UKSIF Response: House of Lords European Affairs Committee, UK-EU relationship in financial services

Introduction

The UK Sustainable Investment and Finance Association (UKSIF) is the membership organisation for those in financial services committed to the growth of sustainable and responsible finance in the UK. We look to promote a more sustainable and inclusive financial system that works for the benefit of the environment and wider society. UKSIF represents a diverse range of financial services firms committed to these aims, and our 290+ members include investment managers, pension funds, banks, financial advisers, data and research providers, NGOs, among others.

UKSIF and our members have played a prominent role in helping to more fully embed sustainability in UK policymaking over recent years**.** Most recently, UKSIF was appointed a representative of the UK's Green Technical Advisory Group (GTAG) to advise on the delivery of the UK's 'green taxonomy' and we look forward to helping ensure the taxonomy can set the highest standard possible for green investment for the rest of the world to follow.

We welcome the Committee's inquiry into the UK-EU relationship in financial services. In our response, we focus on some of the significant opportunities we believe the UK should seek to grasp specifically in the area of sustainable finance following our departure from the EU that can help deliver on the UK's 2050 net-zero objective while providing substantial benefits to the sustainable finance industry and wider economy in the UK.

Post-Brexit opportunities for the UK financial services sector, including in relation to possible areas of future growth

UKSIF and our members believe that current government policies on sustainable finance, as well as policies from the financial regulators, have in many respects led the way globally. In recent years, this has included: becoming the first major industrialised economy to legislate in 2019 to reduce greenhouse gas emissions to net zero by 2050, which has encouraged other countries to follow in our path; the first country in the G20 last year to enshrine in law mandatory Taskforce on Climate-related Financial Disclosures (TCFD) aligned requirements for the largest businesses to report on their climate-related risk and opportunities; and positive reforms to the stewardship and corporate governance regime, including the creation of the world-leading UK Stewardship Code.

Each of these steps has helped promote the success of the sustainable finance sector at home and advance the UK's leadership position globally. Broadly speaking, we believe the policies and signals by government and regulators have generally been effective and helped positively influence the finance sector's and companies' activities on sustainability and climate change. With that said, there are certainly additional opportunities that the UK should now pursue in order to further advance its pre-eminent leadership position on sustainable finance, which we continue to see as a key area for future growth that should be actively prioritised by government.

Firstly, we see a significant economic and leadership opportunity for the UK should we learn from the EU's experience with its 'green taxonomy', which is a list to define for investors and corporates 'green' economic activities. Namely, this means the UK should adopt a different approach in regards to the inclusion of certain nuclear energy and natural gas activities in its taxonomy. The EU's decision to include these two energy sources has damaged the EU's credibility on sustainable finance, sparking protest from a number of EU Member States, the EU Commission's own advisory body on the taxonomy, the Platform on Sustainable Finance, many investors, civil society, and various experts from the scientific and academic communities. The UK government should look to avoid this repeat scenario, and implement a robust 'green taxonomy' that sets the highest standard possible for green investment for the rest of the world to follow and is purely based in science, rather than driven by political considerations and certain industry interests.

The 'green taxonomy' has always been intended primarily as a tool to define a list of sustainable economic activities for investors and companies, but unfortunately in Europe we have seen the taxonomy become a tool to shape countries' industrial and energy policies and as a result it has moved some way from being a science-based taxonomy. We believe nuclear and natural gas should only be considered as part of a separate "transitional environmental taxonomy" of activities with clear phase-out dates. This could incentivise the transition of the real economy, of which a very small part today can be considered sustainable. Companies and investors will be more likely to see the UK's taxonomy as leading the way should natural gas and nuclear be excluded, particularly the former given the need for countries to show they are committed to reducing their reliance on Russia's oil and gas imports in light of their invasion of Ukraine.

Secondly, strong and consistent regulations on the design and disclosure of sustainable funds in the UK could deliver notable opportunities for the UK's financial services sector. It would help boost the burgeoning market for green financial products in the UK, and importantly help savers make better informed investment decisions and ensure their environmental, social and governance (ESG) values are reflected in their investments.

