Green finance position paper

July 2019

Infrastructure and Energy
& Financial Services

CONTENTS

Introduction

The Government's Clean Growth Strategy, published in 2017, provided a blueprint of its ambitions to decarbonise all sectors of the UK economy through the 2020s while meeting its legally binding climate change commitments. The Industrial Strategy published a year later, outlined the Government's plan for increasing the UK's productivity and includes four key Grand Challenges, Artificial Intelligence and data, Ageing Society, Clean Growth and Future of Mobility.

The Government recently accepted advice from the Committee on Climate Change and committed to a net-zero greenhouse gas emissions target for 2050. This sets our domestic target and legislation in line with the commitments the UK agreed to in Paris in 2015, aiming to limit global warming to just 1.5°C. Setting this target creates a clear objective for deep decarbonisation across all sectors, whilst maintaining similar GDP cost to the previous 80% emissions reduction target as a result of decreasing technology costs.

In order to achieve these commitments and for the UK to reach a net-zero target by 2050, the Government will need to work with business and consumers in developing and delivering the correct political framework.

Further decarbonisation of the power sector, decarbonising the transport sector and decarbonising heat, will be some of the UK's greatest challenges. Green finance will play a significant role in addressing these challenges by providing vital capital within an enabling framework framed by the five key recommendations in this paper to support the transition to a low-carbon economy.

Green finance is the provision of finance to investments that take into account environmental considerations. Net-zero will not be reached by 2050 if finance does not aim to support economic growth through reducing pressures on the environment and addressing greenhouse gas emissions.

The UK is the world's second-largest financial centre and the largest centre in Europe; nearly three times the size of centres in France and Germany[1]. Whilst London is already a leading hub for green finance, backed by direct access to investment, liquid capital markets and a global reputation for expertise and innovation, it is arguably falling behind other financial leaders in certain areas. The uptake of green bonds often acts as a reliable guide for how well markets are progressing with green finance. These bonds are specifically labelled to be used for climate and environmental projects and are typically asset-linked and backed by the issuer's balance sheet. However, in 2017 the UK did not make the top 10 nations for green bond issuance[2]. Whilst green bond issuance is increasing in the UK, between 2012 and 2016, only two sterling denominated green bonds were listed on the London Stock Exchange.[3] The LSE does now list nearly 80 green bonds yet when this is compared to other stock exchanges in Europe[4], it is clear to see the disconnect between markets. The French green bond market which features as a case study later in this paper ranked third for green bond issuance behind the US and China in 2017.[5]

The UK government has the opportunity through its Green Strategy to address such areas where the UK is lagging and build on existing strengths in green finance as a world leader, capitalising on financial markets and expertise, to deliver change across the whole economy and provide a global public good.

---

[1] The New Financial international financial centres index https://newfinancial.org/financial-centres-index/

[2] Climate Bonds Initiative (2018) Great Britain Issuance 2017 https://www.climatebonds.net/2018/01/2017-gb-issuanceusd1555bn-new-record-all-2017-numbers-count-our-greenbond-highlights

[3] London Stock Exchange Group (2016) Green Bonds on the London Stock Exchange http://www.londonstockexchange.com/specialist-issuers/green-bonds/greenbondspresentation.Pdf

[4] Driving Ambition in Green Growth https://www.gov.uk/government/news/driving-ambition-in-green-finance

[5] Climate Bonds: France Green Bond Market https://www.climatebonds.net/resources/reports/france-green-bond-market-overview-opportunities

Many businesses and financial institutions have seized the opportunities green finance can bring, however there are others who are yet to embrace it fully. Whether this is as a result of a lack of knowledge or awareness, limited access to clear data and information, or an inadequate policy environment that is not supplying the right access to green finance, there is clearly a role for policy-makers to play to ensure that all businesses can access green finance and can fund their activities in a sustainable manner effectively. This paper will set out key types of green finance, the transition to a low-carbon economy (including reaching a net-zero target) and the sectors that should be of priority in this move, the barriers affecting green finance and recommendations for the way forward.

Summary of key recommendations

The urgency of climate change is clear however policy must be designed that is proportionate and effective in supporting the transition to a decarbonised economy through the development of green finance. To support this transition most effectively and promote green finance across the whole economy, the CBI recommends:

1. **Smarter regulation that provides the long-term clarity needed to support the move to net-zero.** This approach should include a formal collaborative framework between government, regulators, financial services firms and wider industry to ensure the business voice is heard in developing approportionate regulations that promotes the use of green finance.

