

Written evidence submitted by ShareAction

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House of Commons
London
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Response to 'The role of natural capital in the green economy'

I am writing to respond to the Environmental Audit Committee (EAC)'s inquiry on the role of natural capital in the green economy 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 to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the view of clients, beneficiaries, and pension scheme members.

This submission responds to questions 1, 2 and 5.

1) What potential contribution can private capital investment make to measures to secure nature recovery?

Private capital investment can and must be part of efforts to restore nature, given the dominance of private financial institutions in the global economy. Public financial institutions, including governments, cannot alone provide all the financing necessary to address the biodiversity crisis. A report by the UN Environment Program on nature-based spending across G20 countries found that the current total annual investment of USD\$120 billion on nature-based solutions is inadequate. The report called for an increase in spending, to USD\$285 billion, by 2050 'to avert a nature, climate and land degradation crisis.'ⁱ Private financial institutions urgently need to address this investment gap, through increased engagement and consideration of their impacts and dependencies on nature.

In 2021, the Dasgupta Review on the Economics of Biodiversity laid out the critical importance of nature for the global economy. The Review highlights how ignoring biodiversity as a cornerstone of life on Earth is putting significant pressure on both the health of the planet and global economic stability. Human activity has had dire impacts on Earth's ecosystems, with extinction rates now far higher than the average 'background' rateⁱⁱ, resulting in a 69 percent decline in wildlife populations over the last 50 yearsⁱⁱⁱ and one million species now at risk of extinction^{iv}. Functioning ecosystems provide innumerable benefits, including food security, climate regulation and public health benefits. Destruction of these ecosystems pose a major risk to financial institutions, ranging from decreased supply of raw materials and other commodities, to reduced agricultural production and major disruptions to global supply chains. Nature loss leads to decreased resilience, of both communities and economies, and financial institutions need to urgently integrate biodiversity policy into their financial decision-making.^v

With over half the world's GDP (Gross Domestic Product) reliant on nature^{vi}, simply redirecting investment into biodiversity-positive sectors is not enough – companies should be actively de-investing in harmful industries, such as mining. Stewardship approaches should reflect the urgency and scale of the biodiversity crisis and be designed to improve biodiversity-positive impacts whilst minimising negative consequences. Companies should be adopting biodiversity-positive specific policies and embedding these within their strategy and financial decision-making.

Difficulty measuring impacts on biodiversity has been quoted by many investors as a key obstacle to considering nature within financial decisions.^{vii} Data provided by financial institutions should be meaningful and consistent, to allow for comparison across the sector and encourage best practice.

ShareAction supports the launch of the Taskforce on Nature-related Financial Disclosures (TNFD), a framework designed to increase corporate disclosure and transparency around nature-related risks. The TNFD follows the launch of the Taskforce on Climate-related Financial Disclosures (TCFD) in 2017. Under the FCA's ESG (Environmental, Social, and Governance) rules companies are now expected to include climate-related financial disclosures against the TCFD in their annual financial reporting.^{viii}

ShareAction recommends that disclosures against the TNFD should also be made mandatory as a matter of urgency^{ix}. This is an achievable goal for regulators: TNFD intentionally follows the same format, structure, and language of the TCFD, with all 11 TCFD recommended disclosures being carried over into the TNFD recommendations. Making reporting against the TNFD mandatory would be a major step towards securing nature recovery, and the framework has enormous potential to enable businesses and financial institutions to act on nature-related risks if adopted.

Increased due diligence around investments is essential for changing behaviour across the sector, and financial institutions should urgently integrate biodiversity policy into their strategy and decision making. This will hold institutions accountable for addressing the negative impacts their financing activities have on nature, as well as pushing them to start reallocating capital to activities and sectors that actively benefit nature and nature recovery, such as restoring wetlands and sustainable agriculture^x. Analysis of nature in the UK has revealed particularly concerning trends – a report by the RSPB (Royal Society for the Protection of Birds) in 2019 found that 15% of all UK species are at risk of extinction^{xi}, with the 2019 State of Nature report reporting that 41% of species in the UK have shown strong or moderate decreases in abundance^{xii}.

