HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Rt Hon Mel Stride MP
Chair, Treasury Select Committee
House of Commons
London SW1A 0AA

16 December 2020

Dear Mel,

DECARBONISATION OF THE UK ECONOMY AND GREEN FINANCE ENQUIRY

Thank you for inviting me to give evidence at the Committee on the 16 November. I hope this provided a helpful summary of all the work HM Treasury is undertaking on climate policy and green finance in particular. In addition to my responses in that session, please find below written responses to your follow-up questions that we didn't have time to cover, as set out in your letter of 7 December.

You kindly offered to provide further evidence to the Committee on the Taskforce on Climate-related Financial Disclosures roadmap. Could you set out for us:

a) the process by which the Government is rolling out mandatory disclosures;
b) the appropriateness of the timeframes, based on the size of businesses and sectors, at a granular level; and
c) how you will ensure that the proposals are sustainable and achievable by the vast majority of companies.

1. On 9 November 2020, the UK TCFD Taskforce published its Interim Report and Roadmap[1] outlining a pathway to mandatory climate-related financial disclosures across the UK economy. As outlined in the Interim Report, the details of implementation for each sector will be determined by the relevant regulator or government department – subject, among other things, to consultation and cost-benefit analysis.

2. The Taskforce has examined cross-cutting issues, such as interdependencies, capabilities and resourcing across market participants to develop a proportionate sectoral approach that takes account of firms' capabilities to

[1] https://www.gov.uk/government/publications/uk-joint-regulator-and-government-tcfd-taskforce-interim-report-and-roadmap

disclose. Quality TCFD-aligned disclosure is a journey for every organisation and sequencing across sectors is important; the proposals outlined in the Interim Report and Roadmap have been developed through the Taskforce, ensuring a coordinated approach across the investment chain. The UK Taskforce Interim Report sets out a series of milestones for each relevant regulator and Government department over the coming years.

3. The Taskforce will continue to monitor the progress of the cross-sectoral implementation strategy to ensure that a coordinated approach is maintained, and meet to discuss views on challenges faced by organisations within the scope of their respective rules, and to share best practice. Close engagement with industry will be essential as organisations build and evolve their capabilities in the face of the climate challenge, and Taskforce member organisations will work with industry to assist implementation. As an example of this sort of engagement, the FCA and the PRA jointly established and co-chair the Climate Financial Risk Forum, which brings together senior industry representatives and regulators to advance financial sector responses to the risks and opportunities presented by climate change.

4. I am confident that the approach outlined in the Taskforce Interim Report and Roadmap will lead to high-quality, standardised disclosures across the economy that will enable climate-related risks and opportunities to be priced into financial decision-making, without disproportionately burdening firms. The Government will provide an update on progress in the 2022 refresh of the Green Finance Strategy.

Can you confirm that the updated remit letters to the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) will include climate change and the 2050 net zero target?

The Bank of England told the Committee that Treasury approval was needed to implement climate conditionality on its corporate bond purchases. Can you confirm whether the Treasury is reviewing this matter, and if so, whether it is a priority?

5. As part of the Green Finance Strategy we set out the importance of clarifying the roles and responsibilities for those involved in green finance, including the regulators. In October 2019, the FCA, Financial Reporting Council, The Pensions Regulator and PRA published a joint statement on climate change, which the Government supports. The statement recognises the relevance of climate-related financial factors to their mandates and the importance of a collective response.

6. In March, as part of the Remit and Recommendations letter for the Financial Policy Committee, the Chancellor recommended that the Committee should

continue to regard risks from climate change as relevant to its primary objective (to protect and enhance financial stability).

7. The remit for the Monetary Policy Committee is to achieve price stability, and subject to that, support the government's objectives for strong, sustainable and balanced growth. The Chancellor will set out how these are to be defined at the next Budget.

