HOUSE OF COMMONS

Treasury Committee

Oral evidence: Decarbonisation and Green Finance—the Economic Opportunity, HC 2233

Tuesday 8 October 2019

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Watch the meeting

Members present: Catherine McKinnell (Chair); Rushanara Ali; Mr Steve Baker; Alison McGovern; Wes Streeting; Alison Thewliss.

Questions 67-115

Witnesses

I: Rachel Haworth, UK Policy Manager, ShareAction, Bruce Davis, Joint Managing Director, Abundance Investment, and Simon Howard, Chief Executive, UK Sustainable Investment and Finance Association.

Written evidence from witnesses:

- ShareAction
- UK Sustainable Investment and Finance Association

Examination of witnesses

Witnesses: Rachel Haworth, Bruce Davis and Simon Howard.

Q67 **Chair:** Good morning. Welcome to the Treasury Select Committee's second evidence session in our decarbonisation and green finance inquiry. We are really grateful that you are here this morning. You have shown enormous flexibility, given that we have had some changes in our schedule over the last few weeks that you could argue have been avoidable, to some extent. However, you have been unavoidably postponed in being here, so we are really grateful that you are here this morning. I hope you did not have too much difficulty getting into the building. There is obviously huge public interest in climate change and decarbonisation as a topic, so we are really pleased that we have you here to give evidence to our inquiry.

Just to explain, I am Catherine McKinnell; I am the interim Chair of this Committee for a short while, while we go through the process of electing a new Chair, because the former Chair, Nicky Morgan, was promoted to Government. That is just to explain for you and for members of the public who are interested in this session this morning.

Could you all please start by introducing yourself?

Simon Howard: I am Simon Howard. I am the chief executive of the UK Sustainable Investment and Finance Association.

Rachel Haworth: I am Rachel Howarth, policy manager at ShareAction.

Bruce Davis: I am Bruce Davis, joint managing director at Abundance Investment.

Q68 **Chair:** I have a question that I will put to all three of you; you can decide who wants to go first. What role does your organisation play in unlocking capital for net zero?

Bruce Davis: As well as investment, we are a crowdfunding company regulated by the FCA. That is basically our purpose. We allow small investors to put money, from £5, direct into projects and businesses that have a broadly green, positive impact. Net zero, for us, is a change. We have been operating since 2012. From that point of view, we are now focused on how we support businesses towards delivering net zero.

Rachel Haworth: ShareAction is a responsible investment charity. We work with the whole extent of the investment chain, from pension savers to the institutional investors who invest their money, to ensure that the system is working in a sustainable and long-term way. I work in our policy team. We look at how the rules and incentives of the system can be reformed so that more sustainable and responsible investment happens right the way across, from the current leaders to the current laggards. We want to see positive behavioural changes in companies, encouraged by investors, and we believe that this is a really key way of making sure that the UK transitions to zero carbon.

Simon Howard: UKSIF, as we term it, has about 240 members from all across UK financial services—big banks, big fund managers, pension funds, financial advisers and data providers. All of them have a commitment to building a sustainable financial system and to protecting the environment, so the work of all these organisations is aimed at net zero. We have been going for nearly 30 years. The net-zero target is very welcome; it is crystallising a simple objective.

Q69 **Chair:** This is again to all of you; if you have nothing to add, that is fine. Could you elaborate on how green finance, in particular, can help the Government to deliver on decarbonisation?

Simon Howard: Finance has a key role to play in decarbonisation. It will fund the projects. My members are keen and eager to invest, both for profit, with the opportunities coming from decarbonisation, but also in risk mitigation. There is a lot of money already invested in pension funds and life insurance companies, and we need to make sure that avoidable mistakes are avoided. We do a lot of policy work, talking to regulators and Government, briefing and seeking the outcomes that will facilitate that journey. The money is there to invest; we need to make sure that it is done in a sensible way.

Rachel Haworth: I would echo that. There is a big gap in terms of meeting the Paris agreement objectives at the moment. Private finance seems to offer a really useful way of bridging that gap. In particular, for the kinds of companies that will need to either transition or go through a process of managed decline in returning cash to shareholders, their shareholders are going to be a key force for moving them along the right trajectory. Stewardship is really necessary in that way, to move the economy through the transition to zero carbon with minimum disruption.

Q70 **Chair:** Is there a difference between green finance and financing green? Do you draw that distinction in terms of your focus?

Bruce Davis: There is certainly a policy split. I sat on the Green Finance Taskforce, and we divided our time between greening finance and financing green. My business is focused more on financing green. It is a problem area. The reason why we need green finance is that the nature of investments is fundamentally different. They are longer-term and they are often lower-risk and lower-return. That makes it hard for companies to choose that over shorter-term, higher-return but potentially higher-risk investments. You have some real choices that people are making, so green finance is a financial decision.

We would also say that "green finance" is not, in some ways, perhaps the right term, in the sense that we are all impact investors anyway. Our money has an impact in the world. What we try to do is raise people's consciousness to the point where they realise that it has an impact whatever they do and, therefore, effectively putting a political intentionality to deliver net zero is a valid thing to do with your money. An investment is itself a political act; you are deciding what world you

want to see and using your money to achieve it, rather than, say, your vote or your feet, as outside today.

Simon Howard: Financing green is the short-term objective, where there is a degree of novelty and new thinking that needs to be introduced. Ultimately, all of finance must be green, all of business must be green and we must all live in a different way. There is a transition there; I suspect we will be using "transition" a lot today. The two are currently different but we must end up with all of finance green.

Q71 **Chair:** Do you think that the UK's policy landscape provides sufficient long-term signals to encourage finance providers to reliably invest in projects that have a zero-carbon trajectory?

Rachel Haworth: We need systemic, system-wide change, but what we are currently getting is tinkering around the edges. Global financial regulators have got the ball rolling, but there is a lot more that they need to do. They are framing the problem in risk terms and asking every market participant to come with their own solution, but the problem with this is that it could lead to everyone focusing on resilience, i.e. "How do I not go bust in a 2° scenario?" as opposed to, "What do I need to do to make sure that we limit warming to no more than 2° at the very most?".

There are certain things that financial regulators need to do to send consistent messaging to the financial markets. That would include making sure that members' views are embedded in the way that their money is invested, ensuring that institutional investors and financial firms are aligning their activities with the Paris agreement, and having mandatory TCFD reporting, but also, at state level, the Government need to review national policies around tax and trading subsidies to make sure that the wider policy framework is sending the right signals, and that externalities such as carbon emissions are factored into company balance sheets.

Bruce Davis: To add to that, there is a role for regulation there, both from the FCA and Ofgem. At the moment, there is a bit of a disconnect between the signals being sent by regulators and the need to develop finance that can deliver that long-term perspective. Arguably, a lot of the regulation is focused on quite short-term issues, such as the energy bills next month rather than the energy bills in 2030. From a finance and a business perspective, there is a lack of stability to build your strategy towards a goal.

We now have a political objective: net zero. The next stage is to align regulators with that objective, particularly on the finance side. We are mechanistic, in a sense; we have to run along the regulatory lines that we are given, and if those do not change, we cannot act. We are already running up against some issues around the fact that a lot of investments in green are long term; I am talking 20 years or more. Pension funds can deliver that, but they can only invest in certain types of projects, which need to be relatively uniform and relatively large. At the moment you can

characterise green finance as relatively fragmented and relatively small. You have a big gap there.

Businesses such as mine sit in that gap, but we are only £100 million of investors' money at the moment. The reason we are not £1 billion like some of my peers in the peer-to-peer industry is because of that supply problem. It is about getting those businesses to start developing programmes of investment so that you can then bring larger-scale capital in, which requires lower risk, longer-term returns and more predictability in terms of the type of risk they are looking at. They are relatively simple beasts and they do not like bespoke, individual, changing things, as a general rule.

Simon Howard: There is a lot of very good work being done, to a degree in policy and certainly in regulation, but it is all rather tactical. We need a strategic approach, recognising the long-dated nature of the net-zero target. We can have a managed, orderly transition. We still have just enough time to do it. In terms of the kind of things UKSIF will be calling for, we would like more carbon pricing of emissions. It has worked very well in generation but it covers less than half of UK emissions. We need strategic interventions by Government in that area. We would also urge, if possible, the Treasury to mandate, in the forthcoming medium-term spending review, that every Department refers to net zero and considers the impact of the recommendations and its spending on that kind of timeframe. It has to be strategic, not tactical. The tactical is good but we need more.