Since the publication of the Dasgupta Review in 2021, little to no action has been taken by HM Treasury to embed the recommendations into UK financial regulation. ShareAction encourages the Environmental Audit Committee to continue to hold ministers to account for the slow progress in enshrining biodiversity protection within UK regulatory frameworks.

2) How can investment best be aligned with environmental benefits, so as to achieve or surpass the Government's targets for nature recovery?

The rules that govern how financial institutions invest can have an enormous impact – positive and negative – on the environment. At the same time, the financial system does not exist in a vacuum; the environment in which it operates has ramifications on its ability to function efficiently. With 75% cent of land, and 66 per cent of marine environments have already been severely altered by human activities, not enough is being done by governments and regulators to align financial regulation with a nature-positive future and mitigate the systemic risks faced by nature loss.

In the UK, private pensions^{xiii} participation stands at 15.9 million savers.^{xiv} This has put the future of many people's livelihoods in the hands of the financial system. However, interpretations of trustee fiduciary duties remain out of step with today's world – with evidence showing that the management of savers' money is misaligned with a sustainable future: impacting savers' quality of life, including their ability to retire on a liveable planet.^{xv} Common interpretation of the law still understands the purpose of pension investments and investing in the 'best interests' of scheme members, to be to maximise short-term financial returns – at significant expense to wealth creation over the longer-term. These risks have the potential to pose such a significant impact that the structural integrity and functioning of the financial system itself is put at risk.^{xvi} At the same time, these financial risks are a reflection of the impacts of climate change and biodiversity loss that are already being felt and that are predicted to pose an existential threat to every facet of natural and human life – impacts that are, in large part, caused by the activities of companies and governments in which pension funds are invested. Pension trustees need a legal framework that enables them to manage and respond to these risks.

Analysis from New Financial estimates that the UK is lagging far behind the EU in terms of the proportion of market activity that may be considered 'green'.^{xvii} It is worth noting that, as part of the EU Commission's strategy for Financing the Transition to a Sustainable Economy, it committed to clarifying investors' fiduciary duties to reflect the financial sector's contribution to the EU's climate and

environmental targets.^{xviii} The EU is now well on the way towards reforming fiduciary duties to better align with sustainability goals – with the regulator EIOPA (European Insurance and Occupational Pensions Authority) recommending embedding requirements for pension funds to both consider the impact of their activities on sustainability factors, such as biodiversity, and integrate members and beneficiaries’ preferences related to sustainability in their investments.^{xix} Requirements to consider the impact of investment activities on sustainability factors are largely embedded across financial regulation in the EU, beyond just pension funds. For insurers, as of August 2022 this has been not only permitted, but is now mandatory within Solvency II.^{xx}

In the UK, a reframing of pension trustee fiduciary duties would bring the pensions sector in line with climate and societal goals and align with beneficiaries’ best interests. Despite some regulatory clarification in 2018 as to how trustees ought to deal with environmental, social and governance (ESG) factors^{xxi}, the law still frames these factors as relevant if they can be shown to have a short-term material financial impact on specific investments. This makes it difficult for trustees to act in a broader, more holistic way: to factor in the impacts – often longer-term, and more systemic – represented by physical and transition risks, as well as other social and environmental risks, to their overall portfolio. This increases the likelihood that pension schemes are putting savers’ money at risk. The law also does not require a trustee to manage the impact of their portfolio on society and the environment, thereby enabling them to invest in a way that jeopardises savers’ chances of retiring into a world that provides them with a good quality of life.

It is notable that company director obligations require they ‘have regard to’ a range of matters including ‘the impact of the company’s operations on society and the environment’ and ‘the consequences of any decision in the long-term’.^{xxii} The UK Government’s 2023 Green Finance Strategy sets out a welcome commitment to engage with stakeholders on the topic. Now is the time to seize this opportunity to implement meaningful reforms.^{xxiii}

We recommend the Government take the following steps to better align investment with environmental benefits and help to meet its targets for nature recovery:

- 1. Redefine and clarify in law what it means to act in beneficiaries’ best interests.** Clarify and expand, in law, the definition of beneficiaries’ ‘best interests’ to give greater latitude to trustees to act on sustainability impacts, including biodiversity loss. This would also ensure that trustees fulfil their existing duties to consider sustainability-related financial risks and opportunities more comprehensively, by encouraging trustees to act on sustainability impacts – including collaboratively, with other schemes – that are likely to have systemic financial implications in the long-term. It would also better align pension trustee investor duties with company director obligations.
Legislation could entail amending Regulation 4 of the Occupational Pension Schemes (Investment) Regulations 2005 to clarify that all investment functions must be carried out in the best interests of beneficiaries, and to be fair between the beneficiaries (including between present and future beneficiaries), and in doing so have regard to:
 - a. the likely consequences of any investment activities in the long-term (including the way in which the investment strategy is consistent with the profile and duration of its liabilities to beneficiaries, and how they contribute to the medium to long-term performance of its assets);
 - b. the impact of any investment activities on the financial system, the economy, communities, and the environment;
 - c. environmental, social and governance considerations (including, but not limited to, climate change) which the fiduciary investor considers financially material;
 - d. systemic risks, including how the scheme has considered and sought to mitigate systemic risks; and
 - e. where appropriate, the views of beneficiaries.
- 2. Require trustees to outline to savers the scheme’s understanding of best interests and report on how this has guided their decision-making.** This would introduce transparency and accountability to ensure that trustees fulfil their duties. Legislative options include

amending Regulation 2 of The Occupational Pension Schemes (Investment) Regulations 2005 to require that schemes' Statement of Investment Principles (SIP) include an analysis of trustees' understanding of what is in savers' 'best interests', and how they will have regard to the factors outlined above. Additionally, require schemes to report annually to beneficiaries on how they have delivered in their best interests – this could be integrated within schemes' existing Implementation Statement obligations, or as a standalone requirement.

3. **Ahead of legislative reform, publish statutory guidance on how trustees should consider sustainability impacts.** Guidance to include how trustees consider the likely long-term consequences of investment decisions; the impacts of sustainability risks, including system-level risks; and the impacts of investments on society and the environment. It should also place social factors on an equal footing with climate and wider environmental factors. While guidance would represent a helpful tool for trustees, we remain of the view that it will not be enough to shift the dial to help the pensions sector to adequately act on sustainability impacts, including biodiversity loss. This statutory guidance should be seen as a steppingstone towards, rather than a replacement for, broader legal clarification.

5) How can the proposed UK Green Taxonomy support high-quality investments which deliver genuine benefits to nature? What financial disclosures should the taxonomy require?

The Green Taxonomy is a significant opportunity for the UK to become a global leader within green finance, and to achieve the Government's ambitions for halting biodiversity loss and recovering our natural world. The creation of a UK Green Taxonomy follows the creation of the EU Green Taxonomy, implemented in 2020 and designed to provide a classification system for environmentally sustainable activities.

There is particular concern over labelling environmentally harmful activities, such as nuclear energy and fossil gas, as 'sustainable' activities, with Austria describing this as 'greenwashing' and bringing legal action against the European Parliament.^{xxiv} Reflecting the EU's approach, Jeremy Hunt announced earlier this year that 'nuclear power will be classed as environmentally sustainable.'^{xxv} Doing so sends a false message to financial institutions on what is sustainable and undermines the purpose and credibility of the Taxonomy. ShareAction has joined civil society organisations in signing open letters against labelling fossil gas and nuclear energy as 'green' activities, as this inherently contradicts the goal of the UK Green Taxonomy to deliver genuine benefits to nature.^{xxvi, xxvii}

In addition, it is not enough to focus on what is 'green': the rate at which nature is declining means action must be taken on activities harmful to nature. The UK Green Taxonomy does not refer to the agriculture or fisheries sectors – both are sectors that employ practices with devastating consequences on biodiversity. With the UK Green Taxonomy, the UK Government has an opportunity to further champion nature as a priority and include reference to significantly harmful activities. Often referred to as a 'brown' or 'extended' taxonomy^{xxviii}, there is appetite for a classification system that focuses on activities harmful to the environment. For example, a potential extension to the EU Taxonomy to include mining and other such activities has been welcomed by the European Fund and Asset Management Association (EFAMA).^{xxix} The purpose of this extension would not be to 'blacklist' businesses, but instead to encourage a transition towards 'greener' activities. This would further improve the credibility of the UK Green Taxonomy. In response to advice published on an EU extended taxonomy, Maria van der Heide, Head of EU Policy at ShareAction commented: "It is crucially important for investors to know which proportion of their portfolio is not, or not yet, green, as this is where the urgent action is required."^{xxx}

