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Department for Business, Energy and Industrial Strategy
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Also sent via email to netzeroreview@beis.gov.uk

27 October 2022

Dear Net-Zero Review team,

ShareAction submission to Review of Net-Zero: Call for Evidence

I am writing to respond to BEIS' call for evidence on Net-Zero on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices by pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. Among other activities, we work with the financial services sector, including insurance firms, to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the views of clients, beneficiaries and pension scheme members.

1. How does net-zero enable us to meet our economic growth target of 2.5% a year?

The UK's transition to net-zero represents a critical opportunity to support efforts to tackle the global climate crisis and simultaneously boost economic growth. It brings with it broad benefits including driving forwards the Government's "levelling up" agenda, creating the chance for future generations to live, work and retire in a clean and stable environment and increasing inwards investment by capitalising on the UK's status as a global leader in the transition. McKinsey estimates that supplying the goods and services to enable the net-zero transition could be worth £1 trillion by 2030 to UK businesses.[1]

In order to make such large-scale emissions reductions, major economy-wide changes will be required over the next decade. Private investment will be key to achieving this.[2] 94% of issuers expect to move away from environmentally and socially challenged business models in the next five years, while 88% of investors say it is important companies prepare for the effects of climate change. The Climate Change Committee estimate that investment in net-zero will need to increase to £50bn per year by 2030 (from around £13.5bn currently). Given the depth of UK capital markets as well as its deep expertise in sustainable finance, this 'significant ramp up in the scale of investment is eminently deliverable'.[3] Low-carbon finance is expected to be the fastest growing low-carbon sub-sector of the economy between 2030 and 2050.[4] Companies and investors that actively support the transition to net-zero can create millions of new jobs globally and the UK is well-placed to take

[1] https://www.mckinsey.com/capabilities/sustainability/our-insights/opportunities-for-uk-businesses-in-the-net-zero-transition
[2] https://www.lse.ac.uk/granthaminstitute/publication/growing-clean-identifying-and-investing-in-sustainable-growth-opportunities/
[3] https://www.theccc.org.uk/wp-content/uploads/2020/12/Finance-Advisory-Group-Report-The-Road-to-Net-Zero-Finance.pdf
[4] https://www.smf.co.uk/publications/financial-services-and-net-zero/

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advantage of this. Even companies in hard to abate sectors may see the benefits of attempting to decarbonise as financing inflows and lower capital costs can fund the transition and spark growth.[5]

2. What challenges and obstacles have you identified to decarbonisation?

Despite the Government's commitment to net-zero by 2050, various obstacles to decarbonisation remain embedded as part of the UK's policy framework, as a result of market participants' investment policies and as part of a lagging cultural shift to understand the climate crisis. We see three key areas the Government and regulators should seek to address to support economy-wide decarbonisation. The first obstacle is "greenwashing" by market participants. If the City of London were a country, its financed emissions would make it the ninth largest polluter in the world. Between 2016-2021, HSBC and Barclays provided US$107.44 billion to 50 oil and gas expanders.[6] Despite this, the past decade has seen a proliferation of voluntary climate-change initiatives and commitments and rafts of investors flocking to sign up to them. Recent research has found that more than half of businesses in the financial services industry believe at least some competitors are deliberately greenwashing to mislead customers.[7] Apart from exploiting the climate crisis for a competitive advantage, greenwashing risks undermining policy makers' ability to effectively tackle climate and erodes the public's trust that the sector is genuinely working in their interests.

Another obstacle is a lack of legal requirements to mandate decarbonisation. The risks inherent in voluntary initiatives have become clearer over recent weeks. For example the Net-Zero Investment Consultants Initiative (NZICI), a key pillar of the Glasgow Financial Alliance for Net-Zero (GFANZ), has recently seen a key member, Meketa, pull out of the alliance.[8] NZICI was already under pressure following Aon's and Mercer's refusal to join and Meketa's decision has made it a far weaker initiative. Elsewhere two pension funds have left the Net-Zero Asset Owners Initiative while US banks have also threatened to leave the Net-Zero Banking Alliance.[9] [10] Voluntary initiatives are much less effective for the simple reason that signatories can choose to quit as soon as the commitments become too challenging and in some cases GFANZ has in fact led to greenwashing. For example members of the Net-Zero Insurance Alliance still routinely insure new coal power projects with little to no accountability mechanisms in place to address this.[11]

