Update to Green Finance Strategy

UK Finance Response to Call for Evidence from BEIS

22 June 2022

Sent to: evidence.gfs@beis.gov.uk

INTRODUCTION

UK Finance is the collective voice for the banking and finance industry. Representing around 300 member firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation. We work for and on behalf of our members to promote a safe, transparent and innovative banking and finance industry.

We welcome the opportunity to respond to the government's call for evidence on the Green Finance Strategy update. The banking and finance sector plays a key role in supporting the UK's transition to net zero and its wider sustainability commitments. Our members are committed to help finance the transition across the economy, including through lending to crucial areas of the transition, such as greening the housing stock. The banking and finance sector is also committed to decarbonising its portfolios and financing the green economy, in line with the UK's sustainability goals.

If you have any questions relating to this response, please contact Agathe Duchiron, Strategic Policy Manager, at agathe.duchiron@ukfinance.org.uk.

KEY RECOMMENDATIONS

In line with our responses in the following sections, our key recommendations for the government in conducting its review of the Green Finance Strategy are as follows:

- The government should provide robust, coherent **sector-by-sector policy** on the path to net zero, especially with relation to **greening the housing stock**. This will allow the whole economy, including the banking and finance sector, to better align with the UK's sustainability goals.
- The government should promote **greater clarity and a shared vision on key sustainability-related concepts**, such as green finance, or the details of how the green taxonomy will be applied in practice.
- The government should continue to use its international leverage to advocate for and secure increased **coherence of disclosure and risk management approaches across jurisdictions. We support the UK's backing for the International Sustainability Standards Board (ISSB).**
- The government should **provide greater support for SMEs and retail customers** in understanding the impacts of the transition on their operations and/or finances. This will help create greater demand for green finance products, which in turn will facilitate the transition.

Capturing the opportunity

1. What are the key characteristics of a leading global centre for green finance?

- In addition to **increasing alignment with the international net zero trajectory** and wider sustainability goals, a leading global centre for green finance needs to demonstrate strengths across a variety of other measures. These include the banking and finance sector's financing contribution to a greener economy globally; its deployment of innovative tools to support the transition; and its support for standardised metrics and measures that are adopted globally. See answers to questions 26 and 29.

- Throughout our response to this call for evidence, we emphasise that strengthening the UK's position as a green finance leader requires policy leadership in the UK real economy as well as the banking and finance sector alone. Being a leading global centre will require private finance providers to have confidence to lend to and invest in the greening of the economy, which can best be achieved through **bold and consistent government policy across national, local and devolved administrations**. Government action around electric vehicles (EVs), and the clear policy signal provided by banning the sale of petrol and diesel new cars by 2030, is a good example of this. Alignment of the UK's banking and finance sector with the UK's sustainability goals can only happen as part of a **whole of economy transition**, recognising that firms' balance sheets are a reflection of the wider economy, particularly for systemic banks.

- The establishment of the **Transition Plan Taskforce** (TPT) by HM Treasury (HMT) is a welcome step to position the UK as a leading global centre for green finance. Requirements for companies and financial institutions to deliver science-based transition plans to a strict timetable to demonstrate how business models can be re-engineered, particularly in hard-to-abate sectors, are key. Crucially we consider that these rules should apply to both listed and private companies on a proportionate basis akin to the roll out of disclosures under the Taskforce on Climate-Related Financial Disclosures (TCFD) across the UK.

- Being a leading global centre will require a **Green Taxonomy that is accessible for all market participants**. A robust, science-based taxonomy will establish a common, clear and detailed definition of sustainable activities. While we do not take a view as to what should be considered 'green', which is a matter for policymakers, we support wide application of the UK Green Taxonomy to both financial services firms and businesses operating across the real economy. This will encourage consistent data and allow investors, businesses and consumers to make sustainable financial decisions and accelerate the transition to net zero.

- We also consider that the UK should drive momentum **toward the interoperability of high-ambition, global sustainability requirements,** including taxonomies — pursuing convergence wherever possible to avoid fragmentation. A prime example is the UK's support for the ISSB in its efforts to create a uniform and mandatory approach to disclosure.

- A leading global centre for green finance should also develop **skills and capabilities** across the board – in financial services, as well as across all areas of the economy.

- **Consumer awareness** of the imperatives of the transition also needs to be enhanced through public campaigns, to focus the demand for green finance. See our response to question 21.

2. Do you consider the UK's green finance regulatory framework to be world-class?

We consider the UK's green finance regulatory framework to be world class in some areas, but seriously lagging in others. As a caveat, we note that the UK's green finance regulatory framework is still under development and thus is difficult to comprehensively assess without knowledge of all its components; a proper comparison would also require a more detailed analysis of other jurisdictions' frameworks.

Nevertheless, we welcome UK Government **leadership in pursuing a globally coherent green finance regulatory framework**, for example through its support for the establishment of the ISSB. Government's commitment to a robust framework that aligns with international best practice, through the sustainability disclosure requirements, has been welcome – and we look forward to the detail of this. The UK climate prudential framework, following the Prudential Regulation Authority's publication of supervisory statement 3/19 in April 2019,[1] has led the way in informing how banks across the globe account for climate change considerations in decision-making.