Q72 **Chair:** Going back to the point you raised about pension funds, for example, by law their boards have to work in the interests of the shareholders or the policyholders. What incentives are there, and what do we need to see, for pension funds, for example, to take more of an active role in climate change and that to be the focus of investments?

Bruce Davis: There are two things on that. First, there is strong demand. They are beginning to listen to the voices that are being raised, and ShareAction is driving some of that, in terms of getting people to contact their pension funds, as a start point, and find out who they are.

We now have 10 million people who are auto-enrolled into the pension system, and they are just beginning to wake up to the fact that that means they own shares in companies. If they own shares in companies, they have some say in what those companies are doing. We are just at that level of awareness.

The most important fact coming out of the DFID research that was published a couple of weeks ago was 52% of people, overall, saying that they would invest more, i.e. they would be more investing for their future and saving for their retirement, if there was a positive outcome that they could see from that investment in terms of the issues that we are talking about. That is contrary to how the finance industry has been thinking in the past—that somehow this is a trade-off. It is actually beneficial to the

finance industry to start to address these things. That will begin to move the market, but not fast enough. The regulator needs to send stronger signals that it is not just a market-driven thing; this is also part of that fiduciary duty to their members. They need a world to spend that money in that is not detrimental to the goals they are setting out for their retirement. At some point, that will come to a rub where someone takes that pension fund to court and says, "Why are you not doing more?". I do not think we need to get to that point. We could tell pension funds to do it now.

Simon Howard: We run a campaign each year called Good Money Week. By coincidence, it is this week. We have done some opinion polling, and in the auto-enrolled generation—the people aged between 18 and 25—two-thirds of them who expressed a preference are saying that they are as interested in making a difference as in the financial return. There is scope there for a dialogue between the big auto-enrol DC pension schemes and their members, which will encourage the member to save more, which we need if the pension scheme is orientated towards sustainability.

A call UKSIF is making today to this Committee is to ask if we can please mandate that the default funds of the defined contribution pension schemes should be sustainable, where that sustainability can be defined by alignment with the Paris goals. This is the kind of strategic, long-term intervention from the regulators that is now possible and would be welcomed.

Rachel Haworth: Pension investment is something that ShareAction looks at a great deal. Our 2018 ranking of the 10 largest UK auto-enrolment providers found that NEST was the clear leader in addressing climate-related financial risks in the default fund; it scored 86%. No other auto-enrolment pension provider scored above 32%. This is a really clear indication that pension providers generally are not taking climate risk sufficiently seriously.

We need a wider definition of "best interest". Pension schemes, or at least trust-based pension schemes, are duty-bound to act in members' best interests, but historically this has been defined very narrowly and in purely financial terms. As has already been said, there is not much point having a couple of extra per cent. of returns over a brief period if it means we end up with a world that is highly disrupted by climate change. We need a wider definition of "best interest".

We need to move to a culture of taking savers' views seriously. Because we have a pension culture that started with defined benefit, where employers were taking the risk of investing that money, pension schemes do not tend to see their savers as individuals who own that money and should be able to express their views about how it is managed.

Q73 **Alison Thewliss:** To pick up on those points about pensions, first of all, Simon Howard, your institution has previously referred to pension funds

as "sleeping giants". What power can pension funds wield over climate outcomes, and what more should those asset owners be doing to make change?

Simon Howard: The reason they are sleeping giants in the climate context is that they are long-term investors, as Bruce has already said. They are also universal owners, as it is termed. The bigger the fund, the more broad the range, geographically, of its investments will be, in all the different kinds of asset classes. As Rachel has said, if the climate does go wrong, it hits the pension funds, so the interests are clearly aligned and they are obviously very large.

We are talking about perhaps removing some of the behavioural barriers in how they invest. Pension fund trustees, if we are talking about trust-based funds, do an enormous amount of work and are first-class people. In terms of their behavioural characteristics, they are conservative by nature. They do not want to take risk. We need, stimulated by the regulator and stimulated by public opinion, to indicate to them that the envelope of permissible investments and attitudes is broadening. They should no longer be measuring investment performance on a quarterly basis, for instance. They need to look longer and to think in a different way. They need to consider the risks and the opportunities far more broadly, moving into Bruce's area, moving away from listed equities and so forth.

Q74 **Alison Thewliss:** You have highlighted as well the Good Money Week survey. It indicates that 40% of people want a fossil-fuel-free pension product. You feel that there is certainly a gap between this demand and product choice out there on the market. Is it that conservatism that is driving that gap, or is it something else?

Simon Howard: It is probably conservatism at every point. The fund managers will not necessarily develop the product in anticipation of the market. One of the reasons for doing our opinion polling is to show our members that the demand is there. There are a lot of behavioural and conservative issues, but the public opinion, the Paris commitments and the net-zero target will all be accelerating the change. All we are saying is that this is the right direction of travel. This Committee, the Treasury and the regulators should do everything they can to encourage it.

Bruce Davis: It is fair to say that pension funds are increasingly politically aligned with the goal, but they are not practically aligned with it. To make a pension fund become fossil-fuel-free, it would need to change the way it was regulated. The reason it has fossil fuels in there is because it is required to hold a certain type of liquidity and those liquidity requirements are often contrary to green finance goals. In general, green finance investments, because they are nascent—we have been going quite a long time but it is still a small market—do not always have the characteristics that allow them to be held in what would be considered retail funds. They are often, for example, unlisted investments, or they are private investments. A lot of that is to do with broader policy

uncertainty. If we look at some examples of businesses that have explicit goals around net-zero-type objectives, their relationships with the City of London can often be difficult. The City of London does not look at them in terms of their net-zero objectives. It looks at their next quarter's figures. Those companies tend to underperform in terms of their share price, because they do not look as good on the catwalk, effectively, as other companies do in the short term.

What we are building up there is a potential risk in the system, because you are looking at the returns and you are not looking at the risk side. There is a reason why those investments are offering that higher return: because there is a higher risk in there; otherwise the market is broken. We need to think about how we help those firms say, "We are going to make that long-term bet on those investments, even though in the short term that is going to hit our return because we are not getting that initial kick of investing in something that is relatively high-risk", such as speculating on an oil or gas field. These are very different investments.

My pension, personally, is fully divested, but I would not necessarily have recommended it over the last five years of ups and downs of the green industry. I have felt first-hand what it does to your pension, but you have to try these things.

Rachel Haworth: I could have been clearer before that this is a financial issue for pension savers. It obviously also has huge implications for the wider world, but it is about producing risk-adjusted returns. Carbon Tracker produced a report saying that peak fossil fuel demand could be seen as early as the early 2020s. That is obviously going to have a huge effect on share prices. That is talked about a lot; stranded asset risk is talked about a lot. It is becoming increasingly clear that the greatest financial risks are going to emerge if we do not meet the goals of the Paris agreement, in terms of the physical risks that are going to manifest and the macroeconomic risks that are going to result.

In our response, we called for pension funds—and this will start to apply to other financial institutions as well—to align their portfolios with the Paris agreement. That needs to be made a legislative requirement over the short to medium term.

Q75 **Alison Thewliss:** You both mentioned the compromise that people will have to make in terms of returns on that investment in the short term. To what extent can action be taken to help firms manage that?

Rachel Haworth: That would really be over the shorter term. At the moment, fossil fuel companies are still producing good returns but, as Carbon Tracker has found, that could change really quite quickly and pension funds are not going to be able, en masse, to exit fossil fuels in a way that makes for an orderly transition and protects savers' returns across the board. Firms need to be looking ahead and making short, medium and long-term plans about how they plan to tilt their portfolios away from high-carbon assets towards lower-carbon assets, and to

steward the assets that they currently have, so that, as I said before, oil and gas companies are either looking to transition and invest their capex in renewables—certainly to stop exploring new resources—or looking at how they can wind down and return their cash to shareholders.

Q76 **Alison Thewliss:** Does the action by the Norwegian sovereign wealth fund to move out of fossil fuels in investments help to encourage other people?

Bruce Davis: It makes them worried. Imagine if BlackRock did the same.