In the UK, ShareAction welcomes recent regulatory initiatives geared towards tackling climate change such as the Transition Plans Taskforce. Nonetheless we are concerned by the proposed comply or explain approach. We note the statement ahead of COP26 by 532 global investors calling for the introduction of mandatory climate transition plans.[12] By ensuring companies and investors have transparent, robust plans to achieve net-zero we can hold such institutions to account and help to drive decarbonisation across the economy. The UK economy will not decarbonise voluntarily. Transitioning at the speed necessary to tackle the climate crisis will only happen where transition

[5] https://www.refinitiv.com/perspectives/market-insights/how-net-zero-can-boost-economic-growth/
[6] https://api.shareaction.org/resources/reports/Fossil-Fuel-Financing-PolicyBriefing.pdf
[7] https://www.iresearchservices.com/sustainability-what-do-investors-want-now
[8] https://capitalmonitor.ai/factor/environmental/exclusive-investment-consultant-exits-net-zero-alliance/
[9] https://www.ft.com/content/df321358-c6d1-4dfc-8ab7-4526fab1305b
[10] https://www.ft.com/content/0affebaa-c62a-49d1-9b44-b9d27f0b5600
[11] https://api.shareaction.org/resources/reports/Going-beyond-insurers-voluntary-initiatives.pdf
[12] https://www.businessgreen.com/news/4056342/global-investors-governments-raise-climate-ambitions-ahead-cop27

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plans, and other policy initiatives designed to tackle climate change, are made mandatory across the whole investment chain.

A third obstacle is a lack of general understanding by the public of finance and the role it can play in tackling climate change (and other global sustainability challenges). Over £2.6 trillion is invested in UK pensions up from £2.3 trillion in 2015. Automatic-enrolment means that this will continue to increase as more people than ever have their own private pension. This means that getting the rules right that govern investments, and ensuring savers understand how their money is being invested are critical to driving investments into climate-friendly projects. For example, switching to a green pension is 21 times more effective at cutting carbon than stopping flying, going vegetarian and switching energy suppliers combined.[13] A recent poll shows that 66% of people want their pension fund to reflect their values, yet 53% consider themselves to have a low understanding of pensions, investments and financial markets and are not aware if their pension fund has an ethical investment option (53%).[14] In the UK around a third of people a financially illiterate, while 90% of people said they learnt "nothing at all" or "not very much" about finance at school.[15] The UK faces a cost-of-living crisis at the same time as a global climate crisis. Educating the public about finance and reducing the amount of financial illiteracy in the UK could help to tackle both.

3. What opportunities are there for new/amended measures to stimulate or facilitate the transition to net-zero in a way that is pro-growth and/or pro-business?

The past few years have seen a surge in demand for green, environmentally friendly products in every sector, including financial services. There is now widespread support for rapid decarbonisation from the private sector, civil society, climate scientists and the public. We welcome the FCA's recent proposals to create a new classification system for retail fund management products to tackle greenwashing and enable retail savers to understand the sustainability credentials of their investments.[16] Public buy-in is critical to the transition to net-zero as are regulatory initiatives that empower individuals to support the transition. While not everyone has a retail investment product, thanks to automatic enrolment most people do have a pension scheme. Ensuring that pension scheme savers are able to choose a product that reflects their views and enables them to support the transition to net-zero would help to boost investment in green products and increase buy-in amongst the public. We agree with the DEFRA Secretary's statement that "Pensions can be the superpower in delivering prosperity for people and the planet in our race to net-zero".[17]

In our answer to Question 2 we highlighted recent polling which showed a high rate of financial illiteracy in the UK. The same research showed that 73% of people said it was important to know where their pension was invested and recent polling from Aviva found that 65% of employees want their workplace pension fund to be invested responsibly. Despite this, UK pension funds have an estimated £128 bullion invested in fossil fuels, which is equivalent to £2,000 for every person in the UK.[18] Public concern about the climate crisis is not a partisan issue. One recent report outline strong support for climate policies amongst Conservative voters and even estimates the party could lose 1.3