However, this finance-specific framework must be coupled by a **stronger real economy framework**, which will in turn enable the banking and finance sector to support sustainable outcomes. Government needs to implement an appropriate domestic policy environment to inform the wider economy of their own sustainability regulatory obligations, with a view to incentivising the creation of sustainability-aligned financial systems and products that answer the sustainability imperative. **Mobilising finance in the context of the real economy transition requires a clear direction of travel on net zero policy, sector by sector**. A prime example of this is the need for clearer policy direction and policy support in the greening of the UK housing stock, which the UK banking and finance sector will need to support through significant financing. An absence of clear and workable policy risks leaving large swathes of the housing sector behind, and could place homeowners in mortgage traps.

The UK's position as a world-leading financial services centre, with a well-established and recognised regulatory framework beyond green finance makes it a prime candidate for being world-class in the green finance environment. The UK should continue to use this position to **promote global coherence in sustainability-related regulatory frameworks**, whilst reinforcing its reputation abroad for excellence.

3. To what extent does the UK's private and public sectors have appropriate skills/capacity to attract international green finance flows?

Delivering green finance requires a **blend of skills, depth of market and innovation that is synonymous with UK banking and finance**. The UK is a leading global financial centre, with access to a highly skilled workforce and world-class professional services.

Attracting private finance into the real economy, whether from UK-based or international firms, requires a strong skills base in the target sectors. There is a risk in some key transition sectors in the UK (e.g., the construction sector) that skills bases are insufficient to support investment or lending with confidence. We are strongly supportive of a net zero-aligned industrial strategy, building

[1] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2019/ss319

on the Government's Ten Point Plan[2], that will crowd in skills in the areas that most need private investment and lending.

See our response to question 9.

4. What are the UK's comparative strengths and weaknesses in its green finance offering compared to other international financial centres? What are these are for:

a) Capital markets

b) Banking

c) Fintech

Being a global leader means ensuring that multinational firms can offer products and services in and from the UK in a cost-efficient and low-burden manner. This includes promoting global regulatory coherence, while maintaining a high degree of ambition and predictability in regulatory expectations.

We consider that the UK demonstrates clear strengths in its green finance offering:

- We have a robust regulatory framework which is encompassing sustainability at pace across reporting, disclosures, stress testing, strategy, financial planning and transition plans. This will contribute to investor confidence and capital flows, but we must continue to strengthen corporate disclosures for both listed and unlisted entities.
- The UK has developed a strong market for green finance products. One successful example is the green mortgage market and the use of Energy Performance Certificate (EPC) data to unlock funding for energy efficient homes. This example should foster the use of similar comparable, verifiable and accessible data streams to be made available to enable green market growth in other areas (see answers to question 27).
- The UK benefits from swift decision-making instruments compared to other financial centres, for instance by making use of pilot schemes.

However, the UK also shows some weaknesses, particularly:

- The Government still needs to clarify and refine a number of policies and their objectives, including on sectoral net zero plans. The Green Finance Strategy should focus on positive, lasting changes and outcomes across the real economy. For instance, it should not only incentivise current green assets, such as green mortgages, but also the improvement of property loans to encourage further advances for retrofits.
- A clear UK green taxonomy is still required to give clarity around what classes as 'green' and to reduce fears of reputational damage that may come from greenwashing.

5. How can the UK government measure progress towards becoming a leading global centre for green finance?

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/936567/10_POINT_PLAN_BOOKLET.pdf

The green transition requires urgent, whole economy, coordinated effort by the government, the financial services sector and the real economy. UK Government should take a **nuanced, multivariate approach** to measuring progress. In addition to **overall alignment** with the transition to net zero and wider sustainability goals — taking into account the work of the TPT — we recommend that success be measured on the basis of a wider variety of factors, including:

- the UK financial sector's **contribution to financing global sustainability**, e.g. through the investment and lending activities of UK-based firms both domestically and overseas.
- deployment of **innovative green finance tools and services** to mobilise finance and help firms measure and manage their sustainability exposure, e.g. size of UK green and sustainability debt markets; magnitude and outsized role of the UK's sustainability data services offer.
- the UK's leadership role in **shaping globally fungible/coherent sustainability standards**, e.g. through its strong support for the ISSB, as well as taxonomies.
- the sector's contribution to transitioning away from unsustainable assets, including the role that banking and finance firms play in supporting clients to move toward the green economy through their **lending and engagement strategies**.

Given its size, the sustainability alignment of the UK's financial sector reflects the alignment of the wider real economy. The UK Government's drive to green the financial system needs to be coupled with a drive to **rapidly improve the sustainability of the real economy**.

Measures for progress should be grounded in the real-world impact of financing in respect of emissions reduction and quantifying that impact, in order to **promote change and good outcomes through financing**.

6. What areas for potential growth – for example emerging financial products and instruments – are there in green finance for the UK financial services sector?