Financial institutions can use the Green Taxonomy to support high-quality investments which deliver genuine benefits to nature by ensuring international consistency alongside practical useability. ShareAction's research on asset managers, asset owners and banks has shown that a major barrier to including nature within financial decision-making is a lack of knowledge on which data and metrics to use to best measure their impact.^{vii} The Technical Screening Criteria (TSC) of the Green Taxonomy should be science-based, with clear, granular definitions. ShareAction supports GTAG's recommendation that the Government clarify what specific impacts and outcomes the TSC seek to achieve, to avoid undermining the Green Taxonomy.^{xxxi} ShareAction also welcomes the Government's

ambition for mandatory disclosures. Mandatory, industry-wide disclosure reporting is essential to ensure real, high-level change and this will not happen without the relevant legislation to steer financial institutions in the right direction.

Yours sincerely,

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- ⁱ UN Environment Programme, [The State of Finance for Nature in the G20 report](#) (2022)
- ⁱⁱ HM Government, [The Economics of Biodiversity – The Dasgupta Review](#) (2021)
- ⁱⁱⁱ WWF, [Living Planet Report](#) (2022)
- ^{iv} Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES), [Global Assessment Report](#) (2019)
- ^v Taskforce on Nature-related Financial Disclosures, [Recommendations of the Taskforce on Nature-related Financial Disclosures](#) (2023)
- ^{vi} WEF, [Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy](#) (2020)
- ^{vii} ShareAction, [Biodiversity: a scoping report](#) (2020)
- ^{viii} FCA, [Climate-related reporting requirements](#) (2022)
- ^{ix} ShareAction, [ShareAction welcomes new TNFD framework as a step forward for biodiversity](#) (2023)
- ^x WEF, [How can we increase finance for nature-based solutions?](#) (2022)
- ^{xi} RSPB, [A Lost Decade for Nature](#) (2019)
- ^{xii} The National Biodiversity Network, [State of Nature Report](#) (2019)
- ^{xiii} This figure refers to private sector pensions participation only (not including LGPS schemes)
- ^{xiv} HM Government, [Review of the Automatic Enrolment Earnings Trigger and Qualifying Earnings Band for 2023/24: Supporting Analysis](#) (2023)
- ^{xv} Make My Money Matter, [Climate Action Report](#) (2022)
- ^{xvi} Carbon Tracker Initiative, [Loading the DICE Against Pensions](#) (2023)
- ^{xvii} New Financial, [A reality check on green finance](#) (2022)
- ^{xviii} European Commission, [Strategy for Financing the Transition to a Sustainable Economy](#) (2021)
- ^{xix} EIOPA, [Consultation paper on technical advice for the review of the IORP II Directive](#) (2023)
- ^{xx} Principles for Responsible Investment (PRI) Blog, [Solvency II has some new sustainability impact requirements and they matter for insurers](#) (2022)
- ^{xxi} HM Government, [Pension trustees: clarifying and strengthening investment duties](#) (2019)
- ^{xxii} See Section 172 (d) of the [Companies Act](#) (2006)
- ^{xxiii} HM Government, [Mobilising Green Investment: Green Finance Strategy](#) (2023)
- ^{xxiv} Euronews, [Austria to take EU to court over 'greenwashing' of gas and nuclear](#) (2022)
- ^{xxv} ESG Today, [UK Classifies Nuclear as "Environmentally Sustainable" in Green Taxonomy](#) (2023)
- ^{xxvi} E3G, [Joint CSO statement on UK Green Taxonomy](#) (2022)
- ^{xxvii} Reclaim Finance, [92 civil society organizations call on financial institutions to avoid taxonomy-aligned greenwashing](#) (2022)
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- ^{xxx} ShareAction, [ShareAction welcomes Extended Taxonomy report and calls on Commission to act swiftly](#) (2022)
- ^{xxxi} Green Finance Institute, [Advice on the development of a UK Green Taxonomy](#) (2022)