2. **More clarity on data and climate-related disclosures.** Policy-makers should work with regulators to ensure availability of data to inform firms' climate-related disclosures. The TCFD recommendations should form the basis of voluntary disclosure requirements for all firms across the UK.

3. **A long-term approach to developing a usable taxonomy** that keeps flexibility and dynamism at its core, meeting the different needs of different sectors across the whole economy.

4. **Effective incentives to encourage industry to move towards green financing.** Existing financial legislation should be examined to identify where incentives can be built in to encourage green finance.

5. **Clarification of fiduciary duties in relation to climate-related risk.** A clear definition would ensure that the relevance of green issues to investment decisions are considered in a systemic way as part of firms' fiduciary duties. This will drive the UK's green finance agenda throughout the industry.

Case Study: Green Finance Institute

The CBI welcomes the joint initiative from UK HMT and the City of London Corporation to create a Green Finance Institute to champion sustainable finance in the UK and abroad. The blending of finance between Government and the City of London solidifies a key public-private partnership and signals a clear commitment from both spheres to tackle the financial risks related to climate change. The Green Finance Institute maintains London as a key green financial centre, bringing together the UK's existing capabilities, creating new business opportunities, and communicating to the wider market what London's offer is in green finance and insurance. The Green Finance Institute should be supported to make sure that their aims of clear public and market leadership on green finance are reached; including pushing for specific regulatory and policy proposals that might enhance the green finance sector worldwide and promoting London and the UK as a leading global centre for the provision of green financial and professional services. A major challenge remains business confidence in green finance at the same time as the supply side capabilities continue to grow. The Green Finance Institute will leverage the experience and expertise of the City of London to deliver listed and unlisted investment in UK and global green infrastructure, ranging from growing the Green Bond market, to pioneering direct renewable infrastructure investments by UK pension funds.

Building confidence for investors and their clients in green finance will in turn boost the demand for green products, stimulating growth across the whole economy.

The transition to a low-carbon economy

The transition to a low-carbon economy is estimated to require around $3.5 trillion, on average, in energy sector investments a year for the foreseeable future which could generate huge investment opportunities for energy firms.[6] To capitalise on these opportunities, government must guarantee businesses on-going competitiveness within the UK by ensuring that industry is decarbonising here in the UK. If the Government does not seize this opportunity, the risk is that firms move overseas to more competitive markets abroad where there are more support mechanisms.

With the correct political framework, green finance can help to address the decarbonisation challenges faced by business. By providing access to capital, businesses will have access for Research & Development (R&D) for new technologies and access to current innovative technologies that will help them become more energy efficient and in turn improve their productivity.

The scale of the challenge and priority sectors

The upcoming Green Finance Strategy is expected to outline, amongst other things, how the acceleration of green finance will achieve the ambitions set out in the Clean Growth Strategy.

For different sectors, reaching net-zero means different things. Over 50% of the power sector is decarbonised thanks to energy efficiency measures and substantial government support via subsidies for renewables. No other sectors have yet made such progress. However, many low-carbon solutions for heavy emitting sectors such as heavy industry, heat and transport will be electricity based and so it is a whole system approach which is needed to reach this target. This requires cross-industry, cross-party and cross-departmental collaboration to enable net-zero to become the centrepiece to all future policy decisions. **CBI supports sector-specific roadmaps to enable particular industries, such as aviation and energy-intensive industries to achieve this target.**

Power

Identifying what the various sectors within the energy market can do to address their emissions will be key in limiting temperature rises and key to the transition to reaching a net-zero target. Power sector emissions have fallen by 49% since 1990 and in 2017, as in each of the preceding four years, power sector emission reductions with effective financial incentives to drive these changes, including the Green Investment Bank (GIB) developing the world's largest Offshore Wind Fund, were largely responsible for the fall in economy-wide emissions. GIB established in October 2012 had a clear rationale and mission, quickly stimulating investment in the green economy and addressing market failures, attracting co-investment from private investors, and delivering both green impact and financial returns on investments. GIB was subsequently sold to the private sector in 2017. This is a strong demonstration of the effect of UK policies.