Areas for potential growth include:

1. New propositions/products aimed at financing transition activities e.g. retrofits, business expenditure to move to sustainable operations
2. New propositions/products aimed at financing already-green assets e.g. A or B EPC-rated properties, providing finance for businesses offering 'green' products/services
3. Investment in core infrastructure required to support the transition e.g. wind farms, EV charging infrastructure
4. Carbon credits/nature-based credit markets
5. Sustainability-linked bonds

1. There is large opportunity for growth in products to **support customers in financing transition activities**. The housing sector in particular faces a large-scale retrofit challenge. Banking and finance providers can and do provide accessible and affordable finance to clients to mitigate upfront costs of making changes such as improving home energy efficiency and installing alternatives to fossil fuel-based heating. These have significant scope to expand as the relevant technologies are further rolled out. In the mortgage space, residential and buy-to-let (BTL) mortgages at purchase or re-mortgaging stage offer the opportunity to perform retrofitting works, since owners and buyers are

more likely to perform works when first moving in. However, the pace and level of take-up will depend on government incentivisation policies, as well as appropriately targeted disincentivisation and mandating policies, and the development of robust and scalable supply chains. Payment holidays could for instance be beneficial to incentivise retrofit works.

2. There is an important **distinction between financing an existing 'green' asset** (e.g. where a 'Green mortgage' is provided to a home that is already A or B EPC-rated) **versus financing the transition of an asset to become 'green'** (e.g. providing financing for home improvements that move a home's EPC rating from D to B). The transition to a sustainable economy offers an opportunity and a need for both, but distinguishing between the two, in such a way that helps to incentivise these activities while mitigating greenwashing risks, will be critical. It would be helpful if the government could delineate, potentially in a glossary to the Green Finance Strategy review, the critical components of green financing and the roles they play. This would help address some of the current subjectivity within the market – and allow for the industry to focus its solutions to the right areas.

3. Separately, the transition to a sustainable economy will create a range of new opportunities to finance the core **infrastructure** in specific sectors of the economy, e.g. charging infrastructure. Confidence to provide such investments will rely upon bold and consistent government policy in these sectors.

4. Carbon credits and nature-based credit markets remain a key growth sector. With over 70% of land use in the UK being agricultural, this **sector also provides great potential for decarbonisation**, alongside nature-positive strategies and growth in green finance. To unlock this potential however, further progress on education, support and clarity on an overall sectoral transition pathway is required. The linkages between climate and nature are perhaps most obvious in this sector and there is significant opportunity for the development of carbon credits and nature-based credits.

5. We believe that there is considerable potential for the UK Government to pursue **sustainability-linked bonds** ("SLBs" – see ICMA definition[3]), or indeed other similar products. With robust key performance indicators ("KPIs"), as well as material penalties for failing to meet these KPIs, this is a product area that we believe the UK Government should seek to prioritise. We also consider that KPIs, through coupon ratchets / margin adjustments, will keep institutions accountable towards their sustainability targets.

Financing the UK's energy security, climate and environmental objectives

7. How can the UK support a financial system that leverages private investment to meet the UK's climate and environmental objectives?

[3] ICMA defines SLBs as "any type of bond instrument for which the financial and / or structural characteristics can vary depending on whether the issuer achieves predefined Sustainability / ESG objectives".

The banking and finance sector is developing and implementing its green finance obligations and ambitions at pace, for example by setting out ambitious transition plans, and deploying innovative financial products, as demonstrated in our responses to this call for evidence.

The government must provide a **robust, clear and coherent regulatory framework across the real economy, sector by sector**, to support the changes brought forward by the banking and finance sector.

To achieve our sustainability goals, additional support must be provided through **government funding**, with the help of the British Business Bank (BBB) and the UK Infrastructure Bank (UKIB). A wide range of important new green technologies, which are necessary for the transition, will need further government support to lower risks and drive down costs to commercially sustainable levels.

It is a concern for the UK banking and finance sector that the UKIB currently has only £12bn in debt equity and £10bn in guarantees at its disposal, which is small in comparison to some of the opportunities it may be approached with and challenges it needs to resolve. Accounting for expected mobilisation rates, this £12bn will allow it to mobilise only a portion of the much-needed finance for the transition. A key aim for UKIB should be to set very specific objectives[4] on how to deploy the funds at its disposal and how it intends to maximise its impact.

One innovative option could be to set up a dedicated real estate mortgage debt fund with a first loss piece portfolio guarantee provided by the UKIB for commercial real estate. This would help mitigate the significant upfront costs of transition works for commercial real estate, which are exacerbated by long vacancies to undertake the work.

The UKIB and the BBB could also maximise the potential of their financial resources by expanding their risk mandate to cover securitisations. Such a move would allow them to provide guarantees for green projects that would not otherwise be funded due to credit appetite. The tranches in a securitised structure allow for the sharing of risk between government and private capital in a way that generates a commercial return to the UKIB and the BBB. Additionally, as the UKIB and the BBB are not at risk for the full loan, this would only use a small proportion of their balance sheet versus the total size of the facility. This creates opportunities to crowd in private finance and is balance sheet-efficient for institutions such as the UKIB and the BBB who have different risk appetites and capital structures compared to banks.

8. How can the UK support a financial system that leverages private investment to meet the objectives of the British Energy Security Strategy, including in areas such as nuclear, hydrogen, carbon capture and storage and domestic oil and gas production, to reduce our reliance on imported fossil fuels as part of a smooth energy transition?

The banking and finance sector needs more precise and coherent guidance from the Government and independent institutions, such as the Climate Change Committee, on the **role and trajectory of fossil fuels in the transition to net zero**. This would help to inform the balance of competing objectives between energy security and the fight against climate change.