Simon Howard: It indicates that an investor of that size and nature is saying that there is a real problem here. That is a very important message and that will begin to influence people.

Bruce Davis: We could have been having this conversation in 2006 or 2007 about the amazing returns that were coming out of the residential property market; that was on the up and continuing to go up, and at some point the dance was going to stop. We are currently in a dance as regards fossil fuels, and at some point it is going to stop. When it does, one of the large investors will move and other investors will lose. This is the real risk here: it could hurt people's pensions. We are not arguing for divestment en masse. The Bank of England's work on highlighting climate risk and trying to get companies to look at this strategically—i.e. before it happens—is of the right effect in terms of those large investors.

There is a different message around smaller investments and investors. A lot of my investors are looking at this as a complementary risk. They are diversifying. They are saying, "I can see risk in the fact that I am only really allowed to buy equities as a retail investor in the mainstream market, so I am going into new forms of debt products that are being created here". The UK is a leader in that market. There is £20 billion invested into peer-to-peer and different types of bonds. People are doing that to move away from the risks they see in the mainstream markets. We are definitely looking at those types of signals.

Q77 **Alison Thewliss:** At the moment, how easy is it for customers to quickly and simply understand how green their pension investments are? What more could be done to make sure that customers have that information?

Rachel Haworth: Progress has been made over the last few years. The Department for Work and Pensions has given pension savers the right, in trust-based funds, to find out what fund their money is invested in. That still is not a particularly straightforward process, so it raises the question of how many people are likely to do that.

In the last couple of weeks, new legislation has come into force that means pension funds have to take into account environmental, social and governance factors in the way that they invest, and update their statements of investment principles. Defined contribution pension funds, where savers bear the risk, will have to publish, from next year, a statement of how those risks have been taken into account in practical

terms. Things are improving, but we are still quite a long way from a system where pension savers can be comforted that they will be retiring into a world that is compatible with human life as we know it. We do still have a long way to go.

Simon Howard: This is very difficult stuff. There is no agreement in the industry, necessarily, on any particular issue. On nuclear power, for instance, does it help or does it not help? It is vitally important that we find a way of reporting to the end saver, the citizen, but it is difficult.

Q78 **Alison Thewliss:** Finally, on the wider point about financial services companies supporting the Government's ambitions to achieve net zero, to what extent are companies already doing this? What more could they do? Is the consideration of climate risk and opportunity currently mainstream in financial services, or have we a way to go?

Simon Howard: It is mainstreaming. We are getting more approaches from new types of potential members, because they recognise the market movement. We have particular types of members involved in Bruce's area, within infrastructure, who can clearly see the direct and immediate benefit of net zero. For the bulk of money, we need other countries to adopt net zero; we need the idea of net zero to become normative globally. It is not there yet, but the transition, to use that word again, is now clear. We are engaging with more senior-level people in members. One member said, "On the 31st floor—the boardroom—they now understand it. They know why they are employing me. Five years ago, they did not".

Q79 **Wes Streeting:** Good morning. Which aspects of the Government's new green finance strategy will have the most impact on greening the financial system?

Simon Howard: On the day the green finance strategy came out, the four principal regulators all basically made supportive statements about it. The Government have said they will change the letters of remit to those four regulators to include climate change. That is good, but a letter of remit can be changed by another Government. A theme in the green finance strategy is that it is good but could go a bit further. UKSIF's suggestion would be that we need to look at changing the statutory objectives of the four regulators. It is a direction of travel in the green finance strategy, but let us just take it to its logical conclusion.

We welcome the commitment in the green finance strategy to at least matching the impact of the EU action plan. Let us go a bit further; let us exceed it. Britain is the European leader for green finance. Let us make sure we secure that position going forward.

There is some criticism of the strategy. The £20 million venture capital fund tender appears to have stalled. We are not sure why. Green building passports were called for. That does not seem to have been picked up.

We welcome the strategy, and we welcome the commitment, but it is not "job done"; it needs to go further.

Rachel Haworth: I agree that it is a step in the right direction. Particularly positive is the commitment to clarify responsibility for the financial regulators.

One aspect I would like to drill down into a little is the expectation on TCFD reporting. We are really clear that TCFD needs to be mandatory. This is something that has been supported by investors. I cannot really see that there needs to be much of a delay in moving towards a mandatory approach. Russell Picot has said that you need the tension in the investment chain to pull through the information from companies to asset owners, and for that data to be incorporated in the way that financial markets function.

A small piece of evidence that might go some way to support that is our 2017 ranking of the 15 largest European banks, which found that all three French banks scored particularly highly. They commented that this was related to the introduction of article 173 in France, which was a form of mandatory climate reporting. UK banks did relatively poorly, with the exception of HSBC. It is not sufficient that HSBC might be looking to set itself apart on climate issues. This needs to be happening across the board.

Bruce Davis: The strategy has been more effective at looking at what needs to be done in terms of the regulation in the financial system. More needs to be done in terms of the regulators and how they view it. Each of them would say that they are looking at it, but it is not built into their DNA in the way that a statutory objective would be. We saw that with the FCA, when it was given the competition remit; that opened up whole new sectors being able to be developed within the finance sector, my own sector being one of those. Things such as the innovative finance ISA come on the back of that. For us, those are positive things, but regulators do what they are told, so they need to have that more clearly stated.

On the financing green side, we had a lot of energy in the taskforce, and a lot of ideas. We need to maintain that energy. The Green Finance Institute is important to that, and we started to get into convening and reconvening groups, getting industry behind this and doing stuff. There is plenty that could be done.

Work has also been done by the Department for Digital, Culture, Media and Sport, in the Inclusive Economy Unit, looking at financing for society projects, where we are looking at public bodies—local authorities—as lead actors in green finance. A lot of them have declared climate emergencies and now a lot of them are thinking, "How do we finance this?". It is important to emphasise that we saw in the green finance strategy not a lack of will, but a lack of capacity to raise that finance and understand that it works differently from the current finance they raise. We are doing quite a lot of work, led by Leeds University, to help local authorities—

essentially their treasury teams—understand what they can do. There are some rules that get in the way and others that do not. They need to understand how they can look at things such as Invest to Save and so on. That is about how you encourage and educate, ultimately, the finance professionals within local authorities to look at green projects in a new way.

That goes up to Treasury at central Government level, which is again the individual business case of projects being looked at, not their overall contribution to net zero. We need to start being able to prioritise projects within an overall collective contribution, not just the individual business case; otherwise, all we do is the low-hanging fruit, not the difficult stuff. An example of that is energy efficiency and retrofit. We have to do a massive amount of work there. Currently its business case is not competitive with other things, so we are not doing it. That is important.

Q80 **Wes Streeting:** Can I ask you to elaborate briefly on the point you alluded to about the rules that get in the way, in terms of local government treasury management strategies?

Bruce Davis: It is all about guidance there. CIPFA introduced guidance for the way that local authorities think about borrowing. Currently, a lot of them are investing, by borrowing from the Public Works Loan Board and otherwise, into different projects. Not all of those projects, I would say, are net-zero-type projects. Local authorities have particular needs in terms of generating revenue from those investments. It is definitely something they are doing.

Now, they are beginning to understand that net zero is an opportunity for them to generate revenues, but they also need to make sure they are doing those investments across the board, so that they are doing the difficult stuff as well as the easy stuff. At the moment, the easy stuff is easy to make the case for. The difficult stuff is less so, so we have had a bit of a skew towards things that either pick up grant funding or are relatively easy to price.

Q81 **Wes Streeting:** I am wondering if there are any statutory changes you think we ought to be making here, or Government ought to be making, to concentrate minds and to focus the rules in a way that leads to the right kinds of outcomes.

Bruce Davis: It is less telling them what to do and more giving them the capacity to get on and do it. When you look at a treasury department now, it is two people, not 10. They are managing a budget. Our experience of working with them is that they are very good at spending the money, and they have lost the people for the investing side. We need to get into building the capacity. Otherwise, these things will not happen, or they will take a long time. They have more priorities.

Q82 **Wes Streeting:** As a former councillor, I strongly agree with what you have just said. Coming back to you, Mr Howard, the emphasis that you

placed on the guidance and mandates given to regulators was striking across all of your answers. I wonder if the Government's strategy will have any practical impact on how easy it would be for your members to deliver sustainable finance. What is there in the strategy that would make your members think, "Great, they have just made my job easier in a practical sense"?