8. The Government remains committed to including new and ambitious recommendations to the regulators, including the PRA, about the government's net zero objectives, as set out in the 2019 Green Finance Strategy. We plan to issue remit letters at the next opportunity to allow the government to reiterate its expectations for the regulators, ahead of the UK's hosting of the COP26 summit in November 2021.

Will the Treasury incorporate the net zero target into its fiscal rules, and if so, what is the timeframe for achieving this?

9. To ensure Government policy considers our environmental targets, the Green Book mandates consideration of climate and environmental impacts in spending. Additionally, the Office for Budget Responsibility (OBR) is required to publish an assessment of the government's fiscal risks every two years. The OBR's 2019 Fiscal Risks Report featured a new chapter on climate change, where the OBR discussed the fiscal risks of both climate change mitigation and adaptation. On fiscal rules, the Chancellor announced at Budget 2020 that the fiscal framework would be reviewed to ensure it remains appropriate for the current macroeconomic context. The Government will set out further details on its medium-term fiscal strategy, alongside a framework to support its delivery, once the current level of uncertainty recedes.

What policy action is being taken to allow pension savers in default funds to invest sustainably, and by what date will the Government expect UK pension funds to be carbon neutral?

10. The Government has intervened repeatedly in the sustainability of pension scheme investment since 2018:
    - The Department for Work and Pensions (DWP) has legislated to require trustees of occupational schemes to state specifically a policy on climate change, and to require defined contribution (DC) schemes to both publish their policy and to report annually on how they had implemented the policy. Corresponding rules have been made by the FCA for the Independent Governance Committees of workplace personal pensions.
    - DWP has legislated to require The Pensions Regulator to publish a Governance Code for occupational schemes – this included the requirement for occupational schemes to carry out and document a risk assessment of the system of governance including how the trustees assess

new risks relating to climate change, the use of resources and the environment, and risks relating to the depreciation of assets as a result of transition risk.
- DWP has also legislated to extend the requirements on publication of climate policies to Defined Benefit (DB) Schemes, and require trustees of occupational DC and DB schemes, as well as insurers providing personal pension schemes, to: describe how their arrangements incentivise the asset manager to make long-term decisions; and describe their voting behaviour at company AGMs, including the most significant votes cast on their behalf.
- DWP has taken powers in the Pension Schemes Bill to allow it to impose requirements on occupational pension schemes to secure effective climate change governance of the scheme, and to report on how it is doing so. It has consulted on proposals to mandate TCFD-aligned reporting for large occupational schemes, accounting for 70% of assets and 80% of members, beginning from October 2021. A consultation on draft regulations and statutory guidance is expected in early 2021. The FCA has signalled its intention to consult on corresponding rules for workplace personal pensions in the first half of next year.

11. All of these requirements apply on a scheme-wide basis, including the default arrangement. Whilst we welcome pension saver engagement and consumer choice, it should never be necessary to switch out of the default to invest sustainably.

12. Mandatory climate targets would mean that pension scheme governance bodies would be in a position where they are forced to choose between making the right investment decision for their members and breaching legislation. The easiest way to protect themselves in this situation – and, under threat of penalty, the most likely action – is divestment. However, uncoordinated divestment will not help us reach our net zero goal, as the stock could be bought up by other investors and emissions will not be curbed. Pension scheme trustees and savers will remain exposed to the consequences of those high emissions whilst having less ability to hold the emitters to account.

13. Rather, the Government supports a whole economy transition, where duties land equally on all participants in the investment chain. Pension schemes and pension savers – many on low to moderate incomes – should not be singled out for blunt targets in an ineffective effort to fund the transition. This is a much less equitable outcome than the use of disclosure, regulation, and public investment which Government is already committed to.

Given the increasing importance of passive investment funds which track indices, what policy action is being taken to tackle the issue of major investment fund indices continuing to reflect high carbon assets?

14. The first step in shifting finance away from high-carbon investments is to ensure that information about the climate related risks and the environmental impact of such investments are available to investors in a decision-useful way. As outlined above, on 9 November the Chancellor announced the UK's intention to mandate firms across the UK economy to disclose their climate-related financial risks and opportunities by 2025, with a significant portion of mandatory requirements in place by 2023, and to implement a green taxonomy.