Whilst a continued use of fossil fuels in the energy mix is an acknowledged part of the transition, it is so far unclear how the current energy security challenge – and the UK's response to it – impacts that trajectory. Industry and finance alike need **clear sectoral guidance, which in turn will crowd**

[4] The UKIB's proposed objectives and activities can be found in clause 2 of the UK Infrastructure Bank Bill.

in private finance. An increased **focus on demand-side measures** (e.g. energy efficiency, public behaviour campaigns, smart metering) in the Government's energy security would also help bridge the gap between the two competing objectives. This was a critical piece of the puzzle missing in the British Energy Security Strategy[5] – and a clear space where opportunities exist for simultaneously enhancing energy security and achieving our net zero goals.

The objective of reducing energy demand should also be reflected in the Green Finance Strategy review, for instance through targeted grant funding for lower EPC ratings, or integrating discounts into the stamp duty for retrofitting works. The UK should also seek to mobilise the public interest on the need to reduce energy demands through public campaigns.

9. What barriers are there to unlocking private investment to support the UK's energy security, climate and environmental objectives?

The sustainability challenge is arguably the most complex challenge in a generation, and requires an unprecedented level of **cross-sectoral, cross-institutional coordination**. Some key barriers to mobilisation of finance for these objectives are listed below.

1. Policy clarity. As mentioned in our responses above, the UK needs policy clarity across the real economy, sector by sector, to ensure shared expectations and aligned objectives. In a wide variety of UK sectors, the net zero and wider sustainability policy trajectory remains vague, without clear milestones leading to full decarbonisation and uncertainty about which technologies to back (e.g. hydrogen vs heat pumps). The banking and finance sector alone cannot be responsible for fixing this absence of clarity, as it often lacks real-world opportunities in which to invest; and policy ambiguity can make it difficult for the sector to provide clear advice to clients in light of conduct risks. Government policy clarity can help to crowd in industry actors. We welcome Government's commitment to supplement the Green Finance Strategy and Ten Point Plan with sector-by-sector net zero roadmaps, and are keen to work with policymakers to bring banking and finance expertise to develop them. They must be developed at pace to ensure progress is made during this "decade of action".

2. Poor risk/return ratios. Many technological innovations and wider activities needed for the sustainable transition are currently unattractive to lenders due to poor risk/return ratios. Government policy can provide certainty to help lower risk. Even more effectively, government financing and fiscal tools, e.g. via the UKIB and the BBB, should also be mobilised to help unlock private investment and share some of the risks related to new technologies and transition activities. We also see examples where criteria contained in leases, for example for offshore wind farms, restrict the ability to develop an economically viable model.

3. Wider infrastructure challenges. A wide variety of sector-specific infrastructure challenges remain, which need to be addressed on a case-by-case basis. For example, although a highly skilled economy, the UK is encountering a skills shortage, for instance in the construction sector, which impacts the greening of the housing stock.

See also answer to question 26.

---

[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1069969/british-energy-security-strategy-web-accessible.pdf

~~10. How can the UK government assess and measure progress toward financing the UK's energy security, climate and environmental objectives?~~

UK Finance will not be responding to this question.

11. How can the UK best facilitate greater private investment into climate change adaptation and resilience activities?

As per comments above, the UK Government should support robust sectoral transition plans on a sector-by-sector basis, to be drawn up in collaboration with banking and finance sector.

Financing transition activities

12. Are there barriers to the mobilisation of private investment into transition activities? If so, what are they and how might they be overcome?

Responsible lending to carbon intensive sectors is a necessary part of the transition: as society collectively seeks to transition away from fossil fuels, those activities that are most polluting need finance to establish new, cleaner business models. The banking and finance sector faces **serious reputational risks** in supporting transition activities, for instance whilst financing polluting or high carbon emission industries and sectors to sharply reduce their carbon emissions, or whilst supporting the British energy security strategy and investing in interim, less polluting but controversial resources (e.g. liquified natural gas). Such industries are a widely recognised part of the transition, including by the Intergovernmental Panel on Climate Change (IPCC) and the International Energy Agency (IEA).

Lenders and real economy actors need to receive **clear policy and guidance on acceptable investments, and the acceptable trajectory in the context of transition activities**. Public communications and campaigns should also raise awareness of the reality of the transition to net zero, to promote a reduction in energy demands, and help mitigate potential reputational risks.

The **green taxonomy** should allow for **nuance between purely green and transition activities**, to recognise the necessary path of transition, and avoid a binary distinction between green and non-green activities which could ultimately be damaging to the transition by disincentivising financing to interim energy sources.

13. How can the UK become a leading hub in structuring and innovating on transition finance?

In addition to suggestions reflected in other responses, we believe that the government should **recognise the risks posed by innovative and transition activities** to banking and finance providers and consider how to address those.

Government intervention will be needed to first set expectations across the banking and finance industry and across the real economy to distribute the risks and the costs of innovation across the private and the public sector. Examples of areas in which policy coordination will be needed as part of the transition include the nationwide wind-down of petrol stations, during which there is a risk of distributional inequalities if left purely to market forces. Clear expectation setting will enable the private finance sector to provide necessary support to these transitions.

14. Is there a role for the UK government to support the development of transition finance markets in the UK and internationally?