[13] https://adviser.scottishwidows.co.uk/assets/literature/docs/60817.pdf
[14] https://highpaycentre.org/high-pay-centre-briefing-pension-saver-views-on-the-social-and-environmental-impact-of-investments/
[15] https://ifamagazine.com/article/ft-poll-shows-90-learnt-little-or-nothing-about-finance-at-school/
[16] https://www.fca.org.uk/publication/consultation/cp22-20.pdf
[17] https://www.gov.uk/government/speeches/policy-exchange-climate-change-speech
[18] https://www.divest.org.uk/pension-funds-invest-2000-in-fossil-fuels-for-every-person-in-the-uk-new-study/

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million voters if net-zero targets were abandoned.[19] Labour too has highlighted how in contrast to 2019, success at the next election will require a shift to a more "environmentally focussed policy platform".

4. What more could government do to support businesses, consumers and other actors to decarbonise?

One measure that could immediately increase investments into green projects and help wider efforts to decarbonise is to reform the law around pension scheme investments. In the UK alone pension assets under management amounts to over £2.6 trillion, so investment decisions made by trustee boards can have an enormous impact on savers, society and the environment. Over the past few years, a debate has taken place about the nature of investors' fiduciary duties – in particular the extent to which pension scheme trustees must maximise returns and the extent to which so called non-financial factors such as climate change may be taken into account. While the UK Government has taken steps to address these questions, notably through the Occupational Pension Scheme (Investment) Regulations, investment practices remain unaligned with the Government's broader ambition to reduce emissions. ShareAction's Responsible Investment Bill set out proposals for statutory redefinition of investors' fiduciary duties which would act as a tax-free measure that would boost investment into green and sustainable projects.[20]

The Responsible Investment Bill reforms the current interpretation of investors' fiduciary duties in two ways. First, it redefines what it means to act in the "best interests" of scheme beneficiaries by raising the ambition of what is expected of trustees as key actors in the economy and society. While the Bill retains the core legal principle of loyalty to beneficiaries, it extends the concept of "best interests" to include wider benefits e.g. the opportunity to live in a stable and sustainable society, economy and environment. In practice, this could see investors factoring considerations of environmental and societal impact into their investment and stewardship decisions. Secondly, the Bill requires investors to consider 'the consequences of their investment activities on the financial system, the economy, communities and the environment'. This idea of "double materiality", i.e. considering not just the risks and opportunities of investments, but also the impacts of investments has recently been embedded into EU law. From next year, the EU's new Sustainable Finance Disclosure Regulations will require asset managers to report on sustainability risks and impacts at product and firm level. We also welcomed the Treasury's recent announcement that it will introduce new requirements for companies – including in the financial services sector – to make sustainability disclosures including reporting of environmental impacts using the UK Green Taxonomy. Double materiality is increasingly becoming the norm amongst financial services sector participants and if embedded within pension regulation could have a transformative effect in boosting economy-wide decarbonisation.

5. Where and in what areas of policy focus could net-zero be achieved in a more economically efficient manner?

The most economically efficient way to transition to net-zero is through early action with continued commitment and involvement from Government, financial regulators and the Bank of England.

[19] https://www.theguardian.com/politics/2022/apr/25/tories-lose-voters-net-zero-target-ditched-poll
[20] https://shareaction.org/policies/responsible-investment-bill-the-change-we-need

