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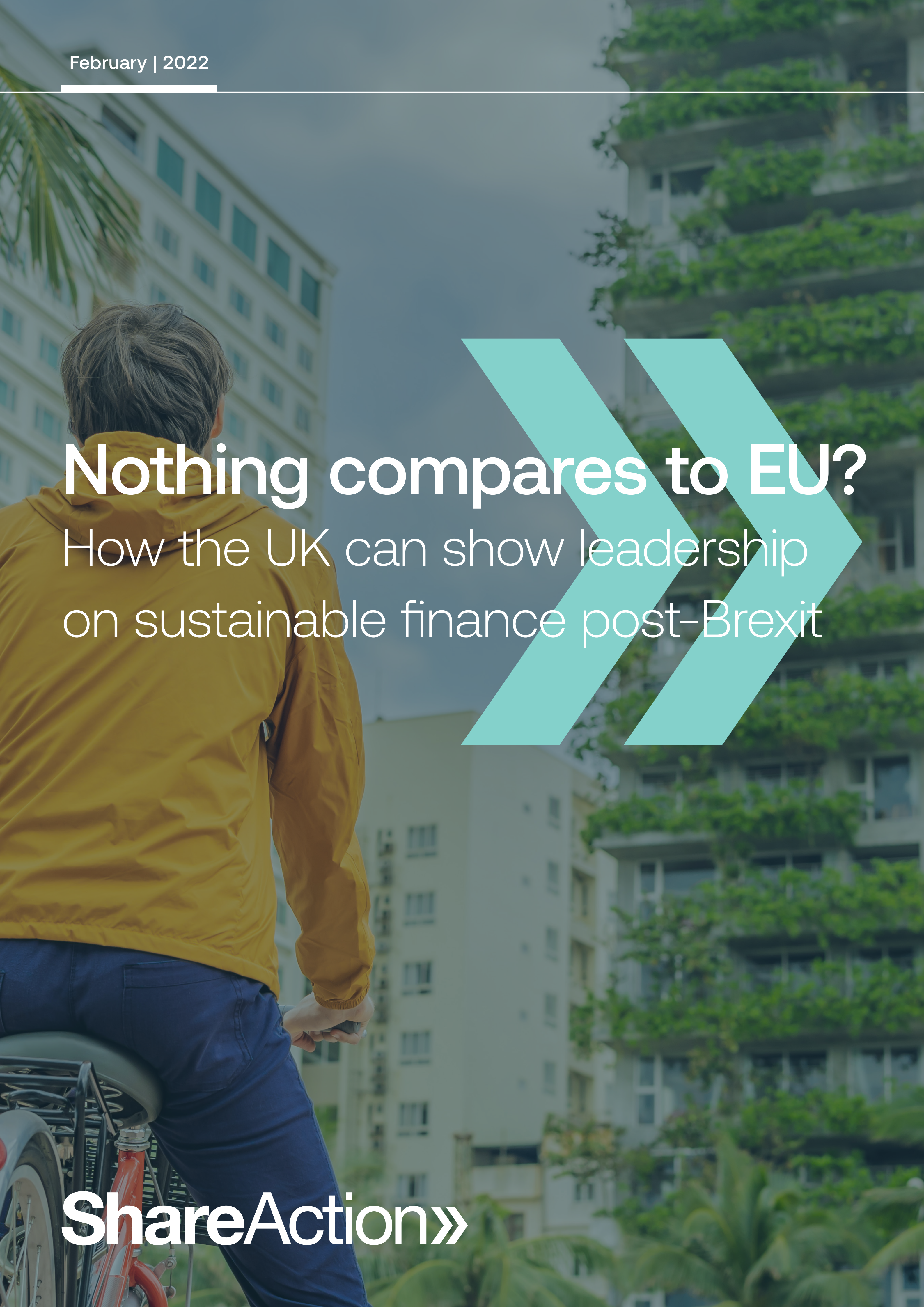

Nothing compares to EU?

