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Rt Hon Mel Stride MP
Chair, Treasury Select Committee
House of Commons
London
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28th August 2020

Sent via online form

Dear Mr Stride,

Response to Decarbonisation and Green Finance inquiry

I am writing to respond to the Decarbonisation of the UK Economy and Green Finance inquiry 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. We have experience, through our Asset Owner Disclosure Project initiative,[1] in understanding and assessing many of the issues faced by asset owners in reporting against the Taskforce on Climate-related Financial Disclosures (TCFD).

Rachel Haworth, UK Policy Manager at ShareAction, sent a written response to the Committee's original inquiry into this subject on 31st July 2019, and subsequently spoke at an oral evidence session on 8th October 2019. Further to this, we welcome to opportunity to respond to the inquiry's expanded terms of reference, in light of recent developments regarding Covid-19.

1) **Should the Treasury's support package to business distinguish between companies based on how much they pollute?**

We believe companies should receive Treasury support on the basis that they take action to mitigate environmental, social and governance (ESG)-related risks. The overall aim of any support package should be to provide financial support to companies in the short term, in exchange for systemic change in their risk management in the long term.

When considering how a support package might be applied, the Treasury should ensure it does not pursue too narrow a definition of a 'polluting company'. There has been discussion of how to ensure a bailout package could be used to ensure some carbon-intensive industries that have been most immediately affected by Covid-19, e.g. commercial airlines, can pursue decarbonisation more quickly. While we would welcome such measures, it would not be sufficient to achieve the decarbonisation of the economy overall. The Treasury should consider where all carbon-intensive industries sit within the overall investment system, and how to ensure capital is channelled towards the low-carbon transition in the long-term.

[1] For further details please see https://aodproject.net/.

To ensure long-term decarbonisation, any Treasury support package should be issued in concert with regulatory reforms of the investment system, such as mandatory reporting for all market participants on climate-related financial information and how their business or investment strategies are aligned with the Paris Agreement (as discussed in more detail below). Once the economic impact of Covid-19 has subsided, bailout recipients will eventually no longer be reliant on Government support. This underscores the importance of putting the regulatory reforms in place now, to mitigate even greater economic damage from climate change and other ESG factors.

The banking sector demonstrates why this is necessary. In April, ShareAction published its latest survey of the 20 largest European banks on their response to climate change. The banks were assessed on numerous areas including their climate-related risk management, provision of low-carbon services, and their governance and strategy. The average score for the banks' performance on climate change was 39.9%[2]. Banks' policies in relation to high-carbon sectors are currently still insufficient to ensure alignment with the goals of the Paris Agreement: most banks' coal policies prohibit coal-related project finance, but exclusions of companies reliant on coal are still limited;[3] only 40% of surveyed banks publish a policy on the shipping industry;[4] only a quarter of banks set clear objectives and timelines when engaging with clients on 1.5°C alignment.

2) **<u>Should the Treasury be directly funding Green infrastructure as part of its Coronavirus spending package?</u>**

We support direct funding from the Government for green infrastructure. We feel the Government's privatisation of the Green Investment Bank in 2017 squandered opportunities to develop such infrastructure, and so we would support using the Covid-19 spending package to boost spending in this area. We understand the Government is now considering a 'Green Investment Bank 2.0' and we would support this also. However, we would stress that any direct funding from Government must be complemented by measures to unlock private capital for green infrastructure. The investment system must be reoriented to supporting responsible investment to do this.

3) **<u>Are there any green related policies that the Treasury should change or commence due to the Coronavirus in order to facilitate the transition to meeting Net Zero?</u>**

As detailed above and in our previous submission, transition to a low-carbon economy is not possible without reform of the investment system. Our capital markets will not fully enable decarbonisation unless they are subject to regulatory reform, and so the Treasury should pursue this immediately. The economic damage wrought by Covid-19 has starkly shown what the crystallisation of risk looks like; as such it should provide impetus to act to stave off even greater long-term economic damage from climate change. In our first submission to the Committee's inquiry in July 2019, we advocated a number of policies that would facilitate the transition to meeting Net Zero. Since then, there has been some incremental progress with these policies, but it has still been insufficient to effect real change. The Treasury should enact these policies now in full.

