House of Commons

Environmental Audit Committee

The financial sector and the UK's net zero transition: Government Response to the Committee's First Report

Third Special Report of Session 2023–24

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Environmental Audit Committee

The Environmental Audit Committee is appointed by the House of Commons to consider to what extent the policies and programmes of government departments and non-departmental public bodies contribute to environmental protection and sustainable development; to audit their performance against such targets as may be set for them by His Majesty's Ministers; and to report thereon to the House.

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Committee reports are published on the Committee's website at www.parliament.uk/eacom/ and in print by Order of the House.

Committee Staff

Dawn Amey (Committee Specialist), Martyn Atkins (Clerk), Alexander Farnsworth (Committee Specialist), Laura Fatah (Committee Specialist), Chloe Jago (Senior Media and Communications Officer), Rebecca Lees (Second Clerk), Gary O'Key (Committee Specialist), Ben Smith (Committee Operations Officer) and Jonathan Wright (Committee Operations Manager).

During the course of the Committee's inquiry Sara Elkhawad was a Second Clerk and Chris Watson was a Second Clerk.

The Committee was also assisted in this inquiry by Colin Harrison (Finance Specialist, Select Committee Team Scrutiny Unit).

Contacts

All correspondence should be addressed to the Clerk of the Environmental Audit Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 8890; the Committee's email address is eacom@parliament.uk.

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Third Special Report

The Environmental Audit Committee published its First Report of Session 2023–24, *The financial sector and the UK's net zero transition* (HC 227) on 29 November 2023. The Government response was received on 29 January 2024, and is appended below.

Appendix: Government Response

The financial sector's impact on energy security

- **We have heard during our inquiry that despite the pledges set out and agreed upon by global governments in the Paris Agreement, private banks have financed trillions of US dollars into fossil fuels. New UK fossil fuel Initial Public Offerings are still being approved, and the UK Government is pressing ahead with new fossil fuel investment opportunities. We have been told that, while the current ratio of investment capital in low carbon energy compared to fossil fuels is 0.9:1, this needs to quadruple to 4:1 by the end of the next decade. While there are examples of financial institutions moving away quickly from fossil fuel investments, the engagement policies enacted by many organisations could be clearer about the extent to which they are still financing companies not aligned with the Paris Agreement.** (Paragraph 53)

- **We absolutely agree with the Minister for Energy Efficiency and Green Finance that energy security and net zero are two sides of the same coin. However, we are concerned that many believe that the Government is sending mixed signals to the market which in turn affects investment decisions in the energy transition. While business decisions are ultimately for those businesses to make, the Government should not underestimate its own influence.** (Paragraph 54)

- **The UK Government should be proud of its world-leading track record in supporting green finance initiatives. At the same time, it must neither be complacent nor lose momentum. The UK must continue to use its leadership position to bring other countries on board and create policy alignment across jurisdictions. For its influence to continue, the UK cannot be perceived to be watering down its own net zero policies.** (Paragraph 150)

(*Response to paragraphs 53, 54 and 150*) Our mission is to achieve energy security for this country, powering Britain from Britain, by replacing imported fossil fuels with green renewables and nuclear energy. This will not only help us reach net zero by 2050; it will also underpin our resilience and prosperity as a nation. The Prime Minister has reiterated in his speech on 20 September 2023 that net zero is a priority for this Government. We will transition to net zero in the most efficient, low cost, business friendly and least disruptive manner possible.

The UK has a strong track record in attracting the investment we need for the clean energy transition - since 2010, the UK has secured close to £200bn of public and private investment in low carbon energy sectors - over 40% of UK electricity is now coming from renewables (48% in Q1 2023), higher than the US (21% in 2022). The UK has done this through a range of financing mechanisms, policy and market frameworks, and targeted public investment.

The UK has halved its emissions, ahead of every other major economy and we have one of the most ambitious decarbonisation targets in the world. We have grown our economy by over 70% since 1990. The UK's approach demonstrates that 'green' and 'growth' go hand in hand, and that the UK net zero transition provides many exciting investment opportunities for the private sector. The UK's 2023 Green Finance Strategy – Mobilising Green Investment – set out how Government will utilise all the levers available to mobilise the private investment needed to deliver net zero, and with that our energy security, net zero and environmental targets, whilst strengthening the UK's leading position at the forefront of the global green finance market.