How the UK can show leadership on sustainable finance post-Brexit

ShareAction»

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Introduction

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Introduction

In 2020, the financial services sector contributed £164.8 billion to the UK economy, 8.6 per cent of total economic output. 3.3 per cent of all jobs in the UK sat within financial services during this period and exports of UK financial services were worth £62 billion, 35 per cent of which went to the European Union.[i]

While other cities, such as Venice and Amsterdam, have gained and lost the status of being the world's largest financial centre, London has largely maintained its dominance since the 1600s.[ii] Until the EU membership referendum on 23 June 2016, there seemed no reason for this to change. However, when the UK and EU agreed the Trade and Cooperation Agreement ("TCA") in December 2020, outlining the future economic terms between the parties, no significant provision was made for the UK's financial services sector. Negotiations are still incomplete and current arrangements time-limited, with both parties having missed the deadline to conduct assessments that could have created more certainty in this area.

This precariousness has caused a vast amount of speculation as to the likely impact of Brexit on the UK's financial services industry. Research has suggested that services exports were £113 billion lower between 2016 and 2019 than they would have been if the UK had not voted to leave the EU.[iii] However, many commentators are optimistic about the strength and resilience of the UK's sector to withstand these changes.

Post-Brexit, the UK Government must prove its commitment to sustainable finance

The EU has already made major strides in sustainable finance. It adopted two significant regulations for sustainable finance in 2019 and 2020 and published a new strategy for financing the transition to a sustainable economy in 2021. The UK played a major role in the development of the EU's plans and it is therefore pleasing to see it reinforce its commitment to sustainable finance through its Green Finance Roadmap (published October 2021) and accompanying COP 26 announcements on ambitions to make the UK the world's first "Net-Zero aligned Financial Centre".[iv]

On the one hand, it might seem unsurprising that the UK has taken this approach: asset managers attracted £4.3 billion in UK retail money to their sustainable funds in 2021, the highest quarterly total on record.[v] Furthermore, as noted above, 40 per cent of UK financial services exports were to the EU in 2019. Global financial firms may find a significant variance in regulatory regimes complicated to handle from a compliance perspective, which could potentially impact the UK's ability to attract global trade.

However, it was obvious to observers of developments in the City that the UK would double-down on sustainable finance post-Brexit. Talk of a "Big Bang 2.0" and calls for de-regulation did not seem natural bedfellows with the inevitable increase in regulation needed to make finance "sustainable".

As the eyes of the world turned towards Glasgow for COP 26, the UK Government announced its intention to become the world's first Net-Zero-aligned Financial Centre, setting out proposals to shift financial flows towards supporting a net-zero economy. This will include asking financial institutions to publish transition plans (at first on a comply-or-explain basis, then moving to a mandatory approach), setting up a high-level Transition Plan Taskforce and publishing a transition pathway for the financial sector which sets out how the sector will transition to net-zero by 2050.

The Government's plans offer stronger and more concrete commitments to follow its declarations of intent on sustainable finance. This is welcome at a time when (at 41 gigatons global emissions per annum) we are counting down the time until we pass 1.5C warming (seven years) and 2C warming (16 years).[vi]

However, sustainability has much broader implications than climate change, despite the monumental urgency and scale of the threat it presents. We face broader ecological challenges – soil degradation, biodiversity loss and much more – as well as spiralling inequality. If we continue to take a single-issue approach to financial regulation, it will take decades to bring in the legislation needed to tackle each one of these challenges. In this paper, we argue for a broader approach to sustainable finance that aligns financial and economic activities with social and environmental needs.

Brexit offers an opportunity to create a smaller, more robust and more purposeful financial sector

We believe that the ultimate purpose of financial markets is to serve society. This aligns with the Bank of England's explanation for the public, which states that financial markets "exist to bring people together, so money flows where it is needed the most. Markets provide finance for companies so they can hire, invest and grow. They provide money for the government to help it pay for new roads, schools and hospitals. And they can help lower the costs you face buying food at the supermarket, taking out a mortgage or saving for your retirement." What's more, as Lord Adair Turner notes, they play the important function of "market making and liquidity provision in key markets… delivering important indirect economic benefits".[vii]

However, since the 1980s, there has been a shift towards "finance-led growth", meaning that financial institutions have gained increased influence and power in relation to other actors in the economy (consumers, governments, business).[viii] Nicholas Shaxson comments, "A century or more ago, 80 per cent of bank lending went to businesses for genuine investment. Now, less than four per cent of financial institutions' business lending goes to manufacturing – instead, financial institutions are lending mostly to each other, and into housing and commercial real estate."[ix] The New Economics Foundation (NEF) notes that "[t]he UK has the lowest real economy credit ratio[1] of the G7 nations at just over 20 per cent" and that this poses risks to financial stability as well as acting as a drag on the UK's broader economic performance.[x]

There is an opportunity here: to create a smaller, more robust, more purposeful financial sector that promotes sustainable and inclusive economic development across the rest of the economy.

