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Rt Hon Philip Dunne MP
Chair, Environmental Audit Committee
House of Commons
London
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Sent via online form

Dear Mr Dunne,

<u>Response to Greening the post-Covid Recovery inquiry</u>

I am writing on behalf of ShareAction; we are a registered charity established to promote transparency and responsible investment practices by institutional investors throughout our capital markets. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters.

ShareAction advocates regulatory reform of the investment system, so that it better facilitates responsible investment and mitigates the financial risk posed by environmental, social and governance (ESG) factors, such as climate change. There has been much debate in recent months on how to 'Build Back Better'. We believe reform of the regulatory framework of the investment system, to mitigate ESG risk and unlock private capital to promote a green economy, is essential to do this. Greening the post-Covid recovery for the long-term is only possible if it has reform of the investment system at its core. Without taking this action, even greater economic shocks derived from ESG factors will damage our economy in years to come.

1) ***How can any fiscal and economic stimulus packages be aligned with the UK's ambitions on net-zero, biodiversity, the circular economy, and Sustainable Development Goals?***

Any stimulus package should reflect the fact that a failure to achieve the UK's ambitions in these areas means we remain exposed to major financial risk. Greening the post-Covid recovery should not be seen as an optional enhancement. Climate change, along with other ESG factors, are a threat to economic stability. Covid-19 has starkly shown how the economy is devastated when the crystallisation of risk happens. Climate change poses an even graver threat, and the Government's response must mitigate this.

Regulatory reform of the UK investment system can make it more transparent and accountable. It can incentivise more long-term thinking by institutional investors. Such an investment system would in turn help build a green recovery, as it would facilitate more responsible investment, grow capital in green industries and mitigation of ESG risk. A stimulus package could be used to accelerate the creation of a responsible investment system.

As a first step, recipients of a stimulus should be required to issue climate-related disclosures. In 2017, the Taskforce for Climate-related Financial Disclosures (TCFD) published a framework[1] for companies to report on their preparedness for climate change. Mandatory TCFD reporting is being implemented in a piecemeal fashion – at time of writing, BEIS are considering implementation, DWP have given themselves powers to enforce mandatory reporting for pension schemes, and the FCA are only considering its application to premium listed companies. For other sizable sections of our economy, in particular banks and asset management firms, there is comparatively little action in this area. For TCFD reporting to be effective, it must apply to all sectors, and this requires a consistent and joined-up approach from Government and regulators.

Making production of TCFD reports a condition of the stimulus package should catalyse activity in this area. This would provide the data on the scale of climate risk companies face, which will enable them to take the necessary action to mitigate it. In doing so they will help build a green recovery.

2) ***How should the policy response to the current crisis differ from the response to the global financial crash of 2008?***

If new regulatory reforms are introduced to the investment system, they should better reflect the balance of power within the investment system. In particular, they should acknowledge the huge influence institutional investors have, and the need for them to use that influence responsibly. Section 172 of the Companies Act 2006 outlines the duties for company directors to safeguard the wellbeing of the company, including in respect of ESG factors. Equivalent legislation is needed for asset management firms who control large amounts of capital in these companies. A regulatory regime is needed that gets directors and their investors working together constructively to improve their ESG credentials.

The UK Stewardship Code, a code of conduct for institutional investors, provides an example of a post-2008 reform that did not go far enough. The FRC published the Code in 2010, and further revised it in 2012 and 2020. The most recent iteration has some welcome changes, in particular an explicit focus on the ESG risk and the responsibility of institutional investors to be incorporate this into their stewardship of assets. Signatories are also required to produce an annual stewardship report, detailing how they have complied with the Code. However, the Code crucially lacks an enforcement mechanism. Without any penalisation for signatories that fail to adhere to the Code, there is no incentive for signatories to be proactive in managing ESG risk. At time of writing we are currently in the first reporting cycle of the 2020 Code, with the first stewardship reports due to be published in 2021. Once the Code has bedded in, we would recommend the Committee makes representations to the FRC (or its successor body, the Auditing, Reporting and Governance Authority) to give the Code an enforcement mechanism. Compared to the reforms we saw post-2008, making these changes to the regulation of institutional investors would mark a much more substantive change to how the investment system operates.

3) **In what areas should interventions be targeted to deliver both economic and environmental benefits in the short and long term?**

As detailed above, reform of the investment system will help ensure all sectors of the economy can deliver economic and environmental benefits. We would stress that this reform should be enacted at all levels of the system to create maximum impact. The aforementioned proposals for how institutional investors, in particular asset managers, are regulated would be crucial for delivering benefit in the short and long term.

[1] Taskforce on Climate-related Financial Disclosures (June 2017). *Recommendations of the Taskforce for Climate-related Financial Disclosures.* Available online at: https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf [accessed 14 August 2020].