Firstly, the Government should introduce mandatory corporate reporting under the TCFD framework. Our July 2019 submission argued for this; since then, TCFD reporting has been implemented in a piecemeal fashion – BEIS are currently 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 sizeable 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. If the Treasury to issue a stimulus package, it should make production of TCFD reports a condition for recipients, to catalyse

[2] ShareAction (April 2020). *Banking on a Low-Carbon Future II*, p. 9. Available online at: https://shareaction.org/wp-content/uploads/2020/04/ShareAction-Banking-Report-2020.pdf [accessed 28 August 2020].
[3] Ibid, p. 10.
[4] Ibid.

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.

Secondly, reporting climate-related financial information is merely a first step towards meeting our climate commitments: necessary but not sufficient. It is reassuring to see that DWP soon plans to consult on requiring pension funds to report on how they are aligning their portfolios with the Paris agreement. The Government should introduce mandatory reporting for **all** market participants that requires them to disclose how their business or investment strategies are aligned with the Paris Agreement.

Thirdly, corporate governance and investor stewardship are key to an effective and measured transition. We support a well-resourced regulator placed on a statutory footing that can take on these challenges. In particular, BEIS should ensure the new FRC board is equipped to continue to strengthen ARGA's stewardship capacity, and the regulator itself should consult on the framework it will use to hold Code signatories to account regarding the 'outcomes and effectiveness' of their stewardship activities. The Code is new, and it is right the focus should be to drive up signatories, but it is equally important firms do not use it as a marketing exercise. The Government and ARGA should therefore consider how ARGA undertakes oversight of Code reporting and the extent to which non-compliance with its principles should result in sanctions.

Finally, we want to see legislative change to ensure institutional investors use their influence in investee companies to pursue decarbonisation. Our July 2019 submission highlighted that Section 172 of the Companies Act 2006 places statutory duties on company directors to safeguard the wellbeing of the company, including its actions on ESG issues. We argued that equivalent legislation is needed to apply to asset managers, recognising that they wield considerable influence over corporate strategy. Our most recent research on the asset management industry shows their response to the climate threat is still insubstantial – our 2020 survey of the world's 75 largest asset managers showed the majority showed a substandard approach to responsible investment, with 51% of those surveyed showing a 'weak' approach and an additional 16% having a 'limited' approach.[5] In light of current events and the need to ensure our economy is put on sustainable footing, the Treasury should take this opportunity to legislate to ensure the asset management industry is pulling its weight to drive decarbonisation.

4) <u>In which ways will the new economy post-Coronavirus allow the Government to change the way it finances the Net Zero Target?</u>

The systemic shock of Covid-19 has brought about a welcome debate on the 'Build Back Better' agenda. The Government now has greater bandwidth than before Covid-19 hit to pursue such an agenda, and should seize the moment to do this, including by reform of the investment system. The FT reported that in the current downturn, 60% of European ESG Exchange-Traded Funds outperformed the MSCI Europe Index.[6] We should aim to ensure this resilience is reflected in the wider economy by reforming the system to facilitate responsible investment.

5) <u>Are there outcomes from the Coronavirus that will enable the Treasury and HMRC to meet the Net Zero target more easily?</u>

There are some outcomes from Covid-19 which may hinder achievement of Net Zero. Some emergency measures the Government introduced have negatively impacted the corporate governance of companies in the short-term, dispensing with transparency and accountability mechanisms that would be in place during normal times. The Corporate Insolvency and Governance Bill (introduced to Parliament by BEIS) enabled companies to hold virtual AGMs to maintain social distancing. A clause in the Bill denied individual shareholders the right to put questions to company directors live via the virtual AGM. This is subject to a sunset clause, with the

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[5] ShareAction (March 2020). *Point of No Returns,* p. 6. Available online at: https://shareaction.org/wp-content/uploads/2020/03/Point-of-no-Returns.pdf [accessed 28 August 2020].

[6] Financial Times (3 April 2020). "ESG funds continue to outperform wider market". Available online at: https://www.ft.com/content/46bb05a9-23b2-4958-888a-c3e614d75199 [accessed 28 August 2020].

Government holding powers to extend it. Given the uncertainty about when the lockdown will be completely lifted, the practice of holding virtual AGMs without live participation from shareholders could become the norm. AGMs are a regular forum where shareholders raise concerns about ESG issues, and achieving Net Zero becomes less likely if this forum is taken away. We would urge the Treasury to work with BEIS to ensure that these emergency measures are not in place indefinitely.

Yours sincerely,

David O'Sullivan
UK Policy Officer, ShareAction