The Government continues to listen to business and react to changing markets, for example:

- In January 2024, we published a civil nuclear roadmap, which sets out the Government's vision for a dynamic civil nuclear sector, supporting the ambition to achieve net zero by 2050.
- In December 2023, we published a suite of documents on delivering hydrogen, including the latest Hydrogen Strategy Delivery update and a new 'Production Roadmap' presenting the Government's hydrogen policy and funding progress since the publication of the Hydrogen Strategy as well as our future priorities and delivery timelines. We also made some important announcements including a list of the 11 successful electrolytic 'green' hydrogen production projects from the 1st electrolytic allocation round (HAR1), the launch of the second electrolytic round (HAR2) and a decision on blending.
- In March 2023, we published the Track-1 Project Negotiation List which includes 8 capture projects which we have selected through the Cluster Sequencing Process to progress to negotiations to form the first two CCUS clusters, based in HyNet and the East Coast Cluster. In December 2023 we launched the Track-1 expansion process for new CCUS projects wishing to connect to the HyNet cluster by 2030. The CCUS Track-2 December 2023 Market Update set out the Government's proposed Track-2 approach of an 'anchor' and 'buildout' phase and high-level timelines, with the anchor project submission window opening early 2024, along with the request for a provisional cluster expansion plan. In December 2023, our CCUS business models update set out the Government's updated proposals for the business model for transport and storage.
- In November 2023, we published key details about the upcoming sixth Contracts for Difference Allocation Round (CfD AR6) with increased maximum strike prices available to new renewable projects.
- At the 2023 Autumn Statement, we announced a £960m Green Industries Growth Accelerator to support manufacturing capacity in the clean energy sectors where the UK has the strongest current or potential advantage, such as Carbon Capture Usage and Storage (CCUS), hydrogen, offshore wind, networks, and nuclear. In January 2024 we announced we will become the first country

in Europe to launch a high-assay low enriched uranium (HALEU) nuclear fuel programme, strengthening domestic supply for new nuclear projects with a landmark £300 million investment.

- We published the Transmission Acceleration Action Plan alongside the 2023 Autumn Statement. By reducing delays in network build, this programme of work is expected to increase investment by up to £15bn over the next 10 years, support thousands of jobs and reduce energy bills for households across Great Britain.

- We published the Connections Action Plan alongside the 2023 Autumn Statement jointly with Ofgem, which builds on work to go further and faster to reduce connection timescales.

We also announced in the 2023 Green Finance Strategy that we would commission a market-led review into growing transition finance in the UK, exploring how to support companies here and abroad to continue to access the capital they need to decarbonise and deliver our net zero ambitions.

The Transition Finance Market Review has now been commissioned by Treasury Lords Minister, Baroness Vere and Department for Energy Security and Net Zero Minister, Lord Callanan. The Review will be led by Vanessa Havard-Williams and supported by a panel of expert advisors and a secretariat in partnership with the City of London Corporation. It will report back to the Government by July 2024, exploring how best to create the conditions for:

- scaling transition focused capital raising with integrity. We want to grow the UK market for new, innovative transition finance services, which should be designed as attractive, investible instruments to unlock long term capital (such as sustainability linked debt and transition bonds)

- maximising the opportunity for UK based financial services to develop, structure and export high integrity transition finance services; and

- positioning the UK's professional services ecosystem as a global hub - supporting this innovative activity and ensuring market confidence (legal, accountancy, consultancy, data and analytics, skills and education)

- **We have heard that vast numbers of fossil fuel assets are at risk of devaluing before they are extracted due to changes in energy consumption and therefore becoming 'stranded assets'. This is a particular risk in the City of London, as one of the top four financial centres where this concern is concentrated. This risk has also intensified due to Russia's full-scale invasion of Ukraine leading to divestment from Russian-linked fossil fuel assets. While there have been some calls for the burden of this risk to sit with the companies which are driving the phase out of fossil fuel investment through individual policies, we have not identified a consensus on this matter.** (Paragraph 33)

- **We recommend that to mitigate against the risk of stranded assets from North Sea extraction, the North Sea Transition Authority should calculate**

what the impact to the UK taxpayer and company profitability would be of requiring the cost of decommissioning to be absorbed for new oil and gas licences through the introduction of duties on operators. (Paragraph 34)

- **We have previously concluded in our report 'Accelerating the transition from fossil fuels and securing energy supplies' that there is not a consensus on the speed of transition from fossil fuels as the Government endeavours to reach net zero by 2050. While the scientific consensus is clear that planned production of fossil fuels is already enough to exceed safe climate limits, with the IPCC's recent Synthesis Report warning that "projected CO2 emissions from existing fossil fuel infrastructure without additional abatement would exceed the remaining carbon budget for 1.5°C", there is a view from some financial institutions, recently endorsed by the UK Government, that new licences have a role to play in reducing reliance on imported fossil fuels. Energy security is sometimes used as justification to pursue new oil and gas exploration, but we have found that this approach may not reflect climate goals effectively, as there is a risk that it may lead to either missing climate targets or ending up with stranded assets. Therefore when planning for net zero energy security and a just transition for the workforce, it is crucial that the Government considers the balance between the North Sea as a declining asset, and the UK's capacity for renewable energy as the UK moves towards a net zero future.** (Paragraph 55)
- **We reiterate the recommendation of our earlier report that the Government set a clear date for ending new oil and gas licensing rounds in the North Sea: this date should fall well before 2050.** (Paragraph 57)

(*Response to paragraph 33, 34, 55 and 57*) The domestic oil and gas industry is vital to the UK's energy security. While the Government is scaling up domestic clean energy sources, the UK still relies on oil and gas for most of our energy needs and there will be continued need over the coming decades.