Transport

Over the past ten years, as emissions in power and industry have reduced, transport has become the largest emitting sector of the UK economy, accounting for 28% of UK greenhouse gas emissions in 2017. Stronger policies and financial incentives must be delivered to encourage uptake of cleaner vehicles and further innovation.

[6] Perspectives for the Energy Transition - Investment Needs for a Low-Carbon Energy System, International Energy Agency, 2017

Buildings

The UK's homes are some of the draughtiest in Europe. Although direct emissions in the UK from buildings fell by 4% in 2017, changing the way in which we use energy in commercial and domestic buildings will play an essential role in the UK's transition to a low-carbon economy and reaching a net-zero target. There needs to be proper engagement of the public to communicate the benefits, particularly of energy efficiency, and embed it into the property market.

Taking steps such as raising building standards, strengthening accreditation and effective enforcement should increase quality throughout the supply chain and support delivery of buildings to a robust standard. Driving quality of service and data, with effective financial backing, will support businesses achieving efficient use of energy and establish confidence and create trust in the industry and supply chain. These building standards should be based on actual operational performance rather than theoretical performance and on energy consumption, to address market failure.

Heat

As heat accounts for over a third of the UK's greenhouse gas emissions and is the largest source of the UK's greenhouse gas emissions. A long-term political framework on heat, that has synergy with the UK's approach to improving energy efficiency, will be a key element in the UK's transition to a low-carbon economy.

The role for green finance

Types of green finance

Green finance comprises all forms of investment or lending that consider environmental effect and enhance environmental sustainability. However, it is clear that green finance markets have developed unevenly as a result of varying levels of demand and supply.

Bank credit dominates financing in Europe representing around two thirds of business investment. The banking share in the total debt of non-financial corporations is currently 82% and, only a small portion is explicitly classified as 'green'.[7]

The lack in clarity as to what constitutes green financial activities and products is presenting obstacles for classification of green assets as well as for identification of further opportunities for green investment. In turn, this makes it harder for businesses to engage with the financial services that are right for them in the move to net-zero. To stimulate the demand for green finance and to foster green investments, the financial sector must be willing to supply sufficient green finance whilst ensuring the attractiveness of green investments for the private sector.

Green Market	Definition and how advanced?
Green bonds	A green bond is a bond whose proceeds are used to fund environment-friendly projects. Between 2016 and 2017, the global green bonds market is believed to have grown by 78% with national and institutional investors funnelling more than $150bn into low-carbon projects during the 12-month period.[8] The global green bond market reached US$155.4 billion new issuance in 2017 compared to US$81 billion in the previous year.[9]

[7]Towards a Green Finance Framework, EBF https://www.ebf.eu/wp-content/uploads/2017/09/Geen-finance-complete.pdf
[8]Major utilities team up to launch sustainable finance hub for European businesses https://www.edie.net/news/6/Major-utilities-team-up-to-launch-sustainable-finance-hub-for-European-businesses/
[9] Climate Bonds Initiative (2017) Green Bond Highlights 2017 https://www.climatebonds.net/files/reports/cbi-green-bondshighlights-2017.pdf

Green lending	Banks are increasingly involved in green loan origination. Private sector financing of green projects is largely originated by banks, residing on their balance sheets in the form of loans. However, there are a range of debt capital market products that can also provide ways through for institutional investors to finance these green loans. This includes covered bonds, asset-backed securities (ABS), mortgage-based securities, and collateralized loan obligations (CLOs). The Green ABS market was launched in 2013 and the market now contains a growing range of products including Solar ABS, green MBS, green CMBS and auto ABS[10]. The European Mortgage Association created the Energy efficient Mortgages Action Plan (EeMAP) with 37 European banks.
GreenTech	GreenTech start-ups can pay a crucial role in developing technologies that underpin the low-carboneconomy transition, however financial markets have struggled to channel capital investment.[11] The value of VC investment in cleantech companies has stalled in recent years and currently account for only 7% of total global VC market.[12]
Carbon disclosures	More and more firms are voluntarily disclosing carbon information in response to climate change. The TCFD provide an internationally agreed framework through which exposures to climate risk can be assessed, reduced and managed. The TCFD has more than 500 supporters, including 457 companies and 56 other organisations.
Investment in low-carbon technology	Investing in low-carbon projects and products that have low environmental impacts. This includes investment in energy efficient technology and renewable energy. Since 2015, annual investment in clean energy has decreased by 60% from £26bn to £10bn. A series of sudden changes to low-carbon energy policy in 2015 could have undermined investor confidence and led to a reduction in the number of projects in development. Disruption from the privatisation of the Green Investment Bank and a reduction in European Investment Bank lending following the vote to leave the EU may also have played a part. The UK needs significant investment in renewable energy and energy efficient technology to deliver emission reduction commitments.
Decarbonisation	Decarbonisation is the process of reduction or removal of carbon dioxide from energy sources. Since 2008, the UK has seen a rapid reduction in emissions in the electricity sector, but this achievement masks a marked failure to decarbonise other sectors, including transport, agriculture and buildings. In the last five years, emissions reductions in these areas have stalled.
Infrastructure investment	As highlighted in National Infrastructure Commission's Assessment last year, there will be substantial pressures on the UK's infrastructure with demographic change playing a significant role. The actions being taken in addressing climate change will affect the way in which we live, work and travel. Future infrastructure investment from both public and private sector will have to keep this in mind. The Government currently has £600 billion infrastructure investment pipeline for the next 10 years.