Simon Howard: There is not anything that will make someone go out and write a different cheque this year compared with last year. The strategy is important because it is showing the direction of travel, and forming the environment in which people will operate in future years.

I am just looking at the lists of other things. We called for a sovereign green bond. I do not think that recommendation has been taken forward. Why not? Other countries are doing a sovereign green bond. That is practical money. Let us do that. There was talk in the taskforce report about a national capital-raising plan. There are some aspects of that in the strategy, but it is a bit thin.

The direction of travel is good. The regulators are important because, as Bruce and Rachel have said, they set the tone in which my members operate. As yet, there are no levers for them to reach out and pull.

Q83 **Wes Streeting:** Do you not think that is something of an indictment of the strategy? I understand what you are saying about the importance of direction of travel, but if it is not going to change practical action even within the timeframe of the next year, in terms of the people writing cheques making different decisions, that is an issue. This is urgent, is it not? As we have already heard, we have declared a climate emergency. I do not get the sense that people are behaving as they would in an emergency.

Simon Howard: We do not want people to panic. I am sorry if that appears semantic. We are talking about long-term finance. It is important that the mindsets change, and the money will follow. We think that more can be done in setting the regulatory environment to do that. Bruce's comments about changes at a practical, local level on the ground are an example of the kind of second-order change that needs to follow once the strategy has been articulated. We see this as a good start, but as a work in progress.

Q84 **Wes Streeting:** On TCFD, which has already come up, what practical impact do you think this will have on the markets? What action should the regulators be taking to ensure firms are ready to meet the expectation? How do you think disclosure should be reported? Is there any merit in treating the reporting framework similarly to the framework for the gender pay gap, where we can have the data in one place and make comparisons?

Simon Howard: We think there is a great deal in there. Our members overwhelmingly support TCFD. On balance, the majority of them are happy with the timing—the review in 2020 and then action in 2022, if

needed—although some are saying it could be quicker. There is some concern, from a minority of members, that if we move things more quickly, and push it too fast, we will just get boilerplate reporting. On balance, as I say, the members are happy with the timing as planned. Overall, I think there will be support for making it mandatory on a comply-or-explain basis. We might be slightly different from ShareAction there.

TCFD is coming. The tension now is focusing on the practicalities: what do you measure, how do you measure it and how do you report it? We need to let the market decide. We need to let the experts work out what is best. A best route will be determined fairly soon. Thereafter, the idea of a central repository is a very good one. We would certainly support that. A lot of what we are talking about in the pension funds is the transparency and making it easy for people to see the data, so a central repository is a first-class idea.

Bruce Davis: It sets out the right principle. You are moving in the right direction, but it is still relatively difficult to get down to the granular detail that will actually change behaviour. While it is good to report what funds you have, those funds do not have any requirements to report what companies they own, so it is quite hard to do. There are people making efforts to make that data more publicly available and, when they do, it is quite surprising what you find. The issue then is what we do about it. Otherwise, you create confusion for people: "Why is my ethical fund holding an oil and gas company?", for example. That undermines the brand of a fund that is saying that it is environmentally positive, and people become cynical.

The key thing there is that things go on within funds that need to be clearer and more out in the open. People are working out ways to access that information. When they do, that will have an effect on the industry, much like the review on their fees. Shining a light on stuff is always good, and that will force people to look at their asset allocations and their portfolio strategies and start to align them with customer needs. The ones that do will win in the market. That will ultimately drive them. At the moment, we have not quite got to that tipping point.

Rachel Haworth: I would have concerns about not going beyond a comply-or-explain basis for TCFD reporting. It is not a silver bullet, but for markets to price in this climate-related information, it needs to be made publicly available. For example, we have engaged with a bank that expressed concern about a lack of mandatory TCFD reporting, on the basis that its own TCFD report would have to be based on all of the entities to which it had exposure, so it would not be able to produce its own TCFD report unless all of those other organisations were also reporting. If there is an organisation where the climate issues were not hugely relevant, that could come out in a TCFD report, so I do not think comply or explain is necessarily the approach that I would go for.

Our view is that regulators need to embed TCFD reporting as a requirement within their rules and take enforcement actions for firms not complying, as they would for any other issue of conduct. The DWP is publishing guidance for trust-based pension schemes and we are helping with this. We think that BEIS and the FCA could do the same for companies and asset managers, so that all organisations are clear about what they need to do.

Q85 **Wes Streeting:** Thank you. There are lots of really practical suggestions that have already come through. Mr Howard has already touched on this in his evidence, but there are these new responsibilities for the PRA, the FCA and the FPC to have regard to the Paris agreement when carrying out their duties. Mr Howard has already suggested that this needs to go further, to become more meaningful. To the whole panel, how might the Government and the regulators go further to give some practical action in this respect? Could credit guidance be used to direct greater investment in areas such as green technology, innovation and enterprise? Thinking back to the big round of QE we have had, we have discussed a lot at this Committee the impact that has had on the equitable distribution of resources in society. What we have not necessarily touched on as much is that, as well as being socially inequitable, it has also led to heavy investment in fossil fuel industries and bonds issued by those sorts of companies. Thinking ahead to the future challenges we might face, should we be talking a lot more about green QE too?

Bruce Davis: The analogy here for me is the housing market at the beginning of the 20th century—not the end—when we had to innovate to get it done. The question to the regulators is why I do not have more competitors. Why is Abundance Investment, which is 100% green and social investment, able to list its competitors on the fingers of one hand? The reason is that it is really hard to put yourself forward. It took us two years, with the old FSA, to get regulated, because we initially went in saying that we thought financial return was secondary to the outcome. For the regulator, that blew their minds. This was in the middle of a post-financial-crash environment, where everyone was feeling particularly nervous about the financial system generally, but we have not really seen any innovations around this. That is because green finance is difficult to do.

Why is it harder? It is long term, it requires understanding of assets and it requires things that, frankly, investment banks have stopped doing to a large extent, at the scale that we need it to happen, so we are not seeing the pipeline of projects coming through. We are not seeing the credit knowledge and the expertise spread as widely as it could be, to bring down costs of capital and speed the flow. You have a sticking point there.

For me it is about how the regulator can point out that this is where it wants to see people focusing, in terms of where they are building their expertise and building their businesses, rather than seeing that as an exercise in managing long-term risk. For me personally, that is a live

conversation with the regulator, about how they get their heads around doing very long-term investing, particularly in terms of debt. It is not something that the regulators necessarily understand in detail. There is a lot of education needed. We have some experience, but the Green Investment Group is looking abroad rather than here, in terms of its growth. We do not have a thriving group of investors looking at the green sector and saying, "This is what we do for a living". The regulators need to think about why that is.

On the capital side, in terms of the residential sector, we still have some strange signals going on around the value of homes that have basically invested into retrofit and how we signal that to the market. I have talked to people who are investing there, such as the Ecology Building Society, which is only doing green investment in green houses. How do things such as stamp duty get used to fight the granite worktop problem? If I have a granite worktop, does that add more value to my home than my solar panel? At the moment the granite worktop might win, in the short term. In the long term, I should be looking at those solar panels and thinking, "That is a good investment. That house is more valuable", but at the moment there is no market signal that really backs that up, and there is no benefit to me as a mortgage holder to take that home on, which has basically future-proofed itself, versus one that is going to need quite a lot of investment in the not-too-distant future to make it potentially either compliant with regulation or just compliant with the world. If I am taking that on now, why do I not get some benefit from that?

We have seen retrospectively that people who make that decision are a better credit risk. That is what Barclays showed with its green mortgage product, but we are not really looking forward; we are not creating a green Experian here. We are not developing that to see what is good for businesses lending to people, particularly homeowners and small businesses, so we can pass that benefit on and do some of these things that need doing, because a lot of them do not provide the sort of returns that you can get from putting different types of things into your home, such as a kitchen refurbishment.

Simon Howard: My bank members are increasingly warm to the idea that a change is being made to the capital regime to make it easier to lend to green stuff and to steer money away from brown stuff, but they all say that we need data, we need understanding and we need to prove that it is long-term sustainable. Bruce has already highlighted that it is hard to discern that. The Ecology Building Society was all for this when we spoke about it. Banking, capital and regime may be a way of altering the flow of money from the very vital and important bank sector, but we need firm data, and there is a role for regulators in there.