Data published by the Climate Change Committee suggests a significant proportion of our energy will come from oil and gas even when we reach net zero in 2050. To meet this supply domestic production is better in terms of jobs, tax receipts and environmental emissions than imported alternatives. Beyond energy, oil and gas will remain essential to modern life for many years to come, including in the production of plastics, chemicals, and fertiliser.

As the International Energy Agency has recognised, the skills and resources of the oil and gas industry will be crucial for the transition to net zero. New licensing will help bolster our energy security, decarbonise production, and bring jobs, investment, and revenue to the UK. The sector's investments, supply chains and skilled workforce are exactly what we need to lead the world in delivering the energy transition.

Even with new licences, UK oil and gas production is declining at 7% a year. That is faster than UK consumption will decline as we meet net zero, and faster than the average rate of decline needed globally to align with 1.5-degree pathways, according to the UN environment programme.

The Government has taken action to avoid a poorly managed decline by agreeing the North Sea Transition Deal, a global exemplar of how a government can work in partnership with industry to achieve a transition which leaves no-one behind. The Government has also introduced the Offshore Petroleum Licensing Bill, providing industry with long-term certainty about the offshore licensing process. This Bill will make the UK more energy independent by increasing investor and industry confidence with regular annual oil and gas licensing. The Bill's emissions and net importer tests will ensure that future licensing supports the transition to net zero.

New licensing simply slows the fall in UK supply, rather than increasing supply above current levels. This ensures a managed decline at a pace that supports the UK's energy security and the offshore workforce's transition away from fossil fuels. The expected emissions from potential future projects are factored into the UK's carbon budgets and will not compromise them being met.

We have already considered fixing an end date for future oil and gas licensing and decided not to pursue this approach. A 2021 review of the future of oil and gas licensing concluded that continued licensing for oil and gas is not inherently incompatible with the UK's climate objectives. On gas, for instance, failure to maximise economic output from the North Sea is likely to lead to increased imports of the current main alternative, Liquefied Natural Gas (LNG). These imports are less secure, more carbon intensive and provide no tax revenue and fewer benefits for the UK's economy, workers and supply chains – the same tax revenue, economy, skilled workers and supply chains that will be vital to the UK continuing to lead the world in the Net Zero transition.

The review acknowledged that this might not always be the case in the future, It therefore recommended that a "checkpoint" be introduced, to ensure that the compatibility of future licensing with the UK's climate objectives has been always evaluated before a licensing round is offered. Globally we are the first significant producer of oil and gas to have actively developed a climate compatibility checkpoint, which tests whether new licences would be compatible with our important climate commitments. On 22 September 2022 we published the checkpoint's design and a detailed response to the public consultation that helped to inform this design.

The Offshore Petroleum Regulator for Environment and Decommissioning (OPRED) is responsible for regulating decommissioning activity including ensuring that the requirements in Part IV of the Petroleum Act 1998 are complied with. OPRED's regulatory regime already ensures that operators are responsible for decommissioning installations and pipelines in the North Sea. Under the 1998 Petroleum Act that asset owners and operators are responsible in law for the decommissioning of their assets. The regime is designed to protect the taxpayer from decommissioning liabilities, and OPRED regularly reviews that purpose in the context of changes to the UK Continental Shelf, including the increased risk of stranded assets. In response to the recommendation in paragraph 34, OPRED would welcome the opportunity to engage further with the Environmental Audit Committee's policy suggestion to understand more about the thinking behind their proposal.

- **We recommend that the Government publish quarterly reports to show how the UK is moving towards greater energy independence while staying on track to meet its net zero target, including an assessment of the effect of scope**

> **three emissions on global efforts to limit global temperature rise to 1.5°C. The notion of "energy security" should increasingly shift towards renewable energy, which can support greater energy independence and reduce reliance on fossil fuels.** (Paragraph 56)

(*Response to paragraph 56*) Over the past two years the Government has set out unprecedented levels of detail in our plans to reach net zero and energy security objectives through the Net Zero Strategy in 2021 and Powering Up Britain in 2023. As part of the Net Zero Strategy, we committed to provide a public update on progress against a range of our climate targets and ambitions including low carbon power generation. We update on these figures annually. The share of electricity generation in the UK that was generated from renewables was nearly 45% in Q3 2023, up from around 7% in 2010.