Extensive research suggests that there is an optimum size for a financial sector relative to the rest of an economy, when credit to the private sector is around 90 per cent of GDP,[xi] and beyond this point it acts as a drain on human and other resources which could be put to better use elsewhere.[2] The UK far exceeds this point: for example, hitting 192 per cent in 2009.[xii] The UK financial sector is currently doing much less than it should to support the real economy, and this is a concern given that it is the real economy that directly meets human needs. As Lord Turner also commented, "not everything that a financial system does is socially useful; and sometimes bits of it can get too big and it would be better for society if they got smaller."[xiii] If one of the consequences of Brexit is that the financial sector decreases in size, there is an opportunity here: to create a smaller, more robust, more purposeful financial sector that promotes sustainable and inclusive economic development across the rest of the economy.

1 NEF defines this as the "stock of lending to non-financial corporations plus the stock of lending to households for consumption, divided by total bank lending".

2 A 2018 research paper found that the cost of 'too much finance' for the UK from the 1990s to the current period was in the region of £4,500 billion (approximately 2.5 years of the average GDP across the period). The researchers suggest that the reasons for this include not just the $1,800 billion cost of the 2008 financial crisis but also the costs of misallocation, which they estimate to be 1.5 times the size at $2,700 billion. (http://speri.dept.shef.ac.uk/2018/10/05/uk-finance-curse-report/)

EU relations and financial services

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EU relations and financial services

UK-EU trade arrangements on financial services remain unclear, creating uncertainty for the industry

The UK finds itself in a novel position following Brexit. As part of the European single market, the UK had significant access to the EU's market in financial services, through the arrangement known as 'passporting'. When the UK left the single market on 31 December 2020, the UK's financial services institutions lost passporting rights. Market access is now made available through a system known as 'equivalence'. This is available to third-party states where the EU deems their legal and regulatory frameworks to be equivalent to those of the EU, i.e. they have broadly the same intent and outcomes. However, the EU can also unilaterally withdraw equivalence at any point, given a 30-day notice period.

As the Financial Times noted, the TCA mentions "financial services" only 90 times, while the word "fish" appears 368 times in the document.

The UK-EU trade deal (the Trade and Cooperation Agreement, or TCA) does contain some high-level agreements on financial services. However, as the Financial Times noted, the TCA mentions "financial services" only 90 times, while the word "fish" appears 368 times in the document. The current equivalence arrangements between the UK and the EU are time-limited and expire in June 2022. The UK has since published its own equivalence assessments but the EU has, at the time of writing, refused to do so (with a couple of exceptions).[xiv]

The issue of "equivalence" seems to have diminished in importance as the full Brexit effect of leaving the single market – following the transitional period – becomes apparent. The Chancellor left the door open for possible future deals, saying that the UK did not plan to undercut the EU's rules, which would make equivalence impossible. He used a speech at the City's annual Mansion House event on 1 July 2021 to say that the UK was pushing ahead "as a sovereign jurisdiction with our own priorities".[xv]

However, the question of equivalence has not fully gone away, as there are some existing EU financial services (and related) legislation which impact the sustainable finance agenda. These have been 'on shored' and are undergoing modification and review. They include the Markets in Financial Instruments Directive (MiFID), Solvency II, Institutions for Occupational Retirement Provisions (IORP), the Prospectus Regulation and the Non-Financial Reporting Directive (NFRD). The Shareholder Rights Directive is also being reviewed. The UK is tweaking these measures and it remains to be seen whether the divergence is significant enough for the EU to deny equivalence. The recent Treasury consultation on wholesale capital markets[xvi] indicates that the UK may be more willing to consider divergence in capital markets.[3]

3 The proposals indicate that the government is serious about really considering what needs to change, and that it is not necessarily restrained by trying to maintain equivalence with the EU.