Rachel Haworth: I would go back to a point I made earlier, which was that we cannot frame this purely in risk terms and expect everything to fall into place. There are just too many vices and too much short-term

thinking in financial markets. We need to send clear signals that tackling environmental, social and governance issues is a core function of financial markets. This is going to involve embedding members' views in the way that money is managed and aligning funds with Paris and mandatory TCFD reporting, but also, as I mentioned before, reviewing national policies around tax, trading subsidies and so on, to ensure that financial markets are pricing in externalities.

I have a few other points. The Government need to carry out holistic reviews of financial regulatory systems to make sure that consistent messaging is being communicated. National capital-raising plans have already been talked about. As Simon said, we need departmental carbon budgets, as opposed to purely financial budgets.

Another point that I found interesting, which emerged from the recent Labour conference, was that Labour is looking at reforming the Treasury's Green Book to make sure that when these types of policies are put into the Green Book, you do not get a "computer says no" type of scenario. We need to make sure that the Green Book is consistent with the Government's wider targets around emission reduction.

Finally, the Future Generations Commission in Wales, which is associated with the Well-being of Future Generations Act, puts a requirement on public authorities to look at how long-term concerns around sustainability and well-being are being factored into all decisions being made by public authorities. That is the kind of model that the UK Government might want to look at in ensuring that every time a decision is made, in different Departments and different local authorities, it is being made with that long-term objective in mind.

Q86 **Mr Baker:** I would like to turn to barriers. You mentioned the Well-being of Future Generations Act, which distracted me a bit. That is just a Wales Act, is it not?

Rachel Haworth: Yes.

Q87 **Mr Baker:** Fine, so I have not missed something. I thought we might have passed something and I had not noticed it. Do you think the traditional oil and gas companies can be part of the solution to climate change? If so, how?

Rachel Haworth: They can be part of the solution in that they need to decide whether they are going to move their capex to renewables or go through a managed decline and return their cash to shareholders. As I have said already, on an individual entity basis, that is something for shareholders and individual companies to work through and to decide themselves. They need to work out what role they can play. We need to be clear that there is not a long-term future for business as usual in the way that the oil and gas sector sees it.

Bruce Davis: I asked this question of the head of strategy for BP, and he said that they had £160 billion of capital and they renew that every 10

years, so that is £16 billion per year. They could do it in 10 years. There is a cost to that.

Q88 **Mr Baker:** When you said they can do it, do you mean they can renew their capital stock?

Bruce Davis: They could completely change their business, 100%, in 10 years. That would have a cost, and we need to look at that. This is not about doing this on the basis that we leave people behind, given our current politics. There would be people who would not be able to make that transition, because of their skills, experience and everything else. At BP, they would have to look at how they can become that different business, but they could do it. It is a financial decision, then, about investment and about shareholder returns and what they have said to people.

At the core of that, though, are people. We need to look at this on a geographical basis too, and that is one of the areas that the green finance strategy has started to look at. Where are the communities that are going to be positively affected, and where are the ones that are going to be negatively affected? The data, which again is from Leeds University and some work done by Leeds city, is that basically around 10% of jobs will be positively affected and 10% will be negatively affected. That is a lot of people, and they are focused in particular areas.

We need to look at how those transitions take place, but that is an engine for change. If you identify where this change needs to take place, we can start to make the investments and say, "Why are they not happening? Why are steel plants not starting to convert to other forms?".

Q89 **Mr Baker:** That is definitely the topic of my questions. Forgive me; I did not mean to cut you off. In saying that BP could replace all its capital in 10 years because of its current rate of investment, it felt like there was a lot of "other things being equal" in there. Have you had any discussions with them, or any reflections, on what those other things would need to be, to enable those kinds of transitions?

Bruce Davis: They would have to make that case to their investors, which I think is what ShareAction is saying. They have the ability to change, because they are investing that much. They reinvent themselves every 10 years, effectively. We are looking at these companies as if they are solid beings. They are not; they can flex and pivot. What I have seen from my experience in the green industry is that we have had to pivot every two years, and that is perhaps why we have not grown so much. I am invested in a company that has done solar grid balancing and has now gone back to storage in the space of six years, because of different policy changes that it has had to react to. You can be agile, and this is the challenge for the oil and gas industry: "How agile are you? Which are the agile ones? Can I invest in those?".

Q90 **Mr Baker:** Is the fundamental point not that they are investing to make

a profit, so the investment will follow the profit? That is what I am driving at when I talk about other things being equal.

Bruce Davis: Profit over what period? Profit is at a point in time. It is an accounting term. I can take profit out of a company; that may not leave a good company behind it.

Mr Baker: That is a fascinating point.

Simon Howard: Bruce is quite right. The companies are commercial, and at the heart of all this is a failure of pricing. Companies are being allowed to pump out the carbon and are not being charged for doing it. That sits with the Governments and the regulators. UKSIF surveyed more than 40 fund managers in April of this year; 86% of the fund managers want the oil companies to align with Paris, so the investors are already saying it. To come to the crux of it, fewer than one in five fund managers believe oil companies will be a good investment if their business is still focused on fossil fuels in the next five to 10 years. The investors get it; they can see ladies and gentlemen like you about to come in on pricing. That will reduce the profit, change the flow of money and make the redirection you are talking about. We can see it there. It is very close.

Q91 **Mr Baker:** You have pre-empted my next question but one. Can I turn to indices? There are indices such as the FTSE4Good Index, which has been criticised for having a palm oil company. There is the All-World Climate Index, which apparently is still exposed to oil and gas. What is your approach to these indices, and what advice do you have in relation to them?

Simon Howard: I talked about behavioural issues in pension funds. Most pension funds will benchmark their fund managers' performance against a benchmark index, so the indices are vitally important. The direction of travel is clear. We need to move to indices that better reflect the crisis we face, and some of the work coming out of the EU is very good here. They are talking of climate transition benchmarks; you would only get into that benchmark if you, the company, had a credible plan to move to Paris alignment. There are then Paris-aligned benchmarks for companies that are already there. We in Britain should thoroughly support this kind of approach. It is future-proofing; it is driving the money into the future-proofed industries. The fact that they are coming out of the EU should not worry us. We should get behind this and push the pension funds, the life companies and the charities to update their benchmarks to reflect the world we are going into. Benchmarks are very important.

Q92 **Mr Baker:** Bruce, would you like to come in on benchmarks and indices?

Bruce Davis: When you look under the bonnet, you start to understand that the way those benchmarks are put together reflects the bias we have at the moment in investment towards particular types of assets, and that is largely driven by a desire to look at financial stability above environmental stability. It goes to some of the things that are agreed at co-central-bank level about financial stability and what they think a good

financial system looks like. At the moment, ours looks a lot different from how it looked in the 19th century.

I am a historian of finance, and we have not always run things this way. We have become rather enamoured with equity markets, as if they are the only way you make investments. I am not convinced that is the right solution, particularly when we are effectively talking about a need to do the kind of build and transition that you would consider if you were going to war. That is what we are talking about here; we are talking about retooling businesses and industries—changing what they are doing. When you do that, you have to make some quite long-term, big bets on what you think the future looks like. We are not really set up to do that. We are set up to invest in companies sitting in indexes.

Q93 **Mr Baker:** I want to bring Rachel in on the indexes, but you have raised a point. I think I heard you talk there about tooling up as if for war. I do not expect you to read this from here, but this is the most recent report on energy trends. I am just looking at oil and natural gas, which are by far the two biggest sources of energy in the UK—coal has been almost eliminated. Nuclear and bio-energy seem to be competing for third, with wind, solar and hydro right down there. Is not the heart of the problem that our economy, as it is today, is profoundly dependent on sectors that you wish to see transitioned away from or eliminated?

Rachel Haworth: This is a real issue. You mentioned FTSE4Good. I understand from my colleagues who work more directly on pure climate than I do that FTSE4Good only includes questions around scope 1 and 2 emissions—that is, companies' operational emissions, as opposed to what happens after their products are sold to their customers. That is only about 10% to 15% of oil and gas companies' total emissions, so there are some fundamental issues that need to be tweaked in terms of how these kinds of things are managed.