15. Taken together, these measures will improve transparency around the climate-related financial risks and opportunities for firms and the environmental impacts that investment decisions have, which will facilitate efficient and informed capital allocation.

16. To support the way that consumers and investors use this information we also supported the creation of the Green Finance Education Charter which will ensure that all graduates from the relevant professional bodies have green finance as part of their curriculum and provide appropriate investment advice.

17. The second step is to provide clear alternatives to investors. The Benchmarks Regulation (the regulation governing investment fund indices) includes disclosure requirements concerning how benchmark administrators take into account Environmental, Social and Governance factors. In 2019, two new categories of "climate-related benchmarks" were also introduced under the Benchmarks Regulation. "Climate Transition Benchmarks" (CTBs) must be constructed so that the underlying assets are on a decarbonisation trajectory, while "Paris-Aligned Benchmarks" (PABs) must be constructed so that the underlying assets are aligned with the objectives of the Paris Climate Agreement. Together, these standards will enhance the transparency and comparability of "low carbon" benchmarks to enable investors to make more informed decisions.

The Chancellor recently announced that the UK will launch a 'green taxonomy', which will take the EU scientific metrics as its basis. How soon will the new UK Green Technical Advisory Group be established, and what is the timeframe for publication of the UK's taxonomy?

18. Regarding implementation of the green taxonomy, you will be aware that the government has made the necessary amendments to retained EU law to ensure that the UK has an effective framework for implementation of the

taxonomy after the end of the EU exit transition period.[2] As part of that legislation, the government is required to publish the technical screening criteria for climate change adaptation and mitigation by the end of 2021, and for the remaining four environmental objectives by 2023. The Government will be launching a Green Technical Advisory Group in 2021 to advise, on an ongoing basis, on improvements that could be made to the taxonomy to better facilitate the UK's environmental goals.

The Committee has received evidence about the importance of 'transition finance' for heavy carbon industries. What is Treasury doing to ensure that this finance is not mis-used and will effectively support a transition to a low-carbon world?

19. In November 2019, HM Treasury published terms of reference for the Net Zero Review into how the transition to a net zero economy will be funded, and where the costs will fall. The Review, which is due to be published in spring next year, will ensure contributions are fair between households, businesses and the taxpayer, and will allow us to maximise economic growth opportunities from the transition.

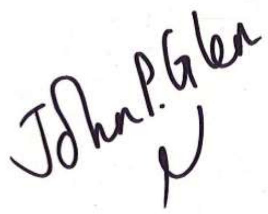
20. Alongside this, it is important that we require companies across the economy to consider the interactions of their business with the environment. As set out above, making climate related financial disclosures mandatory across the economy by 2025 will significantly contribute to a deeper understanding by firms and their investors of the risks that climate has on their business. The UK green taxonomy will define environmentally sustainable activities through a common framework, which will support greater transparency of the impact of firms' activities and investments on the environment. This will increase our ability to allocate capital in the best way to support our transition to a sustainable economy. The issuance of the UK's first Sovereign Green Bond in 2021, and the subsequent building out of a green yield curve, may support companies that are aiming to raise capital to support new green projects by providing a sterling green bond price benchmark.

21. These measures demonstrate the Government's intent in this area. In the meantime there is much that firms themselves are doing to establish credible transition plans for their businesses which we are supporting through our agenda for COP26. For example, 500 of the world's largest companies now have science-based targets for their strategies to transition their businesses to net zero, and over 500 more are in the pipeline. The Taskforce for Scaling Voluntary Carbon Markets has also been established to develop a blueprint for scaling the market for high quality and credible carbon offsets.

---

[2] https://www.legislation.gov.uk/uksi/2020/1385/contents/made

Thank you again for the opportunity to provide more detail to the committee on these specific questions. I do hope that you find these answers sufficient.



JOHN GLEN