The overall impact on financial markets is not yet clear. The full Brexit restrictions on UK-EU business have seen financial services firms establishing new legal entities, obtaining new local authorisations, relocating jobs and moving capital and assets in order to continue to service their clients.[4] A new study from Birmingham's Aston University found that services exports were £113 billion lower between 2016 and 2019 than they would have been if the UK had not voted to leave the EU.[xvii]

However, some commentators are optimistic about the capacity of the UK's financial services sector to withstand the effects of Brexit, commenting that "London's daily trading volumes still vastly outweigh its European neighbours" and citing currency trading as one sector that has remained unaffected.[xviii] A Freedom of Information request from financial consultancy Bovill found that around 1,500 financial firms have applied for permission to continue operating in the UK after Brexit, with around two-thirds not previously having had physical operations in Britain.[xix]

The EU has the first mover advantage in regulating sustainable finance, raising questions about what the UK can offer

And what of sustainable finance? The Chancellor of the Exchequer, Rishi Sunak, said in his 2021 Mansion House speech that the Government will "reaffirm the UK's position as the best place in the world for green finance."[xx] However, the EU is currently the clear leader in the area of sustainable finance regulation. It has the significant advantage of being the first mover: it is already in the process of putting in place extensive regulatory rules including the Sustainability-Related Disclosure Regulation (SFDR) at the end of 2019 and the Taxonomy Regulation in 2020. The Commission also published a new strategy for financing the transition to a sustainable economy on 6 July 2021.[xxi]

The main focus of EU sustainable finance regulation has been on the classification and disclosure of how far economic activities are sustainable (via the EU taxonomy and SFDR). The EU Climate Transition Benchmarks and the EU Paris-Aligned Benchmarks form the third part of this work, aiming to create a set of benchmarks, standards and labels to help financial firms to align their investment strategies with the EU's climate and environmental goals[5].

4 EU restrictions on the use of UK trading venues have led to a sizeable proportion of EU share trading moving from the UK to the EU. The dust has not yet settled for clearing houses: the EU has not yet said whether it will prohibit EU firms from clearing derivatives on UK clearing houses once its temporary equivalence recognition expires.

5 Future steps outlined in the July 2021 sustainable finance strategy[14] are numerous (summarised in full in Annex 1) and include extending the Taxonomy to elements such as "bridging fuels" and nuclear energy, integrating sustainability factors into prudential framework and clarifying that the fiduciary duties of financial firms includes taking account of financially material sustainability factors.

The UK has strong credentials in sustainable finance – but how much can it add to the EU's frameworks?

In the UK Government's *Greening Finance: A Roadmap to Sustainable Investing*, launched in October 2021, it states that it wants to "ensure that its domestic regulation represents international best practice" and "that the UK remains a global leader in green finance after COP26 and helps to move the world towards delivering the global commitments in the Paris Agreement."[xxii] But in the sixth edition of its Global Green Finance Index,[xxiii] think tank Z/Yen placed London fourth in terms of the depth of its green finance offering, behind Amsterdam, Zurich and Copenhagen. In its 'green finance quality' ranking, London had slipped two places compared with the 2019 index, dropping behind Zurich and Amsterdam.

A key question is whether the UK can develop a regulatory framework for sustainable finance that adds anything more to what the EU has already achieved. Ben Caldecott, founding director of the Oxford Smith School's sustainable finance programme, has argued that the EU taxonomy's sustainability credentials have been undermined by lobbying, and that the UK has an opportunity to create a more rigorous home-grown alternative.[xxiv] However, Nick Robins, Professor in Practice for Sustainable Finance at the Grantham Institute, has commented "the EU is a standard-setter...The UK can learn from the EU, but markets need to be closely aligned and there is very little appetite for major divergence."[xxv] Another sustainable finance expert has described the move as a distraction that will end up simply replicating most of the work already done by the EU.[xxvi] Like the EU, the UK is introducing important reporting and classification requirements on sustainability, including:

- Introducing climate-related financial reporting requirements, based on the recommendations from the Taskforce for Climate-Related Financial Disclosures (TCFD), to extend across the economy by 2025;
- Persuading all G7 economies to move towards making climate disclosures mandatory;
- Implementing its own green taxonomy, the UK's equivalent to the EU's system of classifying sustainable investments. This work will be overseen by the Green Technical Advisory Group with the aim of ensuring that the framework is robust and science-based;
- Asking financial institutions to publish transition plans (at first on a comply-or-explain basis, then moving to a mandatory approach);
- Joining the International platform on sustainable finance (IPSF)[24], which allows members to exchange and disseminate information to promote best practices, compare their different initiatives and identify barriers and opportunities of sustainable finance, while respecting national and regional contexts; and
- Introducing the UK's new Sustainability Disclosure Requirements (SDR). This aligns with that of the EU's SFDR but is somewhat different in practice, since it is based on the UK's TCFD regime and proposes to create a classification system that goes beyond just the products labelled as 'sustainable'. At the same time, the Financial Conduct Authority (FCA) suggests how products labelled within SFDR could be mapped against the SDR framework.[xxvii]

Our solution

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Our solution

The UK could go beyond what other nations have proposed and focus on building a well-functioning financial system that has the explicit purpose of building a better society.

While the UK's work on classification and disclosure is a promising start, this is not the only way to create a sustainable economy. Instead, the UK could go beyond what other nations have proposed and focus on building a well-functioning financial system that has the explicit purpose of building a better society. This would offer a real opportunity to showcase an innovative approach to sustainable finance and promote it in the global marketplace. Our proposed solution lies beyond the financial sector, looking towards the rest of the economy.

Sustainable financial regulation should go beyond disclosure to a fundamental change in activities

We do not believe that simply classifying and disclosing the sustainability of existing economic activities will, in and of itself, create a more sustainable economy. For example, research has found that mandatory climate-related disclosure can lead to a significant decrease in holdings of fossil fuel energy securities by investors.[6] However, divestment of fossil fuel companies does not necessarily lead to reduced overall emissions in the real world, and setting emission reduction targets does not mean those reductions have been achieved. A 2020 report commissioned by the University of Cambridge examined a wide array of research on the value of company disclosure in real-world terms, finding that, "Some studies find no correlation between disclosure and companies' actual environmental performance… while others – controlling for size and sector – find a negative correlation… In other words, the relationship between disclosure and environmental performance is mixed at best, and often negative".[xxviii] This is not a criticism of the value of disclosure: it is vital to have more information about what companies are doing if we are to change it. However, it is important to question whether disclosure on its own is enough to transform existing economic activities and, if not, what else needs to be done.

It is critical that we examine and redesign the workings of the system itself, in order to move beyond addressing issues one at a time.

6 The Carbon Disclosure Project (CDP) has found that companies reporting their emissions achieve greater reductions over time, with 38 per cent of companies having emission reduction targets in their first year of reporting and 69 per cent of companies by their third year.

Furthermore, one issue may be the way in which policymakers have approached financial disclosures. There is a tendency to address each issue individually, for example dealing with climate change in isolation to biodiversity, and considering environmental factors without addressing wider social considerations. If this continues, the result is a potentially huge regulatory burden for disclosures across fragmented initiatives. It is critical that we examine and redesign the workings of the system itself, in order to move beyond addressing issues one at a time.

This should include going back to basics and looking at the fundamental incentives driving the decision-making among executives and investors in companies. For example, enacting the Better Business Act[xxix] would require companies to operate in a manner that benefits their stakeholders, including workers, customers, communities and the environment, while still seeking to deliver profits for shareholders. The Government should also raise the ambition of what is expected of fiduciary investors such as pension schemes as key actors in the economy and society by clarifying their duties to act in the 'best interests' of beneficiaries. This could include extending the concepts of 'best interests' to encompass the wider benefits to beneficiaries of a stable and sustainable society, economy and environment.[xxx]

The financial system needs to rediscover its sense of purpose: its social usefulness

In 2012, Andrew Haldane, then Executive Director of Financial Stability at the Bank of England, said that banks need to 'rediscover their social usefulness'. This is correct. UK policymakers should take time to stand back and reflect on what kinds of incentives, activities and culture within the entire financial sector would be truly sustainable and the range of tools they have (or could create) to make these a reality. This goes beyond merely continuing the status quo with "sustainability bolt-ons", which would be unlikely to ever solve the wider social and environmental issues we need to address.