Another point is that fund managers do not really choose the index that they are using unless it is a new fund. If the fund they manage is benchmarked to a non-ESG-focused index, even if they want to underweight carbon-intensive sectors, there is a limit to how much they can do that, because they are concerned about things such as risk of tracking error. I agree with other comments: we need to make sure that we are promoting fossil-fuel-free indices. They need to be mainstreamed. They need to become the default option, because otherwise, as long as we have these kinds of small technical issues that completely change the way markets are functioning, nothing is going to change substantially.

Q94 **Mr Baker:** You have made two points. The first was about the operational carbon costs of companies, and companies' products creating more emissions. Are you referring specifically to oil and gas companies producing hydrocarbon products that are subsequently burnt, particularly in transport?

Rachel Haworth: Yes, exactly. That is my understanding of how FTSE4Good operates.

Q95 **Mr Baker:** I am just very conscious that oil and gas and automotive are some of the very biggest industries that sustain the worldwide economy. I think you are all nodding on that point, just for the record. Does that not point to the sheer scale of the transformation that we are talking about?

Simon Howard: The challenge facing us is enormous. Bruce has brought in a war analogy; I probably would not go that far, but we need to be spending in excess of 1% of GDP per year on the mitigation of this. As you have already pointed out, we need some fundamentally large sectors of the economy to radically change. We have to stop driving petrol and diesel cars. We have to start driving electric. We then, somehow, have to make lorries electric as well. The challenge ahead of us is enormous and that is being recognised, but there are opportunities in this. Let us not be unduly pessimistic. We probably have enough time if we start and move quickly.

There are whole new industries with ample opportunities for employment. Bruce referred to the retrofit opportunity. How many jobs are there in retrofitting housing stock? We are a rich country. Surely we can find a way of doing this. UKSIF fully aligns behind the idea of a just transition. We cannot destroy communities just because they happen to be fossil fuel. We have to put in some mitigation for them. The opportunities are enormous; the demand is enormous; the need is enormous. But we can do it.

Q96 **Mr Baker:** To pick up on that point, you have recognised a tension—because you talked about a "just transition"—with your earlier evidence. If I interpreted what you said correctly, you are talking about using carbon pricing to drive profit out of some of our most profitable industries, but doing that in a just way. You are saying yes, for the record.

Simon Howard: Yes, I am nodding. It may be that the carbon price steps up over time. We may do some direct investment in an area affected by it. We have to push the envelope of thinking, to use a horribly glib phrase. We have to be innovative in this, and finance will fund it. Finance will react. Show us that there is interest and intent, and the money will be available.

Bruce Davis: It is about a long-term signal. We have done this on waste. We said to people, "You will not be able to put stuff in landfill after this date, because it will cost you too much, so you had better get ready". People started to do stuff. If you put a marker out there and say, "This is your deadline; get ready", businesses will respond. They like a deadline; it gives them certainty. It gives them a reason to tell the CEO why they need to do this, as opposed to other things that might distract them in the short term.

Q97 **Mr Baker:** Forgive me, because I have used up quite a lot of time. I want to come to my last point, which looks at something that the London Stock Exchange said. It referred to its controversy-monitoring model as informing its FTSE4Good Index Series. Are you concerned—as I am, frankly—that if people are monitoring controversy to determine whether companies are or are not in indices, it exposes investment decisions to political manoeuvring? I am a politician; I can create controversy as easily as you like. The point I am making is that I recognise the ethical risk there. Do you guys share my concern that there are ethical risks to exposing our society to a controversy-monitoring model?

Bruce Davis: You have to be realistic about what an investment is. An investment is telling someone to do something over a long period of time. You guys do it through laws; we do it through contracts called shares and bonds. They are not that different. Therefore, there is politics in investment. When we pretend there is not, it is arguably more dangerous, because you allow things to happen if you feel like you cannot change them. We treat our financial system with kid gloves, in the sense that we think we cannot change it. This is one of many financial systems we have had, and we can change it.

I agree, though, that you can make transparent why people are making those decisions and what is behind those ethics. We do not want to basically disagree over everything. At the same time, companies have a social licence to make profit and operate in the way that they do. They used to get it from the King or Queen, but now we just let them have it. Maybe some democracy around that would be good.

Mr Baker: Perhaps we will discuss changing the financial system another time.

Simon Howard: Very briefly, many UKSIF members prepare indices and consider controversy. The individuals involved are good people. They are not going to be captured by a pressure group. I think your risk is theoretical, but not practical. The reason why controversies are monitored is that companies prone to controversies are lousy investments. If we had spotted the weaknesses in Volkswagen's governance in advance—some claim they did—investors would have saved many billions of pounds. It is a good area.

Rachel Haworth: I want to echo that. Investors need to be alive to controversies, whether it is an oil spill, casual workers being treated appallingly or any other kind of ethical issue that might come up in capital markets. We need to think about the kind of society we want to live in, and investors need to think about the impact they are having. Bruce is right: we all have an impact from the way we make decisions. We are talking a lot about long-termism, and part of that involves thinking about the kind of society in which we all want to live. The issues being discussed around this table indicate that we want to live in a society that has an environment on which we can rely, which is sustainable, where people can go to work, earn a decent wage, come

home and feed their kids. These issues come up in the way that companies manage themselves, and investors need to take them all into account. It is right that companies should be rewarded for good behaviour and penalised for bad behaviour.

Q98 **Alison McGovern:** I want to start by saying that some of the questions I was going to ask have been covered, so you have been very effective this morning. Also, sometimes in Treasury Select Committee sessions, we are in an inquisitorial role, and sometimes we are very much in a learning role. I feel like I have learned a lot already this morning, so thank you to you all for sharing your time with us.

Mr Davis, you spoke about the Green Investment Bank. Is there anything else you want to add, as a critique or points of information? I am thinking particularly about how we push forward on that journey in changing the structure of our economy.

Bruce Davis: The Green Investment Bank was very successful at what it did, which was to help create the market for investing in offshore wind. Now we have a huge amount of offshore wind providing power from the North Sea. The thing we must not lose is how we go through that process for other technologies. There are quite a few that would like to go through the same process that offshore wind did. One specific one that my company backs is tidal. We are the largest investor in tidal. For a crowd-funded company to say that, you would think it should be an issue, because we are not very big.

What worked there was an investor taking a long-term view in saying, "We will support you to bring down costs and become commercial", and the market being given a signal of what it could move towards, through the contracts for difference mechanism. We should definitely be looking at that in how we commercialise things on which we are developing leadership. We have 9% of the world's tidal resource and 50% of Europe's tidal resource, and we do not develop it. A lot of that is in Scotland.

In those areas, for me, it was not about the Green Investment Bank being a bank or a non-bank bank. It may not have been the right model, but what it produced helped to show that you can take an industry that is relatively nascent and bring it to maturity very quickly. We need to do that across the board if we are to deliver against what Steve recognised, which is that we have to transition quite a lot of different technologies to scale.

One thing about renewables is that we are not talking about new technology; onshore wind is not a new technology. It has been around for decades, but it is not innovating at the moment, because it is not being given the signal that it is seen as scalable.

Q99 **Alison McGovern:** Let me ask the questions from a slightly different point of view. On the other side, in mobilising new technologies and

changing the structure of our industry, what are the risks of Government over-intervening? Why are we not just picking winners here? What is to say we would not pick the losers?

Bruce Davis: You do not pick winners; you set a target and see who wins. But you open competition to everybody. If you set in the future, around 2024, the ability to get long-term revenue from the technology you are using to generate energy, people will develop technologies to compete in that and give the lowest price they can possibly get to. That is what offshore wind did. They were given a five-year target and they delivered. We should do that for more technologies. The intervention is to set the target, because debt investors need visibility on revenue. You need to see the revenues beyond the next Parliament or the next Parliament and a half, which is the way most banks work. We have to look at 20 or 30 years' time.

At the moment, the market is not providing that certainty, so the cost of capital is higher. Whether it is nuclear or renewables, one of the major things driving the cost of energy is the cost of capital. That is a financial system problem. If you can bring down the cost of capital by showing me that I can get payback over longer periods and some certainty of that—not full certainty, but some—I will reduce the risk of the investment and, therefore, the cost of capital.