[10] Creating Green Financial Centres: A Toolkit. HSBC Centre of Sustainable Finance 2019.
[11] Creating Green Financial Centres: A Toolkit. HSBC Centre of Sustainable Finance 2019.
[12] Brookings institute analysis, published 2017.

Barriers to Green Finance

Although the momentum around green finance has increased and governments and businesses are beginning to introduce new initiatives and financial products to expand green finance, the deployment of private capital for green finance is still slow as a result of various market barriers.

Green finance gap

Currently, the level of green investment is lower than what is needed to deliver the decarbonisation needed to meet the targets set by the Paris Agreement. As a result, there is a significant green investment gap which needs to be plugged. The UK set up the world's first Green Investment Bank which was solely dedicated to greening the economy. The bank was launched in 2012 with £3 billion to address market failures affecting green infrastructure projects in order to stimulate private investment. In its three years of operation, the bank committed £2.6bn of capital to almost 70 green infrastructure projects across the UK and was the most active investor in UK green infrastructure.[13] In the absence of the Green Investment Bank, **the CBI recommends that the government sufficiently capitalises the British Business Bank with the resources needed to expand its role and create a fund that promotes green finance for SMEs.** This should be reviewed at the spending review to ensure the British Business Bank is sufficiently capitalised given it is currently operating on emergency funds. This could bridge the gap between climate targets that need to be reached and the funding needed to fulfil these.

Risk of stranded assets

There are many different climate change-related risks that cause asset stranding, such as environment challenges, falling clean technology costs, evolving social norms and new government regulations such as carbon pricing and air pollution regulation. These have been driven largely by attention generated by the Paris Agreement, however as a result research has found that between 60%-80% of publicly listed fossil fuel reserves must be considered "unburnable" if the world is to avoid disastrous climate change, potentially costing the fossil fuel industry $28 trillion in revenues over the next two decades[14]. Stranded assets therefore tend to be fossil fuel supply and generation resources which, at some time prior to the end of their economic life (as assumed at the investment decision point), are no longer able to earn an economic return (i.e. meet the company's internal rate of return), as a result of changes associated with the transition to a net-zero economy.[15] Consequently, investors at times need to juggle numerous timelines and cost-balance analyses to assess assets within their portfolios that may become stranded in the future. Transitioning to a net-zero economy is a long-term process and as such the chance of stranded assets may not become clear until decades in the future. Therefore, being able to predict and outpace the rapid technological, political and social evolution regarding carbon is becoming a big challenge for many investors.[16] There are already examples globally of energy intensive industry reserves becoming stranded by the low carbon transition. Yet, it is also important to note that stranded assets are starting to produce a knock-on effect in other sectors, such as transportation. For example, rail tracks built to transport coal to power plants will now be assessed to decide whether infrastructure will still be needed in decades to come. Policy-makers therefore need to be alive to these threats. There could be a growing role for long-term, forward-looking policy to encourage the shift from brown to green and move brown stranded assets into the green in the move to net-zero.