As per comments above, the UK Government should support **robust sectoral transition plans on a sector-by-sector basis**, to be drawn up in collaboration with the banking and finance sector. Sectoral transition plans must account for the full capital stack, including debt, not just equity investment. Government should promote a public recognition that transition activities are an important part of net zero transition (i.e. weighing in on the divestment vs stewardship debate). The deployment of the UK green taxonomy should include a recognition that the transition is not binary but is a process – firms should be rewarded for undertaking transitionary activities, in line with a science-based net zero, even if these do not fully reflect the "green"-aligned end-state in the short/medium-term.

Developing natural capital markets

15. How can the UK best support the mobilisation of private investment to natural capital assets?

Clarifying guidance and requirements such as the Environment Act (2021) have assisted in spurring innovation and mobilising investment from the private sector. However, ongoing support and guidance alongside legislation is key. The mobilisation of private investment to natural capital will require clear definitions of what is a nature-related opportunity.

The UK can support by ensuring alignment with international definitions / markets, including alignment with approaches such as the Taskforce on Nature-related Financial Disclosures (TNFD), as well as to support coherence across reporting and disclosure requirements.

16. How can the UK government best assess the progress and development of a natural capital investment market?

UK Finance will not be responding to this question.

Ensuring broad access to green finance for local authorities, SMEs and retail customers

17. How can the UK financial sector support the delivery of the UK's climate and environmental objectives at the local level, whilst also benefitting local growth and communities?

The banking and finance sector is already **engaging across the whole of the UK** in mortgage and commercial lending, including to SMEs, with a range of green finance products. While the call for evidence contends that some forms of financial activity are highly geographically concentrated, we point out that debt financing is generally evenly spread across the country.

To help develop our support to the delivery of the UK's climate and environmental objectives at the local level, we would recommend that the government's climate objectives in particular consider how to reduce emissions where they happen (recognising that emissions are distributed across the country), and **how to assist communities affected by the transition**. This will help correct the imbalance in some parts of the country, e.g. areas with a concentration of high emission industries, by transitioning existing industries, or creating new, viable activities to sustain jobs and attract financing.

We fully **support the levelling up agenda**, and advocate for an alignment of objectives between a just transition and levelling up the country. We reiterate that **policy clarity** is a necessary step for the banking and finance sector to be able to support these changes.

As an example of this nexus, there are opportunities to **deploy retrofitting of housing in specific areas with high concentrations of low EPC-rated housing stock** and opportunities to **upskill local staff**.

18. How can local authorities support the mobilisation of private and public investment to key sectors and technologies for the UK's climate and environmental objectives, whilst also meeting local priorities? What barriers to this are there?

Examples of barriers and areas for improvement include:

- The development of greenfield onshore renewables is currently limited in the UK. The **planning application process** remains a bottleneck and, in our view, a reliable and speedy application process is key to meet net zero goals. Local authorities have a role to play in the planning application process and it may be helpful for the **government to support them further in their assessment to ensure a consistent approach is taken across the country**.
- Regarding electric vehicles charging, most charging is likely to happen at home and there will be a **need to finance the infrastructure required for on street charging** in urban areas where residents do not have access to off street parking. This is an area that will need public sector intervention, including at a local level, to support the deployment of solutions for urban charging.

19. What is the current state of capability within local authorities to attract investment, and how can it best be supported?

We recognise that local authorities operate within tight fiscal frames which is likely to hamper investment towards the transition to net zero. See response to question 18 for practical examples where this could present challenges.

20. How can the UK financial sector support SMEs and retail customers to align with the UK's climate and environmental objectives?

The UK **banking and finance sector is at the forefront of supporting SMEs and retail customers** with financing to align with climate and environmental objectives.

We **support a fair and just transition** that aligns with the means and capabilities of all. There is, however, a concern that there is still a **lack of awareness and understanding** amongst SMEs and retail customers about the practical implications of the transition, and the potential consequences of failing to act in time. For instance, the low interest currently observed in greening housing across the country could have real implications for homeowners of lower EPC ratings homes, for instance the possibility to be locked into mortgages of buildings that cannot be retrofitted.

Similarly, there is a lack of knowledge amongst SMEs of the need to green their businesses, as well as the potential need to report on their emissions and climate exposure as part of supply chain due diligence for larger businesses. Innovative tools could help SMEs calculate and track e.g. their Scope 3 emissions. Such a tool could be made easily available to all SMEs, like mortgage calculators, to help them understand their footprint and potential associated risks.

The **banking and finance sector already plays a key role** in supporting its clients, as perhaps one of the sectors which has had most focus on considering the impacts of climate change and the resultant need to adapt. As a ubiquitous point of contact for most SMEs, the banking sector has been at the forefront of informing SMEs about their sustainability obligations.

However, there is a clear **need for the UK's governments to inform and educate the public** on these issues and highlight the real implications for individuals and small businesses, as well as communities at large. This should include focussed communications campaigns to highlight the need to consider how the UK's net zero strategy will impact their lives.

21. Is there a role for the UK government to facilitate broad access to green finance for local authorities, SMEs or retail customers? If so, what should these roles be?

As mentioned above, the UK government and devolved administrations will be key actors in **disseminating necessary awareness and knowledge** among the wider population to increase demand for green finance for local authorities, SMEs and retail finance.

Additionally, we have raised in our responses the overall need for **clear sectoral policy** to lay the path to net zero across the real economy, and to provide clarity for the financial sector. Given many SMEs' positions in complex supply chains, as well as their own exposure to the sustainable transition as part of specific sectors, this in turn will enable greater finance mobilisation.

