international jurisdictions which includes interim and long-term targets and with priority given to companies in energy-intensive sectors.

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**About CDP**

CDP is a global non-profit that drives companies and governments to reduce their greenhouse gas emissions, safeguard water resources and protect forests. Voted number one climate research provider by investors and working with institutional investors with assets of over US\$106 trillion, we leverage investor and buyer power to motivate companies to disclose and manage their environmental impacts. Over 9,600 companies with over 50% of global market capitalization disclosed environmental data through CDP in 2020. This is in addition to the hundreds of cities, states and regions who disclosed, making CDP's platform one of the richest sources of information globally on how companies and governments are driving environmental change. CDP is a founding member of the We Mean Business Coalition.

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