[13] UK Green Investment Bank privatisation process to launch, March 2016 http://greeninvestmentgroup.com/news-and-insights/2016/uk-green-investment-bank-privatisation-process-to-launch/
[14] Stranded Assets: A Climate Risk Challenge 2016, Inter-American Development Bank
[15] Stranded Assets 2017: Carbon Tracker
[16] Should investors be wary of stranded assets? Raconteur, March 21 2019 https://www.raconteur.net/business-innovation/stranded-assets

Case Study: Anglian Water

In 2017, Anglian Water issued the first ever public utility sector Green Bond. The £250m Green Bond is just one element of Anglian Water's sustainability strategy in tackling the increasing pressing global challenge of long-term access to secure water supplies.

The full £250m is expected to fund over 200 green projects and as of 25 May 2018, the total spend across the projects allocated to Anglian Water's 2017 Green Bond Portfolio is £203 million achieving a reduction of 84,716 tonnes of carbon, 61% less than the 2010 baseline.

Key examples:

Water Discolouration

Anglian Water is spending £5.1m on addressing discolouration in the water in the highly populated area of Belstead in Ipswich. The project delivered an outstanding 69% carbon reduction versus the 2010 baseline, which is above Anglian Water's 2020 vision of a 60% reduction. 95% of the material extracted from the ground in the operation was put back into the ground, which drastically reduced the levels of emissions from vehicles, the cost and the level of time to carry out the work. Investing now in this scheme will mean a higher quality of drinking water for the area, reduced disruption in the future and reduced running costs for years to come.

Resilience Project

Anglian Water's treatment works at Grafham, Cambridgeshire are the largest in this region. This enhancement project is an example of continual innovation in the building of ever more resilient systems to meet challenges of growth and climate change. It is a £28million scheme to make supplies of clean drinking water to more than 600,000 people more secure, designed to accommodate growth in one of the fastest growing regions in the country.

The resilience scheme achieved the same outcome as the original plan would have, but at half the cost. Anglian Water built the largest pre-cast service reservoir in Europe, at 40 megalitres - the equivalent of 16 Olympic swimming pools. The final scheme came in £32m cheaper and saved 61% of embodied carbon of the original design.[17]

Recommendations

The scale of the challenge is clear but in dialogue with over 100 members of all sizes and sectors, the CBI believe there are clear steps that can be taken to promote green finance and support the move to net-zero.

Long-termism and regulatory certainty

The move to a low-carbon economy cannot happen without clear regulatory planning and certainty that supports in transition. **The Government have committed to meeting a net-zero target by 2050 and the CBI recommend that all government policy and regulation is focused on delivering the right policy frameworks to facilitate the finance and investment to achieve this.** Whilst this undoubtedly means policy-makers will look towards new regulation, they must also be aware of existing regulation that could hold back progress if it is not modified.

For instance: the impact of Basel III on bank lending, as well as Solvency II on the insurance industry, might not only limit liquidity of funding but also reduce the overall appetite for long-term investments in low-carbon infrastructure. Rules under Basel III mean that long-term financing could become more expensive as long-term projects such as renewable energy projects, tend to have

[17] Anglian Water (2017-2018) Green Bond Annual Report https://www.anglianwater.co.uk/siteassets/household/hr_green_bond_annual_report__website_version.pdf

higher upfront capital costs and restrictions on capital and liquidity will limit the amount of capital available. Similarly, with Solvency II, requirements state that insurance companies who hold their assets in liquid or low-risk instruments will likely reduce their appetite for long-term investments for which there is no public market. These work against infrastructure investments in general, and renewable energy projects in particular. In addition, individual financial behaviour (as well as risk management) is focusing on the short and medium-term horizons, while environmental risks are of a long-term nature. Firms should be encouraged to look beyond short-term business cycles and plan for transitions to low-carbon financing that would be economically advantageous in the long-term.

Data and reporting requirements

Rules to curb climate change could lead to large losses to those investors left with stranded assets. This is why international efforts have been directed into encouraging firms to disclose their climate-change related risks so that investors are better aware of the risks to make informed decisions. The Financial Stability Board's Task Force on Climate-Related Disclosures (TCFD) is a key example of this (see example 1). **The CBI recommend that any new policy or requirements builds on this widely-used international framework to inform financial disclosures.**

Using existing frameworks will facilitate an easier transition to green financing for many firms and reduce the layers of complexity by utilising already existing channels. If market participants do not disclose how the activities they invest in contribute negatively or positively to environmental objectives, or if they use different metrics and criteria for determining the impact in their explanation of the degree of environmental sustainability of an economic activity, investors will find it disproportionately burdensome to check and compare different financial products.