The government also has a role **mobilising its fiscal tools** (e.g. the BBB and the UKIB), which should be used to promote green activities and help where commercial lenders struggle to serve, or share the risks with the banking and finance sector. For example, **targeted incentives** can unlock underserved markets by facilitating financing to SMEs under terms that banks and other financial institutions do not currently provide. For lower value lending (<£25,000), we would suggest that the government consider a portfolio level guarantee. This contrasts with the Recovery Loan Scheme, which is a deal level guarantee scheme. This could also be achieved via an expansion to the BBB's mandate (as discussed in Question 7). We believe that this could influence risk appetite and lower pricing.

We also see a role for central banking in facilitating access to green finance. We recognise, following the outcomes of the Climate Biennial Exploratory Scenario (CBES)[6], that the Bank of England has ruled out using capital through a green supporting factor to support the climate transition. However, the Bank still has a role to play in incentivising green finance. A Term Funding Scheme (TFS) for green lending could provide lenders with access to cheaper central bank borrowing which could then be passed on to lower interest rates on green lending. There is precedent for this in the TFS for SMEs during the pandemic.

As a practical step, the government should also consider improvements to its comms on regulatory expectations for firms including, and potentially the creation of a **'sustainability grid'**. SMEs are faced with a large volume of sustainability related regulatory / legislative initiatives, some of which may further support their access to green finance (i.e. demonstrating eligibility for the forthcoming UK Green Taxonomy). A grid would help unpack the complexity and focus efforts towards complying or preparing with the new obligations. This could leverage the FCA Regulatory Initiatives Grid and have the additional benefit of supporting the financial sector in having an appropriate level of oversight of new sustainability sector regulation and legislation that will impact SMEs – helping banks determine whether there is a need to support clients and any indirect impact that can occur.

High integrity voluntary markets for carbon and other ecosystem services

22. How can the UK best support the development of high integrity voluntary markets for carbon and other ecosystem service markets?

While Q22 to Q25 are not questions UK Finance will respond to, we have engaged with the City of London Corporation and support their position.

23. How can we ensure that these markets encourage robust action on the UK's climate and environmental goals, and appropriately scale up finance flows to support these?

24. How should the UK harness the economic opportunities associated with high integrity growth in voluntary carbon markets and ecosystem services markets?

25. How can UK environmental and economic regulators increase demand for high quality, accredited ecosystems services?

Greening the financial system

[6] https://www.bankofengland.co.uk/stress-testing/2022/results-of-the-2021-climate-biennial-exploratory-scenario

26. What are the key characteristics of a Net Zero-aligned Financial Centre? How would these characteristics apply to a typical UK-based:

- **Bank**
- **or any other relevant industry participant**

UK Finance supports the goal of aligning the UK's banking and finance sector with net zero.[7] The ultimate measure for a Net Zero-aligned Financial Centre will be the full and rapid decarbonisation of the system. For banking and finance firms, this amounts to both (1) decarbonising their existing lending portfolios, and (2) using their balance sheets to finance new sectors and technologies that will replace those carbon-intensive ones. We recognise that the decarbonisation of the economy relies heavily on the action of banking and finance providers.

We propose three key characteristics that should define a Net Zero-aligned Financial Centre.

1. **Robust UK net zero policies in the real economy.** Banking and finance firms' lending and investment portfolios are shaped by the composition of the wider economy — this is true particularly for systemic banks, which have a critical role in financing activities across the whole of the economy. A demonstrated ability to align the sector's lending and investment with net zero therefore relies on a whole-of-economy transition. This in turn requires leadership from Government, to coordinate change in the real economy and create the future industries and opportunities for banking and finance firms to invest in or lend to.

2. **A recognition that transition is a process.** While the end point for the Net Zero-aligned Financial Centre is full decarbonisation, the pathway to that end-point will mean rapidly transitioning the economy away from fossil fuels, building the infrastructure necessary for a decarbonised system, and some continued, time-limited fossil fuel use as a bridge (as recognised by the IPCC and IEA). Given the UK banking and finance sector's role as a global financing hub, it will inevitably play an important role in financing that transition, and should be supported so long as it continues to responsibly engage its clients toward those outcomes. Public scrutiny of this process — through publication of transition plans and wider public engagement — will be important.

3. **A fair assessment that treats all participants equally.** To ensure that the whole economy decarbonises — and not just those firms currently falling into scope of mandatory disclosures — all firms must be scrutinised in the delivery of these goals. As green finance becomes increasingly mainstream, companies should be judged by the same yardsticks. Within the real economy, this poses risks for SMEs in particular: if they are not reporting their climate-related risks or impacts as climate risk is mainstreamed into decision-making, they may find it harder to access finance.

27. What market barriers are there to the integration of environmental-related factors into financial decision-making?

1. **Data.** Since the publication of the first Green Finance Strategy in 2019,[8] the UK Government's deployment of sustainability disclosure requirements has helped improve data availability so that

---

[7] See, for example, our strong agreement with HMT's proposal that the requirement for the PRA and the Financial Conduct Authority to have regard to the desirability of sustainable growth in the economy of the UK in the medium or long term under section 3B of the Financial Services and Markets Act 2000 should be updated to reference climate change and a net-zero economy (https://www.ukfinance.org.uk/system/files/UK%20Finance%20response%20to%20FRF%20consultation%20on%20proposals%20for%20reform.pdf).