Simon Howard: I would echo what is implicit in what Bruce was saying, which is that we need policy stability. I spoke to one of the UK's largest pension schemes, ahead of giving evidence. They said, "Do you know what? The UK is not that attractive as a venue for infrastructure investment because of comments made by politicians in speeches." They pointed to energy and water, and politicians from both large parties have made comments that have unsettled investors. Providing policy stability is a definite win from Government; not providing it would be shooting ourselves in the foot.

Q100 **Alison McGovern:** Our colleagues on the Environmental Audit Committee found that investment in clean energy in the UK fell by 26% in 2017. They said that this was partly due to the point that you just mentioned: changes in low-carbon policy undermining investor confidence. Do you recognise that picture? Mr Howard, you mentioned politicians' role in setting a stable policy platform. Do we have the right policy-making infrastructure to provide a stable policy platform?

Simon Howard: If I may say so, it is probably behavioural. Various bodies are involved in this. With the greatest respect, we need politicians to live up to the potential of those bodies. I could point out, for instance, that we are on track to miss the fourth and fifth carbon budgets, even before they are adapted for the net-zero target. Certainly the fifth one will need to be adapted. The challenge to politicians is to try to step up in a co-ordinated way. I would use the phrase "cross-party", but I hope it does not make me sound naive. Can we not get agreement on the

fundamentals of this, and then talk about the tactics of implementation, where there is clearly a valid role?

Q101 **Alison McGovern:** That is a really interesting question for this Committee and our report. As a final question, if I had a company that had invented some kind of new technology that was capable of changing the way that we generated energy or that transport was powered, or we had created some new invention that could decarbonise our economy, on the whole, is it likely that my company would be well served by British finance?

Bruce Davis: We have some very good structures in place to encourage entrepreneurs—things such as the Enterprise Investment Scheme and the Seed EIS. We have a crowd-funding industry backing a lot of those things, but we fall down when they try to go to scale. We have lots of ideas. I am not short of people asking me for investment to back ideas at an early stage, but it is hard to scale those ideas up. It starts to bring in other elements of the finance industry, which are not set up to look at clean tech in the broadest sense and the way that you describe, because they are different investments. It is a bit like asking a Silicon Valley entrepreneur to understand a wind turbine; they do not get it, because it is not software. It does not produce 30 times return on their equity over five years, so they do not do it. We have a financial system that is set up to do a particular thing, but it has a different job now. That is the bit we are not very good at.

My company is entirely set up to try to fund those types of investments. The first investment we launched was a 20-year bond, which had not been done since 1880 or something. It meant we had to bring in a whole load of innovations, things such as secondary markets and other types of infrastructure. In general, the FCA is quite focused on innovation; it wants to see new things, most of the time. Sometimes, it changes its tone of voice on those new things and what it thinks about them, but it is generally supportive of what we are doing. That is what we are talking about: it is changing the way that these companies work. That is looking at building societies and why they are not lending to these things. What gets in the way of doing that practically? You often find it is their risk and compliance department. That is really detailed stuff, down in the weeds, but it matters to where that capital is allocated.

Simon Howard: The smaller the investment and the less liquid it is, the harder it is to get it going in this country. I am not an expert on the United States, but it appears to be easier over there. Some of my private equity members speak enviously of the environment over there.

In passing, the liquidity point that Bruce touched on is important to retail. If the Committee is looking into Woodford Investment Management, I would urge you to be careful which babies you throw out. A lot of this stuff is illiquid, and retail people want to invest in it. Let us not ban illiquid in retail; let us find a way of making it work sensibly. The UK

system is not necessarily good at innovation and small-scale stuff, and you should talk to Bruce about that in detail, as I have.

Rachel Haworth: This does not speak directly to your point on private equity, but we still have a real issue, going back to the Kay review in 2012, about short-termism in equity markets. Equity financing is still not being used to promote research and development in companies. It ends up being a lot more about mergers and acquisitions, and a lot of other activity that is not very productive for the economy. I encourage this Committee and the Government to look at doing a wider-scale review of why we have not made much progress on that at all, and why we still see so much short-termism. As long as short-term pressures are coming down from shareholders, companies are not going to take a longer-term approach.

Q102 **Rushanara Ali:** Good morning. We have already heard about the role of major companies, such as Shell, BP and others. If we look at the comparative data on who emits, the UK is low down, with 1% of emissions, compared to China, India, America and so on. As you well know, the City of London hosts and finances companies that contribute to or account for about 15% of global CO_2 emissions. Positive Money's written response to us said, "UK banks are the worst in Europe, with Barclays lending over $85 billion and HSBC more than $57 billion towards fossil fuels". There are many others. You have already talked about the FCA, innovation and the conflicting attitudes towards it, but also towards what we do. What should the regulators be doing to drive the right kind of change, going in the right direction, to reduce CO_2 emissions worldwide, given the role of financial services and financing?

Bruce Davis: As I understand it from the PRA's letter to CEOs, and from the things it has done, it is seeing this as a potential financial crisis. That is my reading of it. It is saying to banks, "You need to explain that risk on your balance sheet. How big is it and what is it? You need to be thinking about it strategically, as your business." The PRA's assessment is that that is beginning to be strategic, but it is trying to push it up the chain. Things such as the Senior Managers and Certification Regime, we believe, will make that more of a focus for those individuals. We are then seeing that you need to start taking responsibility for those investments.

Q103 **Rushanara Ali:** Do you think those actions are sufficient to get the transition that is needed, and that there is enough urgency?

Bruce Davis: No, in the sense that I have not yet seen a bank saying how it is going to transition. What does that bank look like once it has transitioned? They need to start saying what their direction of travel is, rather than reporting their progress—i.e. giving a backwards-looking assessment of that risk. They need to say where their assets are going to be in five or 10 years, and what they will look like when they have done that. That is not really being described to the market at the moment. If you are investing in bank shares, you are investing in something that is

still moving towards climate risk. You have to assess that risk. We are all invested in bank shares through our pensions.

Rachel Haworth: This is where requiring financial institutions to align to Paris could be powerful, particularly relating to investors' portfolios. We need to get to the point where investors are talking to companies, as Bruce said, about what their direction of travel looks like, and what degree of warming they think their company strategy is compatible with. If we can require investors to indicate the kind of robust engagement with which they are saying, "We need to see that your company strategy is consistent with the Paris agreement, or we will be legally obliged to sell our shares in your company," it could be quite powerful. The IIGCC is already looking at the detail of what that might look like. The more ambitious Government are in taking this kind of action, the more money will flow in the right direction to investment research, so that clients are well equipped to make the necessary changes. Financial firms will often wait for Government action to move forwards on these kinds of things, so we need that clear signal.

Simon Howard: The PRA intervention, which both Bruce and Rachel have mentioned, is very good indeed. Having a named individual always focuses attention. Having demanded business plans, I hope they will be shared publicly, so that we can see what they are. We hope they will be challenged robustly. I do not think the UK needs to be ashamed of the 15% figure, as long as we are leading the transition, and as long as the regulators, who are governing the work we are doing that is represented by that 15% figure, are world-leading in their approach. If we can get to a model where people know that if a deal is going through London, with its world-leading climate consciousness and regulatory environment, it means the deal is good or better than average, we should go for that position and maintain it.

Q104 **Rushanara Ali:** Why should we not be ashamed of it, if it is fuelling increases in emissions?

Simon Howard: It came with a qualification: as long as we are transitioning. The transition needs to be quicker and vigorous. As long as we are doing that, we should not be ashamed of playing a part in funding that transition and telling the oil companies they need to change—the message we have been giving you.

Q105 **Rushanara Ali:** As Bruce was saying earlier, not a single bank has demonstrated that it is in that trajectory or transition.

Simon Howard: They need to change.

Q106 **Rushanara Ali:** Then they should be ashamed, should they not?

Bruce Davis: Banks talk about their clients, do they not? HSBC has made a big commitment of, I think, £100 billion to help its clients move to become green. They are seeing it in terms of how that money is used. You are right to raise it, though. The fact that we have 1% of emissions

in what we do and 15% in what we finance covers pretty much everyone in this room. That is quite a good focus. We put an awful lot of effort into our choice of coffee cup, but very little into what pension fund we have. We need to say, "Why can I not see that? Why can I not measure that, in the way that I can with coffee cups?"