However, in order to ensure a level-playing field, disclosures should initially be on a voluntary basis. The reporting process is at an early stage of development and many firms have not at this stage implemented recommendations from the TCFD or incorporated this into their portfolios or looked at their clients' preferences.

Example 1: TCFD

The TCFD provide an internationally agreed framework through which exposures to climate risk can be assessed, reduced and managed. The TCFD has more than 500 supporters, including 457 companies and 56 other organisations (e.g., industry associations, governments). The companies represent a broad range of sectors with a combined market capitalisation of over $7.9 trillion. This includes over 287 financial firms, responsible for assets of nearly $100 trillion. In addition to the 457 companies that support the TCFD, the Task Force's review identified another 104 companies that, in their financial filings or sustainability reports, stated they are already aligning their reporting with the TCFD or expressed intent to implement the recommendations.[18]

Taxonomy

A key to regulatory certainty is the creation of a clear, coherent and flexible green finance taxonomy. However, finding a true definition for green finance requires an extensive deep dive into all sectors of the economy to identify what it means for each sector. Work is already well underway at the European and international level to define a cohesive taxonomy and the CBI **believes that the government should, when agreement is reached, adopt an international taxonomy that prevents prescriptive categories that are likely to change rapidly as the market adapts over time.**

[18] Task Force on Climate-related Financial Disclosures: 2018 Status Report https://www.fsb-tcfd.org/wp-content/uploads/2018/09/FINAL-2018-TCFD-Status-Report-092618.pdf

In this sense, the evolution of technology is vitally important. The government must be aware of the rapid changes in technology and should make sure that innovation, which lies at the heart of green finance, is not stifled within fixed definitions. The energy sector is a key example of innovation catalysing green development and new ideas for energy production and emission reduction must not be held back by static definitions. Currently, there is no clear global definition of low-carbon, green or sustainable finance, and no global standards about what should be considered a 'green' investment. As well as threatening economic confidence and acting as a barrier to the scaling up of green finance initiatives, it also adds to the danger of greenwashing. A lack of clear definitions can lead to unsubstantiated or misleading claims about the environmental benefits of a product. Adhering to an internationally agreed taxonomy would reduce the distortion of the market through mis-selling and mis-labelling of products as a result of greenwashing.

Similarly, the government must be wary that creating a green finance taxonomy could ultimately lead to investments being channelled into certain areas. For example, the majority of projects that could benefit from green classification tend to be of small to medium-scale whilst an average investment size project is normally not below 5 million euro with an average investment size of 20 million euro across the whole economy.[19] However, whilst new, green products may be more environmentally sound in the current market, large industry players can help shift brown products into the green over the long-term as they invest more heavily in their transition programmes. Green transition rhetoric cannot develop in the context of short-term considerations. Delivering an effective transition to a net-zero economy requires large-scale investment into assets that are amortised over several years. Large businesses who transition to net-zero economies, driven by investments in clean energy and energy efficiency can become strong drivers in job creation and upskilling enabling climate-resilient economic growth and sustainable development. They should therefore not be penalised by policy-makers looking at the short term, immediate greening of financial products. Furthermore, the government should steer well clear of using the taxonomy as a punitive instrument. There is a risk that proposals could prescribe what market actors should invest in, classifying assets or companies and in essence creating a "negative-list". The CBI believes that this would have dramatic effects on the access to finance.

Incentives

The CBI also believes that the government should be exploring what incentives are needed for firms to take up green financing as a core business issue. The Global Green Finance Index (GGFI), highlighted the lack of appetite among market practitioners to address high impact sectors to divest away from fossil fuels.[20] Regulated market incentives would arguably help to shift capital away from these energy intensive industries and shift finance into green projects. Similarly, the Climate Bond Initiative (CBI) believe that constraints such as additional transaction costs because issuers must undertake additional due diligence to track, monitor and report on the use of proceeds.[21] Similarly, there is also a cost incurred through sustainable reporting for companies. For example, whilst the price of green bonds and non-green bonds, which come from the same issues, is not different, the extra costs of reporting required for a green bond issuance is not compensated by any financial benefits. **The CBI believe that it is necessary for government to introduce incentives to encourage increased use in green financial products.** When investors are faced with barriers when attempting to achieve green finance goals, the market is held back. With the right incentives, more corporates will invest in green products and will embrace sustainability fully.