[8] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf.

lenders are better able to integrate environmental-related factors into their decision-making. We expect the deployment of non-binding guidance on mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs by the Department for Business, Energy and Industrial Strategy in February 2022 to enhance this availability.[9]

Access to **client sustainability-related risk and impacts data** nevertheless remains a barrier to assessing banking and finance firms' Scope 3 emissions, and therefore fully integrating these factors into decision-making. Industry should collectively move toward **standardised approaches** for reporting, ultimately leading to use of common open-source APIs, to streamline and improve accuracy of analysis (covering risks, impacts and transition plans). **SMEs** make up a large portion of many banking and finance firms' Scope 3 emissions either as direct customers or components of supply chains — access to SME sustainability data is particularly challenging. Similarly, improved access to energy performance data is desperately needed to allow firms to better measure their sustainability-related risks via e.g. mortgage portfolios: this could be supported, for example, through real-time energy performance certification rating, buildings passports or real-time retail/actual energy usage data.

2. **Barriers to finance mobilisation.** Integration of environmental factors into decision-making by banking and finance firms relies on a whole-of-economy transition, which needs to be facilitated by **detailed action plans** and a combination of widespread and targeted government interventions to address key transition barriers. This is currently absent for large swathes of the UK economy, where Government leadership is required. Examples include clear transition plans for phasing out petrol stations and upskilling in the retrofit industry. Further examples are detailed in responses to the previous section.

3. **Transition finance.** As part of the action plans described above, the importance of transition finance must be recognised, to guard against the reputational and regulatory risk associated with important transitionary activities. For example, many banking and finance firms have taken the decision to actively work with their clients on their decarbonisation journeys, rather than removing them from their portfolios. Firms who take the decision to participate in that activity — as an explicit, science-aligned component of the transition — should not be penalised.

28. What should the role of the UK government or regulators be to support the greening of the financial system? How could they go further?

1. Filling **data gaps**. See answer to question 30.

2. Greening the financial system is dependent on having a **pipeline of real economy sustainability activity** into which to move lending. Given the size of the environmental challenge and climate crisis, this needs to happen at an unprecedented scale and pace, and cannot be achieved solely through market forces. **Government engagement** is needed to set clear direction on a sector-by-sector basis, and to use policy and public spending levers to address key market failures. For example, in greening the existing housing stock, UK and devolved governments can help drive costs of new technologies down by using targeted public funding, for example for retrofits in public buildings and social housing; a country-wide awareness-raising campaign is also needed to ensure that

[9] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1056085/mandatory-climate-related-financial-disclosures-publicly-quoted-private-cos-llps.pdf.

homeowners know what is expected of them. Similar clear and robust policy is needed across all sectors. This should include:

- **Roadmaps** for key emitting sectors, setting out interim milestones for achievement of goals, and clarity on technological choices where appropriate (e.g. heat pumps vs hydrogen). These roadmaps should help banking and finance firms navigate the transition landscape, setting out e.g. moments where fossil fuel-reliant technologies are fully phased out.
- Targeted use of **public financing** to crowd in private finance and/or drive down the costs of new technologies, drawing on existing processes and institutions (e.g. the UKIB and the BBB – see answer to question 7).
- Targeted **policy interventions** that help address specific barriers, for example the skills deficit in some new/rapidly growing sectors.

3. **Transition finance.** Government should support a public narrative that makes clear the role of transition finance and engagement with firms on the path to net zero and a sustainable/resilient future.

The publication of the **UK Green Taxonomy** will offer greater clarity to investors and lenders and support the crowding-in of finance to "green"-defined sectors. However, during the transition to a sustainable economy, this must be coupled by a more nuanced assessment recognising that some lending is deployed specifically to help shift non-green firms or activities toward green. Some sectors/activities also have a recognised role in the interim economy, even if they will ultimately be phased out. Many firms take on reputational or regulatory risk because they have taken a judgement that it is better to support an asset to a greener end-point than to sell to another buyer. This action should not be punished. Assessments of green alignment therefore cannot be adequately captured or rewarded with reference only to a taxonomy, and should also make reference to the UK Government's and wider transition pathways.

4. **Greater cross-government coordination**. Greater alignment across government departments on Green Finance, including e.g. through shared objectives and priorities, would help support the greening of the financial system.

29. How can the UK government measure progress towards greening the financial system?

See response to question 5.

The UK Government should take a **nuanced, multivariate approach** to measuring progress. In addition to **overall alignment** with the transition to net zero and wider sustainability goals — taking into account the work of the TPT — we recommend that success be measured on the basis of a wider variety of factors, including:

- The UK banking and finance sector's **contribution to financing global sustainability**, e.g. through the investment and lending activities of UK-based firms both domestically and overseas.
- Deployment of **innovative green finance tools and services** to mobilise finance and help firms measure and manage their sustainability exposure, e.g. size of UK green and sustainability debt markets; magnitude and outsized role of the UK's sustainability data services offer.

- UK's leadership role in **shaping globally fungible/coherent sustainability standards**, e.g. through its strong support for the ISSB, as well as taxonomies.

Given its size, the sustainability alignment of the UK's banking and finance sector reflects the alignment of the wider real economy. The UK's drive to green the financial system needs to be coupled with a drive to **rapidly improve the sustainability of wider industry and the economy**.