The EU, and the UK's, approach to creating a sustainable finance system has effectively been 'more finance'. But as Lord Turner, previously chair of the Financial Services Authority (FSA), now the FCA, has said: "[t]here clearly are bits of the financial system, and particularly the bits that relate to fixed income securities, trading, derivatives, hedging, but possibly also aspects of the asset management industry and equity trading, which have grown beyond a socially reasonable size", commenting that certain financial innovation is "socially useless activity".[xxxi] Mark Carney commented in 2013 that "finance that becomes disconnected from the economy, from society, finance that only talks to itself and deals with each other… becomes socially useless".[xxxii]

This is a problem for government. As long as financial markets fail to price in the "externalities" such as carbon emissions (and much wider issues like poor public health and inequality), the resulting human, environmental and economic harm will fall upon broader society rather than the businesses that are doing the damage. Humanity has been in "ecological overshoot" since the 1970s, and we are currently using the equivalent of 1.75 Earths to provide the materials we use and to accommodate the waste we produce.[xxxiii] It is not clear that the market will solve these problems even if it has better information. The UN reported in 2020 that progress is being made towards some areas of the Sustainable Development Goals (SDGs). However, it emphasised that even this progress was being offset by “growing food insecurity, deterioration of the natural environment, and persistent and pervasive inequalities”.[xxxiv]

One option is to price externalities into the market more robustly (and we do need a proper carbon price) but there are other things UK policymakers could do if they look at the economy afresh. They could explore and identify the kinds of financial activity that are useful for us as a society: meeting human needs while staying within the limits of what the planet can sustain.[xxxv] Socially useful activities could include:

- financing energy-efficient social housing through municipal bonds;
- stewardship encouraging investee companies to pay the Real Living Wage;
- encouraging big companies and public bodies to procure goods and services in the local communities in which they operate (the Preston model[xxxvi]).

Social usefulness is not a new idea. In the early 1970s, workers at the Lucas Aerospace Corporation responded to their company’s announcement that thousands of jobs would be cut due to restructuring[31]: in 1976, they developed 150 ideas for new products, including medical equipment and early designs for wind turbines and hybrid cars.[xxxvii] This was ultimately unsuccessful, since the company rejected their proposals, but their work still offers a vision for a more purposeful, useful economy. As Mike Cooley, a designer at the factory, said in 2009: “Just look around. There is work to be done on all sides. What is lacking is the imagination and courage to creatively address it.”[xxxviii]

Such imagination and courage was recently shown by workers at the GKN Automotive factory in Birmingham, who faced the closure of their plant and job losses following a hostile takeover of GKN by private equity firm Melrose Industries PLC in 2018. The GKN workforce put together a 90-page plan setting out how they could reorganise production to save money and make the new components needed for electric vehicles. However, in an echo of its 1976 predecessor, Melrose rejected the plan and is going ahead with closing the plant.[xxxix] This is the exact opposite of financing the just transition we require.[7] As long as we allow short-termist takeovers to continue, generating vast short-term profits for firms and decimating communities, attempts to build a sustainable financial system will come to nothing.

7 We define the just transition here as a fair and inclusive process that prioritises the social needs of workers, communities, consumers and citizens impacted by the transition to a net-zero economy.

The Government needs to identify what socially useful economic and financial activity looks like and address the fundamental incentives driving behaviour.

The Government needs to identify what socially useful economic and financial activity looks like and address the fundamental incentives driving behaviour. This should include creating a holistic strategy for encouraging lending and investment in socially useful areas, using tools such as blended financing and tax incentives. It might involve creating a new regime in financial regulation where financial products and services are assessed and permitted on the basis of social usefulness. This would shift the burden of proof, as contemplated by Lord Adair Turner: "Does that mean that we as regulators have to sometimes ban new products and say, "I'm going to ban that unless you can prove to me that it is socially useful"? The whole burden of proof in the past has been the other way round—an organisation like the FSA has worked on the assumption that it has to define that there is some specific market failure, or else our intervention is not legitimate."[xl]

We need strong regulators that can ensure well-functioning markets, protect consumers and encourage socially useful activities

Carlota Perez has commented, "the whole problem of adequate regulation has to do... not with restraining finance but with steering it away from the toxic behaviours of recent times and opening sufficiently profitable avenues in the direction of the real economy."[xli] We need more planning and direction from the Government if we are to tackle the massive existential threats we face, identifying what outcomes we want to see and how to get there.