Further down the investment chain, pension funds also have a role to play to deliver economic and environmental benefits. Pension assets total $2.9 trillion (102% of UK GDP)[2]; as the Committee noted in its Greening Finance report[3] in June 2018, the pensions industry has a role to play to decarbonise our economy. Introducing a legislative requirement to for pension schemes to align their investment strategies with the goals of the Paris Climate Agreement would help ensure this capital delivers economic and environmental benefits, while protecting the assets of scheme members from the long-term financial risk climate change poses.

4) **How could the Autumn budget be used to shift taxation from economically beneficial things, such as jobs and incomes; to environmental harms, such as pollution and waste?**

The budget should begin an assessment of new ways of taxing or trading carbon, or make current measures more effective. The Government should consider what signals they are sending to financial markets about how they price in externalities such as carbon emissions.

5) **What sustainability conditions should be attached to Government bailouts for high-carbon industries?**

As detailed above, requiring recipients of bailouts to publish TCFD reports would produce the data needed to get these industries on a sustainable pathway.

6) **How can the economic recovery stimulus be used to deliver green jobs at a time of potentially high unemployment?**

If the investment system is rewired to incentivise responsible investment, it will provide a boost to green industries. For example, ShareAction's research into bank financing of the shipping industry examined how the industry is expanding its research and development of green technology – examples include a battery-electric cargo ship developed by Guangzhou Shipyard, and a tanker vessel retrofitted with rotor sails developed by Maersk.[4] These burgeoning green industries will create more jobs, but only if the capital is available. Ensuring the recovery stimulus creates greater disclosures of climate risk will accelerate the transition to a low-carbon economy, and build investment in green industries.

This approach should be complemented by direct funding from the Government. Since the Green Investment Bank set up by the Coalition Government was privatised in 2017, BEIS has mooted the idea of a 'Green Investment Bank 2.0'. We would support such a move to ensure more green jobs are created.

7) **The pause in economic activity, fall in traffic and increase in working from home during the lockdown has resulted in rapid reductions in air pollution and greenhouse gas emissions; what measures can be utilised in the recovery to continue these trends as economic activity resumes?**

The same rule applies here, in that if we have an investment system that pursues decarbonisation, it can help continue these positive trends. For example, ShareAction published a study of the investment opportunities in the electric vehicle industry. In 2018, electric vehicles accounted for

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[2] Willis Towers Watson (2019). *Global Pension Assets Study 2019*, p. 23. Available online at: https://www.thinkingaheadinstitute.org/en/Library/Public/Research-and-Ideas/2019/02/Global-Pension-Asset-Survey-2019 [accessed 14 August 2020].

[3] House of Commons Environmental Audit Committee (6 June 2018). G*reening Finance: Embedding Sustainability in Financial Decision-Making.* Available online at: https://publications.parliament.uk/pa/cm201719/cmselect/cmenvaud/1063/106305.htm#_idTextAnchor013 [accessed 14 August 2020].

[4] ShareAction (May 2019). *Changing Course: Bank Financing of the Shipping Industry,* p. 20. Available online at: https://shareaction.org/wp-content/uploads/2019/05/Changing-Course-Bank-Financing-of-the-Shipping-Industry.pdf [accessed 14 August 2020].

2.5% of new vehicle sales, representing a 68% year-on-year increase.[5] The introduction of local environmental measures, such as the Ultra-Low Emissions Zone in London,[6] creates new incentives for corporate fleets to switch to electric. Overall the scenario is ideal for investors to engage with companies about adopting electric vehicles and building charging infrastructure – indeed EV100, a global corporate initiative, is already pursuing this.

To sustain the recent trend air pollution and greenhouse gas emissions in the long-term, we must develop more environmentally friendly industries such as these. This can only happen if we create an investment system that incentivises investors to engage with companies on these issues.

8) **In the run up to Conferences of the Parties to UN conventions on climate change and biodiversity next year, how can the UK use its influence, as both host of COP26 and when holding the Presidency of the G7 in 2021, to influence the nature of economic rescue packages around the world?**

The UK should use its clout as a global financial centre to champion the idea of economic rescue packages being conditional on greater disclosure of financial risk. It would highlight to other countries, in particular those with sizeable financial services sectors of their own, that such measures are prudent to avoid a further economic crisis brought about by climate change.

Yours sincerely,

David O'Sullivan
UK Policy Officer, ShareAction

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[5] ShareAction (December 2019). *Electric Vehicle Fleets: An Impact Opportunity for Investors,* p. 4. Available online at: https://shareaction.org/wp-content/uploads/2019/12/EV-Briefing-for-investors.pdf [accessed 14 August 2020].
[6] Ibid.