In accordance with the Climate Change Act 2008 (CCA), the UK has also set six carbon budgets out to 2037, which act as interim targets towards the UK achieving Net Zero by 2050. The UK publishes its net carbon account annually, regularly tracking progress against its multi-year budgets and ensuring a high level of accountability. This is in addition to final statements after the end of each carbon budget period. The UK has over-achieved against the first and second carbon budgets, and the latest projections show that we are on track to meet the third. We also provide a detailed annual response to the Climate Change Committee's Progress Reports, a statutory duty which is publicly available. The latest in October 2023 contained updates on performance of 28 metrics.

Internationally, we have also committed to a 2030 NDC target under the Paris Agreement and reporting under the Paris Agreement begins in 2024. We report every two years to the United Nations Framework Convention on Climate Change on progress towards our international targets, and the UK also undergoes scrutiny on transparency of reporting through the International Assessment and Review process every two years.

Plans for transition: reporting requirements

- **We welcome the Government's intention to consult on requiring companies to disclose transition plans. However, the current "comply or explain" basis should be for an interim period only: a company can disclose by simply not having a transition plan, defeating the point of the policy.** (Paragraph 68)

- **We agree with the Government that the operating environment will become increasingly difficult for those firms that do not set out their plans for contributing to net zero. However, we do not think it is enough to leave the issue of transition planning to the market. The UK led the way globally with its introduction of mandatory reporting in relation to the Taskforce on Climate-related Financial Disclosures (TCFD), and now risks losing its leadership position in the green finance space by deferring its commitment to mandatory transition planning made at COP26. At the same time, we understand the risk of capital flight and the need to remain internationally competitive.** (Paragraph 69)

- **The Government's consultation on requiring companies to disclose transition plans should include consideration of making it compulsory to have and to disclose a transition plan—not just if a company happens to have one—and**

the most suitable timetable for doing so. Beyond this consultation, mandatory reporting of transition plans should remain the Government's ultimate aim. (Paragraph 70)

- **We welcome the publication of the Transition Plan Taskforce's disclosure framework for transition plans, and the steps taken to achieve international alignment of that framework. We believe that those who publish transition plans should follow a compulsory framework, to ensure comparability and to mitigate the risk of greenwashing. While investors have an important role to play in determining the credibility of transition plans, it is vital for measuring our progress towards net zero that 'credibility' is not subjective. We recommend that the Government should introduce regulations, to be phased in and monitored over time, to ensure that companies developing and disclosing transition plans do so in accordance with the Transition Plan Taskforce's guidance.** (Paragraph 88)
- **A plan is only effective if it delivers its contents. The Government should set out simple, consistent regulatory expectations for net zero transition plans and establish an independent mechanism for monitoring and evaluating and verifying organisations' net zero transition plans, to ensure that they are aligned with Paris Agreement compliant pathways.** (Paragraph 89)

(*Response to paragraphs 68, 69, 70, 88 and 89*) We are supporting organisations in the finance sector as they transition their activity to align with net zero pathways. In April 2022 we launched the Transition Plan Taskforce (TPT) to create the gold standard for private sector climate transition plans.

Building on what we set out in the Green Finance Strategy on transition plans, our upcoming consultation will consider the UK's approach to transition plans. The consultation will consider the role of the TPT's Disclosure Framework, and help to inform the UK's assessment and endorsement of the International Sustainability Standards Board (ISSB) standards. In particular, the consultation will help to inform our assessment of the transition plan-related material within International Financial Reporting Standards (IFRS) S2.

As acknowledged, transition plan disclosures already form part of the Financial Conduct Authority (FCA)'s TCFD-aligned disclosure rules for listed companies, asset managers and FCA-regulated asset owners. In addition to this, the FCA introduced guidance encouraging listed companies and asset managers/asset owners to make transition plan disclosures where headquartered or operating in a jurisdiction with a net zero commitment, or to explain why not. The FCA have now committed to consult on guidance that will set out their expectations for listed companies' transition plan disclosures at the same time as consulting on their policy approach in relation to the ISSB standards. They plan to develop their guidance with reference to the final outputs from the TPT.

