To: Rt Hon Kwasi Kwarteng MP, Secretary of State, Department for Business, Energy and Industrial Strategy

CC: Rt Hon Rishi Sunak MP, Chancellor of the Exchequer;
Rt Hon John Glen MP, Economic Secretary to the Treasury;
Lord Callanan, Minister for Business, Energy & Corporate Responsibility;
Andrew Bailey, Governor of the Bank of England;
Rt Hon Alok Sharma MP, COP26 President

1st July 2022

DEAR SECRETARY OF STATE,

The ongoing cost of living crisis has demonstrated the acute need to reduce our dependence on fossil fuels and scale up investment in the net zero transition. Cementing the UK's energy security and economic resilience will require a rapid reallocation of public and private finance away from polluting sectors and towards green ones. Financial institutions, real economy firms, regulators and governments must pull together in the same direction.

This will require the government to set out a comprehensive plan for how it will drive the transition, ensure its costs and benefits are fairly distributed, and support the private sector in creating and investing in new sustainable markets. The 2022 Green Finance Strategy is a critical opportunity to address a major missing piece of the UK's Net Zero architecture: a clear plan to realise the Chancellor's commitment to making London a 'Net Zero Financial Centre' and align public and private financial flows with the government's decarbonisation, adaptation and nature goals.

This letter unites leaders from across academia, NGOs and think tanks in welcoming the BEIS Call for Evidence and sets out a collective call for the following five principles to underpin the Green Finance Strategy and ensure it is a success:

1) SET OUT AN AMBITIOUS, WHOLE-OF-GOVERNMENT STRATEGY FOR ALIGNING FINANCIAL FLOWS WITH A 1.5C TRANSITION PATHWAY, AND ADAPTATION AND BIODIVERSITY GOALS, TO BE REGULARLY ASSESSED WITH INDEPENDENT MAPPING OF PROGRESS AND INVESTMENT GAPS ACROSS PUBLIC AND PRIVATE FINANCE.

The Green Finance Strategy should aim to put climate and nature at the heart of policymaking, coordinating different arms of government [1] to work together to join up financial regulation with fiscal, monetary, environmental and industrial policy and finance the transition across every sector of the economy, as well as halting and beginning to reverse the decline of biodiversity by 2030. Financial flows should be regularly and independently assessed to identify investment gaps preventing the UK from meeting its climate, nature and adaptation targets.

2) SUPPORT ACTION ON 'PHASE 3' OF THE GOVERNMENT'S 'GREEN FINANCE ROADMAP' THAT ACTIVELY SHIFTS FINANCIAL FLOWS IN LINE WITH A 1.5C TRANSITION PATHWAY.

The government should use policy and regulatory tools to actively shift private credit and capital in line with a rapid, managed transition. Since climate change poses a severe threat which could lead to irreversible harm, the government and regulators should take a precautionary approach to climate-related risks in the financial system, fully integrating climate into prudential and monetary policy frameworks and ensuring that the high risks related to fossil fuel lending are reflected in regulation [2]. The government and the Bank of England should use targeted lending schemes and coordinate monetary and fiscal policy to keep the cost of capital low for green lending and stimulate critical green investment [3] [4].

3) ESTABLISH A KEY ROLE FOR PUBLIC INVESTMENT AND POLICY IN DRIVING A RAPID, FAIR TRANSITION AND REDUCING ENERGY DEMAND.

Public investment must play a critical role in driving the transition, ensuring costs and benefits are fairly distributed. The government should also scale up strategic public finance to create new markets and leverage private finance to sustainable opportunities. For example, the UK Infrastructure Bank could be mission-critical to decarbonising the built environment and delivering efficiency measures by coordinating public and private sources of capital to underpin large-scale retrofitting, but given its currently small capitalisation, must coordinate with other sources of public investment and funding [5].

4) ESTABLISH A SCIENCE-BASED, CREDIBLE AND ROBUST LEGAL AND REGULATORY FRAMEWORK TO INCENTIVISE AND ENFORCE THE PRIVATE SECTOR TRANSITION TO NET ZERO.