There is real potential to achieve this through the Government's ongoing review of the regulatory frameworks covering the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).[8] The UK Government is reviewing the framework for financial regulation in the UK post-Brexit and has identified that "[a] gap in the original FSMA model is that, while it set high-level general objectives and principles, it did not provide for government and Parliament to set the policy approach for specific areas of financial services regulation."[xlii] With this in mind, the Government is planning to introduce new policy framework legislation setting out the overall purpose and regulatory approach needed for the regulation of specific financial sub-sectors. The regulator would then take this into consideration when developing policy and designing regulatory requirements for that particular activity.

If the Government were willing to set a policy approach for regulators to follow, this could allow us to move away from the idea that these systemic issues can only be framed in risk

8 The FCA focuses on regulating the behaviour of financial firms, aiming to ensure financial markets work effectively and consumers are treated fairly. The PRA, part of the Bank of England, prudentially regulates and supervises major banks, building societies, credit unions, insurers and investment firms. It focuses on promoting the safety and soundness of these institutions, as well as helping to protect policyholders.[33]

terms, to be solved by asking every market participant to come with their own response.[9] The Government has already begun taking steps in this direction: in March 2021, the Chancellor wrote to the FCA stating that it should "have regard" to the government's commitment to achieve a net-zero economy by 2050 when considering how to advance its objectives and discharge its functions.

That said, November 2021 proposals from the Government[xliii] to add new objectives on growth and international competitiveness are concerning. The question is what will be gained by creating more formal objectives around competitiveness and growth when they are already there in some form in the regulators' objectives and principles. By adding a new secondary objective for the FCA, are we going to see rules weakened to attract business? That would be a cause for concern and potentially undermine the very integrity of the UK market that makes it attractive. Just as international businesses use the UK's legal system for its high standards and rule of law, we should focus on strong regulators that can ensure well-functioning markets that protect consumers and, ultimately, avoid financial crises that are bad for competition and growth. This is a missed opportunity to think about how the way the markets are regulated could align with a sustainable economy.

We should focus on strong regulators that can ensure well-functioning markets that protect consumers and, ultimately, avoid financial crises that are bad for competition and growth.

There is also real concern that proposed changes to powers of the executive and the regulators could result in decreased transparency and scrutiny around financial legislation and regulation. It is crucial that all voices are heard in developing public policy for the financial sector, not just the financial sector itself. Given the impact of the financial sector on the real economy, communities likely to be affected by its real-life impact should be brought into the discussions, as well as experts representing their interests. Financial regulators should create new formal mechanisms to allow for meaningful and broad stakeholder input.

We need to talk about growth

Growth is an important part of this conversation. Economic growth, as measured by Gross Domestic Product (GDP), can be defined as the continual aggregate expansion of economic activities. It is a model that has predominantly served as an indicator of economic success for global governments. There have long been critiques of this model but these are increasingly coming from mainstream sources. This includes the Dasgupta Review on Biodiversity,[xliv]

9 For example, the FCA states in its webpage on climate change and sustainable finance that it aims to make sure that its regulatory approach "creates an environment in which market participants can manage the risks from moving to a more sustainable economy and capture opportunities to benefit consumers."

commissioned by the UK Treasury, the World Economic Forum's Dashboard for a New Economy[xlv] and the Wellbeing Economy Governments partnership (WEGo),[xlvi] of which Scotland and Wales are members.[xlvii]

Research has found that, beyond a certain point, GDP-growth does not improve human welfare or life satisfaction.[xlviii] As currently pursued, it overlooks and contributes to inequalities, including those based on gender and race. What is more, the cumulative impact of economic growth pursued for its own sake means that we are consistently overshooting the limits of what the Earth can sustain.[xlix]