- **We welcome the Government's commitment to just transition principles in its Green Finance Strategy and the inclusion of specific workstreams in the creation of the transition plan disclosure framework and implementation guidance. While the Transition Plan Taskforce acknowledges the inclusion of just transition principles within its working group and includes a definition**

within its guidance, we are concerned that it does not appear to include those principles explicitly within the transition framework itself, which may leave organisations with no further knowledge of how their transition plans should consider wider stakeholders. (Paragraph 90)

- **We recommend that the Government publish further guidance to stakeholders to advise explicitly how just transition principles should be considered within the transition plan framework, to ensure that companies are able to provide better outcomes for all people, including workers and their communities.** (Paragraph 91)

- **We welcome the references to nature in the Transition Plan Taskforce's framework; however, we consider that the framework could go further on nature. We recommend that the Government should take steps to incorporate into the framework the contribution by a company towards halting and reversing nature loss within the overall strategic ambition of its transition plan.** (Paragraph 92)

(*Response to paragraphs 90, 91 and 92*) The TPT's core mandate is to develop a framework for corporate and financial institutions' climate transition plans. In response to stakeholder feedback, the TPT has launched three Working Groups on nature, adaptation and just transition. These groups are providing advice on the appropriate integration of these topics into the TPT's outputs, noting that the understanding of nature-related transition issues is currently limited to climate ones.

The Government has always been clear that UK Sustainability Disclosure Requirements should be underpinned by internationally recognised standards as far as possible, to ensure that environmental issues can be tackled across borders, especially for those firms operating in multiple jurisdictions.

- **We welcome the Government's intentions for Sustainability Disclosure Requirements (SDR). As part of that framework, we welcome the Government's intention to incorporate International Sustainability Standards Board (ISSB) standards and make them mandatory, its consultation on reporting scope 3 greenhouse gas emissions, and its intention to adopt the Taskforce on Nature-related Financial Disclosures (TNFD) reporting. Having internationally-aligned standards such as the ISSB standards is vital for reducing the risks of greenwashing and carbon financing leakage.** (Paragraph 102)

- **To maintain the UK's global leadership in green finance reporting, the Government must keep up the momentum. We recommend that Ministers set out an overarching implementation timetable for the SDR, including for TNFD reporting, and commit to making TNFD reporting mandatory, continuing the trail the UK blazed for TCFD. The Government should consult on TNFD definitions, and should phase in compulsory TNFD disclosures over the next three to five years, starting with the largest companies.** (Paragraph 103)

(*Response to paragraph 102 and 103*) We remain committed to implementing Sustainability Disclosure Requirements (SDR) and we set out clear plans to implement the components of the SDR regime in the 2023 Green Finance Strategy.

Businesses can report and act on evolving nature-related risks, opportunities, impacts, and dependencies using the Taskforce on Nature-related Financial Disclosures (TNFD) risk management disclosure recommendations and guidance, launched on 18th September 2023. The UK Government has been one of the largest donors and supporters of the global, market-led TNFD initiative. We will continue to actively support the TNFD's work and encourage UK businesses and financial institutions to engage with the TNFD recommendations and the work of the UK TNFD National Consultation Group, which is being led by the Green Finance Institute (GFI). We will consider how best the TNFD's recommendations should be incorporated into UK policy and legislative architecture in a manner that is coherent with global sustainability reporting.

- **While we welcome the Government's intention to introduce a UK green taxonomy, we are concerned to note the delays to its introduction. As with transition plan frameworks and disclosures, we support the principle of a mandatory taxonomy to ensure comparability. We recommend that the Government seek to introduce the UK green taxonomy as soon as possible. That taxonomy should include a spectrum of definitions—'fifty shades of green', as one of our witnesses put it. During the period of voluntary reporting against the green taxonomy, the Government should monitor and report quarterly on progress, to optimise its implementation and ensure that it becomes mandatory no less than two years after the beginning of the voluntary period.** (Paragraph 111)

- **It is unfortunate that, due to the delays to the introduction of the green taxonomy, the remit of the Green Technical Advisory Group expired before the testing period of voluntary disclosures could begin. We urge Ministers to heed the group's calls for a long-term institutional home for the UK green taxonomy.** (Paragraph 112)

(*Response to paragraph 111 and 112*) The Green Finance Strategy 2023 committed to implementing a UK Green Taxonomy, an important tool to increase transparency into the market to mobilise private investment into green activities and to tackle greenwashing.

Developing a usable and useful taxonomy is a complex and technical exercise and the Government continues to work at pace and expects to publish a consultation on this shortly.

In the Green Finance Strategy 2023, the Government set out that we will consider the introduction of mandatory company disclosures against the Taxonomy once it has had opportunity to bed in. The Government will therefore introduce a testing period of voluntary disclosures for at least two reporting years before considering the introduction of mandatory obligations. This is to ensure that the Taxonomy provides accessible and reliable information that is useful to markets. We will monitor the voluntary reporting period carefully following consultation.

The Government does not wish to place undue burdens onto companies whose size or scale makes the disclosure of taxonomy-related information unreasonable. Therefore, we will develop proposals with proportionality in mind.