Strong standards and market disclosures are necessary, but will not be sufficient in driving the transition at the pace and scale required. Private sector transition plans must be embedded in robust legal and regulatory frameworks that incentivise and oversee implementation, and are supported by access to high quality data and analytics to aid financial decision-making. To ensure the market has access to clear and credible data on environmental impact, the government should reject classifying gas or biomass as 'green' in the UK taxonomy [6] and take the opportunity to introduce a statutory objective for net zero alignment and nature protection in the upcoming Financial Services and Markets Bill.

5) SET CLEAR OBJECTIVES FOR UK INTERNATIONAL LEADERSHIP AND COOPERATION, INFORMED BY GLOBAL JUSTICE PRINCIPLES.

The Strategy should clarify how the government will fulfil its own international obligations and use its considerable influence in international political, multilateral and supervisory fora [7] to drive international standardisation of ambitious policy and regulation. The government should meaningfully consult with climate-vulnerable communities and governments, scale up grant-based climate finance and other forms of assistance, ensure high integrity implementation (by closing existing loopholes) of its commitment to end public financing for new fossil fuels overseas, and expand this to private finance.

Since the government published its last Green Finance Strategy in 2019, the need for proactive efforts from governments to align the financial sector with ambitious climate and nature targets has become increasingly urgent. The International Energy Agency [8] and the UN IPCC [9] have made stark warnings that investment in new oil and gas fields and coal supply must stop now if we are to reach net zero emissions by 2050, and estimate that annual global investment in clean energy needs to more than triple to $4 trillion by 2030 [10]. Moreover, green financial reform will also need to incorporate adaptation and nature recovery if the UK is to build a sustainable economy.

However, ongoing activities within the City of London are undermining these ambitions. The five largest British banks, including many with net zero targets [11], have financed fossil fuels to the tune of £275 billion since 2016 [12], risking the long-term stability of the financial sector and wider economy [13]. The Bank of England's recent climate stress test estimates that climate change could cost UK banks up to more than £340 billion in a severe physical risk scenario in which climate action is delayed [14]. There is also increasing awareness of the strong link between nature loss and financial instability [15]: UK banks and asset managers provided a further $16.6 billion to just 20 deforestation-linked businesses between 2015 and 2020 [16].

At the same time, the UK is facing a cost of living crisis, in large part due to our reliance on expensive and volatile fossil fuels to meet our energy needs. To stabilise energy prices in the long term, we need to reduce our dependence on oil and gas sources by stopping all new fossil fuel expansion and rapidly upscaling investment in renewable energy and energy efficiency. Exploiting domestic oil and gas reserves will not improve the UK's energy security or bring down bills [17]. In addition, without preventative action to stimulate green lending, raising interest rates across the board is likely to widen the green finance gap.

As noted by the Climate Change Committee, the challenge now is to move from private sector engagement and measuring climate risk towards actively shifting capital allocation [18]. The government's 'Greening Finance: A Roadmap', published in October 2021 [19], outlined three phases to greening the financial system:

1. *Informing* investors and consumers
2. *Acting* on the information to create expectations of business, and
3. *Shifting* financial flows in line with the UK's net zero commitment.

Action to date has focused primarily on phase 1, and to a lesser extent phase 2. Given the short remaining time frame for reaching Net Zero in line with 1.5C, and the rising costs from our reliance on fossil fuels, we now need to see a much more active approach to phase 3, *shifting* financial flows.

The Green Finance Strategy is therefore a crucial opportunity for the Government to establish an ambitious and whole-economy approach to transition planning. The five principles outlined above will support the UK in delivering a fair, sustainable and productive economy, and establish the UK as a global leader in sustainable finance.

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ENDNOTES:

(1) Including BEIS, HMT, DEFRA, DfT, the Bank of England and regulators.
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(10) International Energy Agency (IEA), 'Net Zero by 2050', May 2021: https://www.iea.org/reports/net-zero-by-2050
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(16) Global Witness, Deforestation Dividends, October 2021: https://www.globalwitness.org/en/campaigns/forests/deforestation-dividends/
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