Yet our economies are currently designed to depend on growth, requiring it to avoid social crises. There is no one clear answer to this conundrum. One possibility is the "Degrowth" concept, which calls for a move away from market mechanisms and values towards grassroots, alternative and care-based economies, conviviality and localisation. Another is the theory of "Steady State Economics", which holds that states can use market mechanisms to manage emissions and resource use. A third is the 'New Economics of Prosperity', which seeks a more differentiated or agnostic approach to growth. This includes policies to mitigate capitalism's growth imperative (such as working time reductions, job guarantee scheme, and a care and repair economy) while also recognising the challenges of a perceived 'hair shirt' existence.[l]

No matter what approach we eventually take, we need to talk about how we measure the performance of a sustainable economy. A starting point could be what Bill Baue refers to as a 'threshold approach' to sustainability: asking regulators and standard-setters, such as the IASB and SASB, to link corporate activity and its material footprint to externally defined measures of social and ecological carrying capacity, such as planetary boundaries.[li]

Conclusion

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Conclusion

We believe the UK Government should, via the financial regulators, provide a clear steer for financial organisations that they should support and reward socially useful activities, for example with better loan rates and greater levels of investment. This could build on existing work in terms of taxonomy labelling and requirements for disclosure. This would draw on but go beyond the good work that has been done by the EU in the area, avoiding the need to reinvent the wheel and maintaining regulatory consistency between jurisdictions. However, we can go further and faster than the EU, to cement the UK's reputation for leadership in sustainable finance whilst recognising the scale and urgency of the global challenges we face.

We can go further and faster than the EU, to cement the UK's reputation for leadership in sustainable finance whilst recognising the scale and urgency of the global challenges we face.

The EU and UK have both made important contributions to the sustainable finance agenda, developing new ways of defining and labelling concepts that have always been hard to pin down from an economic perspective. That said, we do not believe that simply classifying and disclosing the sustainability of existing economic activities will, in and of itself, create a more sustainable economy. Post-Brexit, the UK Government should explore and identify the kinds of financial activity that are useful for us as a society, as well as addressing the fundamental incentives driving behaviour in these systems. This would be a significant moment in the history of financial regulation in the UK. We should grasp the opportunity to equip ourselves to face unprecedented ecological challenges with an imaginative, outward-facing approach to financial regulation that aims to facilitate shared prosperity within planetary boundaries and flourishing local economies across the UK.

Annex 1: Steps outlined in EU's July 2021 Sustainable Finance Strategy

- Introducing legislation to recognise and support the financing of so-called "bridging fuels" to a zero-carbon economy, such as gas. This may include extending the Taxonomy to activities with an "intermediate" level of environmental performance.
- Extending the Taxonomy to activities not yet covered, such as agriculture and nuclear energy.
- Creating new bond labels, such as transition or sustainability-linked bond labels.
- Exploring means of encouraging green financing and lending for small and medium-sized enterprises (SMEs) and individuals.
- Enabling and encouraging innovation to help SMEs use digital sustainable finance tools and support retail investor understanding of the sustainability impact of financial products.
- Creating a natural disaster insurance dashboard and initiating a Climate Resilience Dialogue between insurers, re-insurers, public authorities and other stakeholders.
- Reviewing technical standards under the SFDR for social factors and publishing a report on the provisions required for a social taxonomy.
- Developing the use of green budgeting tools for public finance and risk-sharing between public and private investors.
- Supporting international work on integrating sustainability into financial reporting and accounting.
- Taking action to improve transparency of credit ranking and rating outlooks.
- Integrating sustainability factors with prudential frameworks for banks and risk management systems and supervision of insurers.
- Working with European supervisors and the European Central Bank to capture, monitor and manage systemic risks.
- Requiring large EU companies and listed companies to disclose sustainability targets and their progress towards meeting them.
- Clarifying that the fiduciary duties of financial firms include taking account of financially material sustainability risks and considering sustainability preferences of their clients.
- Taking action to improve the reliability, comparability and transparency of environmental, social and governance (ESG) ratings.
- Assessing whether supervisory powers, capabilities and obligations are fit for purpose in addressing greenwashing.
- Developing a robust monitoring framework to measure capital flows to sustainable investments, to monitor and assist with an orderly transition of the EU financial system.

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About ShareAction

ShareAction is a NGO working globally to define the highest standards for responsible investment and drive change until these standards are adopted worldwide. We mobilise investors to take action to improve labour standards, tackle climate change and address pressing global health issues. Over 15 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. Our vision is a world where the financial system serves our planet and its people.

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