Furthermore, aspects of current prudential regulation skew the cost of capital to favour non-green, short term corporate loans. For example, Pillar 1 Basel III assigns a lower risk weight to short-term

[19] Towards a Green Finance Framework, EBF https://www.ebf.eu/wp-content/uploads/2017/09/Geen-finance-complete.pdf
[20] The Global Green Finance Index 2, September 2018 https://www.longfinance.net/media/documents/GGFI_2_Full_Report_2019.02.07_v7.1.pdf
[21] Creating Green Financial Centres: A Toolkit. January 2019

(1-3 year) recourse balance sheet corporate loans, in comparison to, long-term (7 years or more) project finance loans to off-balance-sheet entities as the latter type of loans is riskier due to their longer maturity and non-recourse structure. Consequently, the risk-weighting framework, resulting in higher capital requirements for bank long-term lending project finance for environmentally sustainable economic activities, is typically long-term, and has a significantly higher cost in terms of capital requirements.[22] **Government should examine existing prudential legislation to identify where incentives can be built in to encourage green finance.**

<u>Fiduciary duty</u>

All investors have a responsibility to follow their fiduciary duties in their investment decisions. However, this can often be interpreted differently by different investors. To address the changes of climate change fully, they must be able to clearly factor the risks of exposure to climate risk in their decision-making. In order to enable the UK financial system to respond effectively to climate risk and to develop in line with climate goals**, Government must ensure that the fiduciary duties of firms are well defined in relation to green finance and their obligations**. Fiduciary duties are the bedrock of UK investment industry and the way they are defined helps set the assumptions for appropriate investment behaviour. The CBI believes that many pension fund trustees are unaware of their fiduciary duty regarding the consideration and incorporation of climate requirements and as such do not necessarily focus their attention on these issues. **A clear definition would ensure that the relevance of environmental issues to investment decisions are considered in a systemic way as part of their fiduciary duties therefore driving the UK's green finance agenda throughout the industry.**

Summary of policy recommendations

1. Government must create smarter regulation that enables clean growth across the whole economy

The UK needs an agile and robust regulatory regime to deal with new challenges, risks and customer demands to enable financial services to support UK growth. This will provide the regulatory certainty to encourage private investment to support decarbonisation.
Climate change has become an important issue for the whole economy and will soon develop into a central business issue for all corporates and financial actors. Following the UK's adoption of a net-zero target, all subsequent government policy and regulation should be focused on delivering the right policy frameworks to facilitate the finance and investment to achieve this. This means that the regulatory framework for financial services must favour long-term investments but also adapt as we make the transition. **Government should also examine existing prudential legislation, such as BASEL III, to identify where incentives can be built in to encourage green finance.** This will be increasingly important as the UK leaves the EU and begins to shape its own financial regulatory landscape.

2. Government must provide more clarity on data and climate-related disclosures

Without clear, available data on what constitutes green investments, firms do not have scenarios or criteria to compare against, resulting in less well-informed decisions on sustainable investments. It is therefore important that **policy-makers work with regulators to identify what data firms should initially use to inform investment decisions. Government should also build off the**

---

[22] Towards a Green Finance Framework, European Banking Federation https://www.ebf.eu/wp-content/uploads/2017/09/Geen-finance-complete.pdf

recommendations of the TCFD to introduce voluntary disclosure requirements for all firms across the UK.

3. A long-term approach to developing a usable taxonomy is needed

The CBI recommends that government looks to the international level for a usable, global taxonomy and adopt these standards once they have been agreed global level. Any taxonomy should prevent prescriptive categories that are likely to change rapidly as the market adapts over time. This should inform decisions around the environmental impacts' products have as well as counter the harmful effects of greenwashing. **This should remain voluntary until more concrete work has been done to establish the success of the taxonomy.**

4. The right incentives are needed to encourage industry to expand their green financing offerings, while also stimulating consumer and client demand for green products

The CBI believes that the government should be exploring what incentives are needed for firms to take up green financing as a core business issue and move climate change from a reputational issue to a strategic business issue. The CBI also recommends that the government sufficiently capitalises the British Business Bank with the resources needed to expand its role and create a fund that promotes green finance for SMEs. This should be reviewed at the spending review to ensure the British Business Bank is sufficiently capitalised given it is currently operating on emergency funds. The success of the Green Finance Taskforce should also be built on to bring in the regulators, ensuring effective collaboration in the move to net-zero.