We thank the Green Taxonomy Advisory Group for their expert advice on developing the Taxonomy and the members of the Energy Working Group for their advice on the development of criteria in the energy sector. Following the consultation, the Government will consider what external advice is required going forward.

Private investment: a roadmap to net zero

- **We welcome the Government's progress in developing blended finance models for net zero projects, in particular the work of the UK Infrastructure Bank (UKIB) which, according to the evidence given to us by the Minister, has created around £4 of private capital for every £1 of public funding invested. Such models are valuable for de-risking and stimulating investments in emerging technologies that may help the UK achieve its net zero target. We therefore welcome the Government's continued work with the Green Finance Institute in this area and its timely goal of drawing conclusions in advance of the next spending review.** (Paragraph 127)

- **The Government must keep to its ambition of setting out its future plans for net zero blended finance solutions by the next spending review, and should include nature recovery projects within this suite of solutions. The Government should set out in one document all its different blended finance models, cross-checking them against its various sector roadmaps both to ensure that solutions are targeted towards the investment gaps that need to be filled, and also to ensure that institutions such as UKIB are supporting the right projects with appropriate levels of investment.** (Paragraph 128)

(*Response to paragraph 127 and 128*) In November 2023 we announced the Net Zero Blended Finance Project. The project aims to improve the capacity and expertise of the Government to explore innovative blended finance approaches in funding designs for net zero technologies, mobilising additional private sector investment to support the UK's transition to net zero.

The project will consider how best to target blended finance approaches to address investment gaps as appropriate, and this will include working closely with UK Infrastructure Bank alongside other public finance institutions. As this work develops, we will consider how best to keep the market informed.

- **We welcome the many net zero sector roadmaps that the Government has published and plans to publish, which should provide investors with the detail they require to help their investments align with the Government's net zero target. We particularly welcome the fact that nature is included among these investment roadmaps, and urge the Government to publish the next round of roadmaps, promised this autumn, without delay. While we received limited calls for an economy-wide net zero investment roadmap, we did not receive enough evidence to arrive at a conclusion on whether this is needed. This makes tracking green financial flows across the economy all the more important.** (Paragraph 129)

(*Response to paragraph 129*) Alongside the 2023 Green Finance Strategy, the Government published a series of net zero investment roadmaps including for offshore wind, hydrogen, carbon capture utilisation and storage (CCUS), and heat pumps setting out the investment opportunities and relevant government support to make sectors investable. Investors have responded positively to these. The civil nuclear roadmap was published in January 2024. An update to the hydrogen investor roadmap will be published in February 2024 and a roadmap on nature will be published by the end of 2024.

Following the commitment to publish additional roadmaps, the government published the Advanced Manufacturing Plan in November which covers the UK's approach to mobilising investment in the future of manufacturing sectors covering Zero Emission Vehicles and Green Industries (including UK Government support for Offshore Wind, CCUS, Nuclear and Hydrogen sectors).

- Understanding levels of investment across the economy is vital for knowing whether the **UK is on track to meet its climate and nature targets. That is why we welcome the work underway by the Government to explore methodologies for tracking both net zero-related financial flows and nature-related financial flows. We recommend that the Government go further and turn this research into a formal tracking mechanism by a date no later than the end of the current Parliament. The Government should task either an existing independent body, or create a new independent body, to track net zero and nature-related financial flows, as well as investment in high-carbon projects. Within a year of setting up this tracking mechanism, the Government should review financial flows against its investment roadmaps to determine whether those roadmaps provide sufficient coverage of the whole economy. It should also use this information to inform whether further incentives or regulation are required to shift financial flows towards the Government's net zero and nature targets.** (Paragraph 130)

(*Response to paragraph 130*) We recognise that tracking investment flows will help industry and the UK Government to monitor progress against our targets and provide timely assessment on the impact of UK Government interventions and industry response. In response to calls from the Climate Change Committee and National Audit Office, the UK Government committed to 'work with external partners and data providers to better track private investment into the net zero economy going forward'. We are also committed to monitoring annual private finance flows into nature's recovery in England against our target.

We commissioned two pieces of external research to scope existing investment tracking methodologies and evaluate available data sources:

The scoping phase of UK Landscape of Climate Finance (LCF) research to develop a pilot LCF model to track investment into net zero sectors has now concluded, and we are considering next steps, including the potential role of an independent body. Stakeholder engagement with data holders, financial sector participants and existing LCF developers has informed this scoping and methodology phase.

Research has also concluded into options to track private finance into nature's recovery in England. Further to this, we will begin gathering data this year against our target for this finance to reach at least £500m every year by 2027, and over £1bn by 2030.