Q107 **Rushanara Ali:** I am going to move on to pensions, which are about £2.2 trillion of assets. Is that right? Simon, do you agree with the Association of Member Nominated Trustees that the fact that the pension fund management market has not implemented the so-called red lines to enable pension schemes to take a more active asset ownership role represents a market failure in environmental stewardship?

Simon Howard: That issue needs to be investigated.

Q108 **Rushanara Ali:** By the FCA?

Simon Howard: By the relevant regulatory people. We are rightly increasing the responsibilities of pension fund trustees. When I speak to the AMNT and other trustees, they occasionally say, "Our fund manager will not listen". That sounds like a failing to me. My members point to some challenges in information technology and the practicalities of splitting the vote in a pooled fund. I would like to have the facts on that.

Q109 **Rushanara Ali:** Your submission to this inquiry talked about the proposed Markets in Financial Instruments Directive, and changes that would incorporate environmental, social and governance factors into the suitability assessment for financial products. How would this development affect the green finance market, and how might it be affected by—I am going to say the B-word—Brexit? We almost made it to the end, but I am afraid I had to bring it up.

Simon Howard: We can address the B-word in this context very easily. Last year, the Corley report on social impact investment and the Green Finance Taskforce both made the identical recommendation that financial advisers, when onboarding a client, should ask about the client's values. All the feedback from my financial adviser members is that if you raise the issue with the client, they are very interested. They suddenly realise, "Hang on, lots of the funds available to me are investing in tobacco, gambling, pornography and fossil fuels." The financial advisers report great customer loyalty. If the adviser can take the client through this, the client is happier and the money flows. We fully support that, irrespective of whether it is coming via the EU or the FCA. Let us just crack on and do it.

Q110 **Rushanara Ali:** Are there other comments on Europe and the context of Britain leaving the EU? What does it mean?

Bruce Davis: On the retail investment side, it means relatively little at this point, because we do not have full alignment there. Hopefully it will focus on some things that the system needs to look at, which would move more slowly through the European side, particularly around

creating secondary markets for these types of assets, on which we are not focused, and increasing the market for these types of assets.

Rachel Haworth: I do not have anything to add on that particular point, but I want to pick up on the red lines. We support the AMNT in its statement, though we understand it is using the term "market failure" loosely. As I understand it, it wrote to the 35 biggest fund managers to ask about their policy on pooled fund voting, and all 35 said they would not do it. I understand that their point on market failure is that it is impossible for pooled funds to do stewardship effectively. That has some serious implications on how well companies are being stewarded as a whole, given the number of pooled funds out there. We strongly encourage regulators to work out what issues there are here and take action to address them.

Q111 **Rushanara Ali:** Are there any further points on Brexit and its impact on the green finance regulatory landscape? What would be your ask of the Chancellor, in relation to unlocking private capital for net zero? Is there anything else you have not covered that you want to cover? Now is your chance.

Bruce Davis: There is some stuff around the taxonomy, which is my least favourite word in the sector. There is an awful lot of work being done on the taxonomy and the EU is leading on that. We need to align with what the world thinks green is. There is no point having a UK version, a European version and an American version of green. Those asks come back to the public sector and local authorities having declared a climate energy and needing to play a role. The point about net zero is that no one is left behind. It does not work if we do not all do it. We have to look at how local authorities are resourced, and their ability to assess and finance the projects they need to do.

In particular, we are looking at how they can use their citizens to finance that directly, through bonds or loans, much as they used to. That happened in the 1980s, last time I checked. We see that as a way of getting communities to buy into this change, physically, and see how it works in practice. My investors are more likely to do these things, because they have seen how it works, even with £5. That is the point here: we need citizens to start to see that they are part of the system; it is not someone else's problem.

Rachel Haworth: I agree with those points around the just transition. I should have mentioned this earlier. It is really important that, every time we think about climate change, we think about the just transition, bringing people along with us, bringing in those communities and making sure no one is left behind in this industrial change. That also speaks to our international responsibilities. We need to make sure we are doing as much as we can to reduce our emissions, given we have produced a lot of them historically.

Simon Howard: UKSIF members are quite worried about the taxonomy, for a variety of reasons. They like a lot of the EU action plan, but the taxonomy concerns them. The Governor of the Bank of England made a speech in New York last week, in which he basically said that we should not have a binary taxonomy, but should have 50 shades of green. UK sustainable finance wants a permissive, inclusive approach, rather than a binary, didactic approach, at this point. It will change. There must be a global understanding in due course.

On what we would ask of the Chancellor, I would mention the pricing mechanisms again and the medium-term spending review. But responsibility for the net-zero target should not sit with the Chancellor. It must sit squarely with the Prime Minister and every succeeding Prime Minister.

Rushanara Ali: That assumes the Prime Minister is not a climate denier, of course.

Simon Howard: You should not let the Prime Minister be a climate denier.

Q112 **Rushanara Ali:** I have one final question, in relation to the point you made earlier that 1% of GDP needs to be spent on mitigation. Then there is the international dimension. Who has done the thinking around the overall expenditure? I know a few years ago there was a lot of thinking and work on the green fund and so on, but only a small proportion of that has been contributed to by the international community. What percentage of worldwide GDP is required for mitigation? Are the wealthy parts of the world doing enough, notwithstanding the Paris agreement? Related to that, and linked to the point about domestic regulation and just transition, is there a role for some sort of international arbitration mechanism—the equivalent of the International Criminal Court for international climate justice? What are your views on those two points?

Simon Howard: My 1% estimate ultimately comes from the Stern review, and the Committee on Climate Change has also talked of it, so it is that order of magnitude.

Q113 **Rushanara Ali:** You said that was for the UK. What is it overall?

Simon Howard: I think Stern was 1% globally, and the Committee on Climate Change is very close.

Q114 **Rushanara Ali:** Is that still the same and relevant, or should it be higher?

Simon Howard: I believe it still is, but we must be behind the curve, so we might argue it is nudging up. No one is spending enough, not the rich world and obviously not the developing world. The idea of some kind of arbitration body for equity in this issue is very interesting. It is the first time I have heard it suggested. Yes, we will probably have to go there, will we not?

Bruce Davis: You can look at it in terms of GDP spend, but what we are looking at is a transfer of asset wealth. That is how the Bank of England is looking at it. I am trying to think of the numbers, but it is about £30 trillion of assets in fossil fuels that need to transition into new areas. We are creating wealth through this process, and some wealth is being destroyed. That is capitalism. It is about spending and what you are putting it towards, but also about building up assets and investments.

I do not think we are quite looking at this as an investment point. You are creating something when you build a wind turbine; it generates value over a long period. That has value to its investors. We are still looking at the cost of that energy, rather than that investment, and the UK being a leader in creating those investments. The international point is around what industries we are creating that people will want to use and invest in. We have not really measured that, or what the positive impact of it will be. It is still this negative idea of cost.

Rachel Haworth: This is starting to get a little out of my scope, but we need to take a holistic approach when we look at the climate crisis. It is easy, because of the urgency that we are all aware of, to feel like any kind of measure is acceptable to combat climate. We need to think about the effect on communities, both in the UK and internationally, when we are investing in projects, whether it is public or private finance. We need to make sure there are safeguards in place that mean we are creating value, not extracting it. Where private finance is involved, there need to be clear regulatory structures in place for how that capital is deployed.

Q115 **Mr Baker:** You just reminded me that the Prime Minister brought back to our minds how we are on the cusp of fusion power. We have been on the cusp of fusion power for a long time. Your faces tell the story; would you invest in fusion research?

Bruce Davis: No; I think Government should be investing in that. It is at that stage. Maybe the private sector is thinking about fusion, but I am not sure I will be putting my money into it. Governments have a role to play in creating the knowledge base and what we can commercialise. We are not fully aligned on that, in the way clean tech is being supported. Somewhere, the ball gets dropped.

Mr Baker: You are not all planning on fusion saving the day. That is the point I am getting at.

Bruce Davis: It is not quick enough.

Chair: Can I thank you once again for being here today? We are very grateful not only for your patience and flexibility, but for the evidence that you have given today. I have to echo what Alison said: it has been incredibly informative for us and really helpful. I am sure it will make good reading as part of the report we eventually come out with—on a cross-party basis, you will be reassured to hear. That is the purpose of this inquiry. Thank you very much again.