Providing the market with the right data

30. What steps can the UK government take to support a robust investment data ecosystem to attract green finance flows?

The UK government should continue to play an active role in requiring and enforcing disclosure of sustainability-related risks and impacts by **corporates**, as this remains critical to measuring banking and finance sector exposure across lending portfolios.

Within the UK, government can support this process by giving its backing to **specific reporting methodologies, approaches and APIs** (covering risks, impacts and transition plans), as well as providing guidance on open questions like use of data proxies/estimates. Data should be easily imported and accessible by banks and other users (e.g. through online APIs linked to a company name, or simple lookup features). Data could then be processed for use by banking and finance providers so that firms can conduct actionable analysis across large lending books. This includes specific guidance for **SMEs**, which make up a significant proportion of many banking and finance firms' Scope 3 emissions but struggle to report effectively. The Government should take the lead by promoting a single methodology for SMEs to report on their sustainability impacts and risks, including carbon emissions, which would overcome a currently patchy landscape of methods, emissions calculators and approaches. UK Finance and members would be happy to work with Government to help develop solutions to these challenges. The data should also show improvements over time to ensure users can track reductions in emissions (i.e. year on year changes should be trackable by users) to avoid the risks related to e.g. current EPC data. Frequency of update is important for this purpose.

Separately, government should continue to ensure appropriate **sequencing** of reporting requirements so that banking and finance firms can account for corporate reporting with adequate lead-in time. We support time-lag after corporate disclosure deadlines, so that there is sufficient time for banking and finance firms to account for client data in their own reporting. The duration of any time-lag should be subject to further engagement with the industry.

Government should be lauded for having made **EPCs for the real estate sector widely available** — a notable exception globally and the kind of approach to data as a public good that helps the understanding of the issue. Such a "public good" approach should be generalised whenever possible — e.g. making electricity and gas consumption public for properties; flood insurance claim data; flood projection data. To improve further on properties, it would be useful to increase the frequency of EPC certification (e.g. mandate them after building work or at the point of remortgaging) and to increase the scope (e.g. mandate for all properties, not just those that are for sale or rent). It would be important as well to have information about the embodied emission of new build and improvement work (commercial as well as residential). A further option would be to ask utilities to publish properties' emissions/energy usage data, which would enable mortgage lenders to report emissions directly rather than inferring them.

Internationally, the UK government should continue to use its international leverage to advocate for and secure increased **coherence of disclosure and risk management approaches, including taxonomies, across jurisdictions**. The increasing divergence of sustainability-related risk reporting and management expectations is a major burden on many firms — affecting those with multinational operations, as well as those whose loan books or supply chains touch other countries. Government should continue to give its strong backing to the work of the ISSB to build a single agreed baseline for reporting, and use other fora like the G20 and G7 to encourage convergence around that baseline.

Government should continue to recognise that corporate and financial sector reporting **will improve over time**, with some challenges likely to persist over the coming years due to data gaps. There will be a particular challenge for firms exposed to markets in which sustainability reporting is not yet widespread.

31. Are Scope 3 (supply chain) emissions data important for investors to assess and manage climate-related risks and opportunities?

Yes, **Scope 3 emissions data are absolutely critical** for lenders to accurately assess and manage climate-related risks and opportunities, because they give a sense of the overall risk a company faces in its supply chain, both upstream and downstream. Incomplete access to data remains a major barrier to understanding risk. While use of proxies and estimates enables firms to offer indications of their Scope 3 risks, opportunities and impacts, accuracy will significantly increase as corporate disclosure improves. Banking and finance firms cannot report fully on or manage their climate-related risks and impacts without corresponding data from clients, covering both own-impacts/risks and those in their supply chains. To be most useful, Scope 3 data should be broken down per activity type for companies that have a diversified business model (e.g. for a utility, split between electricity generation, electricity distribution, gas for heating etc.).

32. Is there a role for the UK government to support businesses (of different types and sizes) to make good quality Scope 3 emissions disclosures (including SMEs in the value chain of disclosing entities)? If so, what should this be?

See response to question 30. We would welcome the opportunity to further work with Government and partners to devise solutions on SME disclosure.

Leading internationally

33. Up to 2030, how can the UK government best support the global transition to a net zero, nature-positive financial system that is both inclusive and resilient?

The UK Government should continue to use its international leverage to advocate for and secure increased **coherence of disclosure and risk management approaches across jurisdictions**. The increasing divergence of sustainability-related risk reporting and management expectations is a major burden on many firms — affecting those with multinational operations, as well as those whose loan books or supply chains touch other countries. As sustainable finance becomes increasingly mainstreamed into financial decision-making, poor disclosure practices may ultimately lead to access-to-finance issues for firms in jurisdictions that do not require such reporting. Government should give its strong backing to the work of the ISSB to build a single agreed baseline for reporting, and use other fora like the G20 and G7 to encourage adoption convergence around that baseline.

In the interest of achieving a **level playing field**, the Government should continue to invest resources to promote **robust environmental goals globally**, including through the process established by the United Nations Framework Convention on Climate Change. UK Export Finance and Overseas Development Assistance should be used to help mobilise finance in the most strategically impactful areas. We welcome Government collaboration with UK private financial institutions to identify barriers and catalysts to private finance mobilisation in emerging markets and developing countries.

ENDS