- **We applaud the UK Government and civil society for leading the way in building a global voluntary carbon market. We appreciate the difficulty of achieving a global price for carbon, but it is ultimately needed to prevent a race to the bottom where industries flock to headquarter in jurisdictions with the lowest penalties for polluting the planet and derailing the Paris Agreement to limit global warming to 1.5°C. A global price for carbon would also help to remove the perverse incentives in individual nations' carbon pricing schemes such as the UK emissions trading scheme, where high-emitting industries may be inadvertently subsidised to prevent capital flight. We recommend that the Government launch its promised consultation on voluntary carbon markets without delay.** (Paragraph 141)

(*Response to paragraph 141*) The UK Government recognises the potential role that voluntary carbon markets could play in the delivery of domestic and international net zero, noting that market integrity concerns need to be addressed to maximise this opportunity. We welcome the progress made in 2023 to improve the integrity of VCMs, including the work of the Integrity Council for the Voluntary Carbon Markets (IC-VCM) and Voluntary Carbon Market Integrity Initiative (VCMI), both launched under the UK's COP26 Presidency to develop international best practice.

Building on this, the UK Government will consult on potential next steps, seeking views on the role of specific government and regulatory interventions to enable the growth of high-integrity voluntary markets in the UK and beyond, maximising synergies between carbon and nature markets where appropriate. As announced at COP 28, the consultation will include the Government's intention to endorse the outputs of ICVCM and VCMI, and consider how these could be reflected in UK policy, regulation and guidance. The consultation will also test demand for a new labelling scheme for UK credits, in addition to our existing work with the British Standards Institution to develop Nature Investment Standards. We intend to publish the consultation in early 2024.

The UK is a strong supporter of carbon pricing, through both domestic action and our support for international uptake using our aid budget, technical exchanges, and advocacy through the PM-endorsed Global Carbon Pricing Challenge.

But progress on this takes time, and the early movers in decarbonisation risk having their actions undermined by carbon leakage. That is why the UK announced that we will implement a carbon border adjustment mechanism (CBAM) by 2027 to ensure that UK decarbonisation efforts lead to a true reduction in global emissions rather than displacing carbon emissions overseas. The delivery of the CBAM will be subject to further consultation in 2024.

- **Having been a long-standing leader in climate finance, the UK now risks falling behind by failing to install mechanisms to mitigate carbon leakage. The EU has already launched its carbon border adjustment mechanism (CBAM). It is now over a year and a half since we called on the Government to begin work immediately to develop a UK CBAM. We welcome the Government's consultation on addressing carbon leakage risk, but are concerned to note the Minister's view that it is better to encourage other countries to develop their own carbon pricing than to introduce our own CBAM. As we have argued**

before, the UK should be doing both. The Government must get on with it and plug the leaks that the UK's emissions trading scheme risks causing, by developing a carbon border adjustment mechanism. (Paragraph 142)

(*Response to paragraph 142*) The UK is committed to provide certainty to industry around the steps it will continue to take to protect against carbon leakage at all stages of the Net Zero transition. That is why in July the UK ETS Authority set out the overall level of free allocations that will be provided from 2026. In December the Authority published a consultation on the second phase of the free allocation review, focusing on distribution of allowances during the second allocation period (2026 – 2030) to ensure they are better targeted at sectors most at risk of carbon leakage and tailored to a UK context.

The UK is committed to reaching net zero while mitigating carbon leakage, as businesses transition in the context of high global energy prices. We are committed to taking action to manage carbon leakage risk domestically, at the same time as working towards international solutions and encouraging others to join the UK on a pathway to net zero.

The consultation 'Addressing carbon leakage risk to support decarbonisation' ran from 30 March 2023 to 22 June 2023, and received over 160 responses. This exploratory consultation sought views and evidence from a broad range of stakeholders on potential policies to manage future carbon leakage risk.

On 18 December 2023, the Government published its response to the consultation. After carefully considering all responses, the Government will implement a carbon border adjustment mechanism (CBAM) by 2027, applying a charge on the carbon emissions embodied in imports from the following sectors: aluminium, cement, ceramics, fertiliser, glass, hydrogen, iron and steel. The CBAM will mean that imported goods in these sectors will pay a comparable carbon price to domestic goods. The CBAM will ensure the environmental integrity of our decarbonisation policies. It will also give UK businesses the confidence that when they invest in decarbonisation it will result in a true net reduction in global emissions. The delivery of a UK CBAM will be subject to consultation in 2024.

The Government has also announced its intention to work with industry to establish voluntary product standards that businesses could choose to adopt to help promote their low carbon products to consumers; and to develop an embodied emissions reporting framework that could serve future carbon leakage and decarbonisation policies. These measures will also be subject to further technical consultation in 2024.