5. Fiduciary duties must be clarified and well defined in relation to climate-related risk

In order to enable the UK financial system to respond effectively to climate risk and to develop in line with climate change goals**, government must ensure that the fiduciary duties of firms are well defined in relation to green finance and their obligations**. Fiduciary duties are the bedrock of UK investment industry and the way they are defined helps set the assumptions for appropriate investment behaviour. **A clear definition would ensure that the relevance of green issues to investment decisions are considered in a systemic way as part of their fiduciary duties therefore driving the UK's green finance agenda throughout the industry.**

Case Study: French Green Bond Market

France boasts one of the earliest domestic green bond markets in the world and in 2017 it ranked third for green bond issuance behind the US and China.[23] Issuance commenced in 2012 when three local government bodies issued the first green bonds to fund projects that included green buildings, low carbon transport, cycleways and renewable energy and has developed rapidly ever since. The country's green bond market has been fuelled by non-financial corporates and government-backed issuers since 2013. Excluding the green sovereign bond, 2017 market volume more than doubled from 2016 of which half of this growth can be attributed to non-financial corporates[24].

The growth of the French market, backed by corporate involvement, outlines the success that a collaborative approach to sustainable finance policy can bring. Business and corporates fuelled the

---

[23] Climate Bonds: France Green Bond Market
https://www.climatebonds.net/resources/reports/france-green-bond-market-overview-opportunities
[24] Climate Bonds: France country briefing
https://www.climatebonds.net/files/files/France_report_final_20_04_18.pdf

green bond market in France and the UK, as Europe's leading financial centre, should not allow itself to fall behind other European markets with such an important issue.

The French Government in 2015 also become the first country in the world to ask investors to disclose information concerning their contribution to climate goals through Article 173-VI of the Law of Energy Transition for Green Growth. This law requires major institutional investors and asset management companies to explain how they take green criteria into account in their risk management and investment policies. It applies the "comply or explain" principle, meaning that flexibility is offered to investors to choose what information is useful to inform their reporting. This is an approached proposed by the FCA and should be explored further by the UK as a viable principle to underpin national sustainable finance policy.

Similarly, French financial players have adopted a number of initiatives to drive market momentum, including "Finance for Tomorrow". Originally launched in May 2016 by Paris EUROPLACE and the actors of the Paris Financial Centre, it aims to promote sustainable finance in France and internationally. It contributes to a shift in financial flows towards a low carbon and inclusive economy, in line with the Paris Agreement and the Sustainable Development Goals. The UK's Green Finance Task Force and the commitment from UK Government to invest up to £20 million alongside at least £20 million from private investors in a new venture capital fund, the Clean Growth Fund, are welcome steps in the right direction and momentum cannot be lost here. Government must continue to work with UK financial actors to cement itself as a world leader in sustainable finance.

Conclusion: the UK must continue to be a world leader in sustainable finance

Green finance has the opportunity to redefine the UK economy and enable it to meet its climate goals. Businesses and policy makers have a huge role to play. Policy must be created that encourages businesses to take up green finance and actively seek out changes that will aid them in a transition to a low-carbon economy. However, throughout this process policy-makers must be alive to the climate-related risks, as outlined in the paper, that could negatively detriment businesses. Market-led solutions must therefore seek out the opportunities that a transition to a low-carbon economy can bring as well as the benefits green finance could bring across the whole economy.

Green finance is but one part of a sustainable finance agenda. The CBI will continue to work with members to develop its sustainable finance narrative, to explore wider societal and governance models and how they can work effectively for business.

As the UK leaves the European Union, the UK must continue to build on its global leadership in this area to support a clear shift to a sustainable economy. With a collaborative framework that ensures the corporate voice is heard, a usable regulatory framework that puts customers first, and a policy outlook that drives a sustainable business environment across the whole economy the UK can seize the opportunities presented by green finance in the move to net-zero.

To share your views on this topic or ask us a question, contact:

Chris Wilford
Head of Financial Services Policy
Chris.Wilford@cbi.org.uk

Megan Griffith Otway
Policy Adviser
Megan.Griffith-Otway@cbi.org.uk

Abdul Kamara
Policy Adviser
Abdul.Kamara@cbi.org.uk