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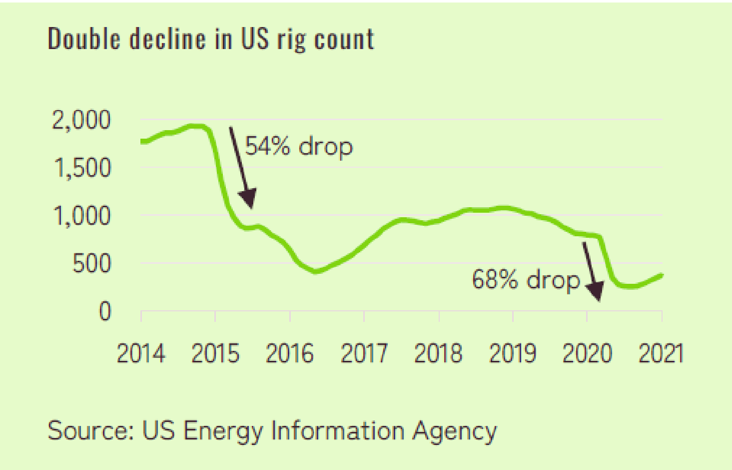
While we welcome the Government's ambition to delivering net-zero in a way that is pro-business and pro-growth, we note with some concern a focus on costs.[21] Inevitably the transition to net-zero will involve short-term costs, but the longer countries wait to make the shift, the larger those costs.[22] A recent report from McKinsey outlines a range of risks associated with a disorderly transition including increased labour market disruption, risks of asset stranding and increased physical climate risks amongst others.[23] The Bank of England's recent climate stress test estimates that climate change could cost UK banks up to more than £340 billion in a severe physical risk scenario in which climate action is delayed.[24] Managing these risks requires a precautionary approach and active involvement of the Government and financial regulators.

Ensuring regulatory frameworks that guide investment are fit for purpose is essential to avoiding a costly and disorderly transition. Legal and regulatory certainty – or at least predictability – allow market participants to prioritise investments that support a path to net-zero. Following the Paris Agreement, international initiatives such as TCFD have helped to support businesses and investors to understand the risks they face from climate change. Much more is needed, however, to address risks associated with the decline in value from fossil fuel assets associated with the transition particularly around lending. Finance Watch notes that:

> *"The 60 largest global banks have around $1.35 trillion of credit exposures to fossil fuel assets. At the moment, the climate-related risks associated with these assets are not reflected in bank capital rules to make sure that banks can cover future losses.*
>
> *The current practice of not treating banks' fossil fuel exposures as higher risk assets under the Basel framework not only encourages the continued build-up of prudential risk, but is also effectively a subsidy from banks to the fossil fuel industry, which we estimate to be worth around $18 billion a year, equivalent to under-pricing the credit risk by 1.3%."*



In the US, fossil fuel boom and bust has happened twice in the past 10 years. As the graph below illustrates, cheap Wall Street debt and high oil prices allowed the US shale industry to grow to unsustainable heights in 2014 and 2019. The result was shale oil prices plunging a dramatic 70% between 2014 and 2016 causing more than 100 bankruptcies. Following the relative highs until 2019, Covid-19 and failed OPEC+ talks drown down both demand and price. Dwindling revenues forced US

[21] https://www.gov.uk/government/publications/review-of-net-zero
[22] https://www.imf.org/en/Blogs/Articles/2022/10/05/further-delaying-climate-policies-will-hurt-economic-growth
[23] https://www.mckinsey.com/capabilities/sustainability/our-insights/the-net-zero-transition-what-it-would-cost-what-it-could-bring
[24] https://www.bankofengland.co.uk/stress-testing/2022/results-of-the-2021-climate-biennial-exploratory-scenario

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frackers, collectively owing $200 billion in debt, into bankruptcies. The Dow Jones industrial stock market index dropped a record 20% in one day.

This resulted in hundreds of thousands of job losses in the oil and gas industry and the loss of billions by US pension funds. In a recent briefing paper we propose that one way to avoid a similar situation in the UK is by ensuring the UK's regulatory framework post-Brexit is reviewed and brought in-line with our commitment to net-zero. Specifically, we argue that the PRA should implement "one-for-one" capital requirements as part of the Solvency II review.[25] This form of capital requirement would match capital leant to finance fossil fuels with capital held in reserve to protect against potential losses. This would act as an emergency brake on fossil fuel investment and help to protect the stability of the broader UK economy by ensuring institutions are risking their own capital rather than the public's.[26]

I hope our views are clear, but please do not hesitate to contact us if you have any questions.

Yours sincerely,

Fergus Moffatt
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[25] Last month ShareAction joined other civil society organisations in sending a letter to the PRA calling for such an approach available at https://neweconomics.org/uploads/files/Open-letter-to-BoE_-climate-and-capital.pdf

[26] Our broader views on ways to make the Solvency II regulation fit for purpose are outlined at https://api.shareaction.org/resources/reports/ShareAction-Solvency-II-Consultation-Response.pdf