The UK CBAM will work cohesively with the UK ETS to ensure imported products are subject to a carbon price comparable to that incurred by UK production, mitigating the risk of carbon leakage. The UK ETS Authority will review whether free allocation should be adjusted to reflect any changes to carbon leakage risk for given sectors.

The UK Government will continue to engage with the UK ETS Authority as both develop carbon leakage policies.

- **Local authorities have a significant role to play in green finance, from delivering grants at the household level, to collaborating with financial institutions on local net zero projects, and crowding in private capital for large scale projects. However, they are hindered by a fragmented funding landscape and limits on technical capacity.** (Paragraph 161)

- **We welcome the work that the Government has done so far to provide a "one stop shop" of information on net zero grants to which local authorities can submit competitive bids. The Government appears to have streamlined the number of competitions for English local authorities somewhat, apparently taking the total from 22 to 18. However, this does not solve the problem of local authorities having to spend time and resource putting together applications that may fail, preventing them from having the visibility they need to plan for the long-term and develop investable projects. Furthermore, place-specific net zero measures have been shown to be more effective than place-agnostic measures. We recommend that the Government move away from competitive grants for net zero projects, and consider allocating some funds on a needs basis, and provide core funding for all councils to take forward climate action across their own services. We also recommend that the Government consider issuing funds for place-specific measures that are less constrained by the nationally set criteria of central-government issued grants.** (Paragraph 163)

(*Response to paragraphs 161 and 163*) We agree that local authorities are important players in the delivery of national net zero targets and are well placed to lever in commercial investment for net zero. To support them in this we are providing £19m for a Local Net Zero Accelerator programme to unleash the potential of local government to attract private sector investment for green growth by piloting new approaches in three areas. This is alongside our Local Net Zero Hubs Programme which supports local authorities to develop net zero projects and attract commercial investment. The UK Infrastructure Bank also includes a lending facility of £4 billion for local authorities at preferential rates.

There is a range of funding available for local authorities to meet net zero, including through their core settlement, grants, and UK Growth funding. In the Net Zero Strategy the Government committed to exploring how we could simplify and consolidate funds which target net zero initiatives at the local level where this provides the best approach to tackling climate change, and we are taking this work forward. We have already announced pilots of a devolved approach to buildings' retrofit for the trailblazer devolution deals in West Midlands and Greater Manchester Combined Authority.

More generally, the Levelling Up White Paper set out the Government's ambition for a simpler and more streamlined funding landscape for local authorities. We are committed to continually improving the way funding is delivered and we published the Funding Simplification Plan in July 2023. This plan sets out the Government's ambition for increasing the effectiveness and efficiency of the current funding system.

- **We welcome the ongoing work to provide technical support and advice to local authorities, including through the Local Net Zero Hubs, UKIB, Net Zero Go, and the Local Net Zero Forum. We also welcome the Government's intention to work with the Green Finance Institute to provide assistance to local authorities to develop commercially attractive net zero investments. We suggest that the Government conduct a mapping exercise to ensure that local authorities most in need of technical support receive it.** (Paragraph 164)

(*Response to paragraph 164*) Government understands that there is variable capacity and capability to deliver net zero across different local authorities. The support we provide already takes into account the information that Local Authorities give us about the technical assistance they are requesting.

The Boards for the Local Net Zero Hubs identify how best to apportion resources for technical support against regional priorities. Where local authorities are delivering net zero programmes such as Public Sector Decarbonisation Scheme or the Local Electric Vehicle Infrastructure Scheme, there is often an element for technical support based on local authorities' assessments of what is needed to deliver the programmes. Local authorities are best placed to assess their own needs and assign resources to programmes to achieve this.

- **We welcome the 50% increase permitted for individual grants under the Boiler Upgrade Scheme, and we would wish to see the overall envelope of funding increased subject to sufficient uptake.** (Paragraph 162)

(*Response to paragraph 162*) The Government is committed to supporting the low carbon heat market and reaching our ambition of 600,000 heat pumps a year by 2028. However, the capital cost gap between fossil fuel systems and heat pumps remains a barrier for customers. That is why on 23 October 2023, we increased the grant level for heat pumps under the Boiler Upgrade Scheme to £7,500.

The uplift is designed to improve access to the scheme by covering more of the upfront cost differences of a heat pump and makes it one of the most generous schemes of its kind in Europe. We also announced on 18 December 2023 £1.5 billion of funding for the BUS extension from 2025–2028. This additional funding and extension to the scheme should give industry the certainty needed to invest confidently in heat pumps.

In the meantime, we have a confirmed budget of £150m for financial year 23/24 and for financial year 24/25. The budget is currently underspent so there is room for significant growth in the market.