The FCA's recently launched initiative on a new investment labels system will help consumers navigate the diverse range of sustainable investments in the market. It will ensure firms are held to account for their sustainability claims and we hope actively combat 'greenwashing'. A lack of common criteria defining what constitutes a sustainable investment has been a challenge historically, making it extremely hard for savers to compare different funds in the market and assess how these might align with their values.

In its initiative on the labels system, the regulator has seemingly learned some of the lessons from Europe's experience with the Sustainable Finance Disclosure Regulation (SFDR), which has not accounted sufficiently for transitioning investments. This proposed inclusion in the UK's labelling system recognises that many, many businesses will need to transition to more sustainable practices in the decades ahead and that this will be absolutely critical for the UK to meet its net-zero objective. The specific 'transitioning' category proposed by the regulator in the investment labels system would help consumers identify funds with strategies that aim to influence underlying assets towards meeting sustainability criteria over time, for instance through active stewardship and engagement.

We believe the minimum criteria for the UK's investment labels system will need to be sufficiently robust in order to further guard against 'greenwashing' risks. In the EU's SFDR, we have seen too many funds included in one of its main categories, 'Article 8' with many funds claiming to be 'Article 8' compliant despite possessing limited sustainable characteristics, posing risks for savers. We will need to ensure the integrity of the UK's system, so funds at the much lower end of the sustainability spectrum are not miscategorised as 'sustainable' for clients and savers here at home.

Finally, there are very considerable opportunities for the financial sector should the UK move much more rapidly towards becoming a nature-positive economy. A first step we would like to see for government to more comprehensively take forward the work of Professor Sir Partha's Dasgupta Review of the Economics of Biodiversity, conducted last year for HM Treasury.

A formal process should quickly be established for considering the implementation of the Review's findings into policymaking over time. A group of investors, regulators, civil society, and other groups could be convened for a series of discussions to consider recommendations for finance and business. We called for this action in a letter to the Chancellor of the Exchequer in September last year, believing that government should look to build off the momentum generated by the Review and seek to more explicitly integrate biodiversity risks and opportunities into financial services and companies' decision-making and its own policymaking.

We also would like the UK to play a prominent leadership role in supporting the work of the Taskforce on Nature-related Financial Disclosures (this aims to provide a clear nature related financial risk framework to encourage better corporate disclosure and redirect financial flows towards nature-positive outcomes), including encouraging a broader group of countries, such as the G20, to engage with the TNFD and endorse its work. This would build momentum off the G7's endorsement last summer of the Taskforce, which UKSIF and investors strongly welcomed.

Finally, we support the calls for a 'Global Goal for Nature' that is nature positive and based around the objective of reversing biodiversity loss by 2030, and would like the UK to play an active role in the adoption of this 'Global Goal,' and the objective of making all financial flows consistent with this Goal, in the upcoming Post 2020 Global Biodiversity Framework that we hope will be finalised at COP15 in China later this year. Collectively, these actions would form part of a more effective response from government to the Review's findings, and signal the UK's intention to adopt leadership and real ambition on biodiversity.

Prospects for, and the potential impact of, any UK-EU divergence on financial services - particularly regulatory divergence, as well as UK agreements with other partners

Broadly speaking, we support as much consistency as is possible between the UK and EU's sustainable finance regulations which will be valuable for our members serving clients across Europe, but this should not come at the expense of implementing robust, world-leading regulations here at home. Some consistency with the EU's rules will be positive, particularly for our larger members, many of whom have large global operations, financing and investing in companies and projects, and serving clients across different markets in Europe.

For example on 'green taxonomies,' very, very contrasting rules on taxonomies between the UK and EU could be damaging, and mean that firms in the UK will need to follow one set of taxonomy requirements for products marketed in EU markets and a separate set of requirements in the UK. This could, among other issues, lead to misleading disclosures for savers.

With that said however, as mentioned already in our response we should recognise that some of the significant issues we have seen with some of the EU's rules, such as its 'green taxonomy' and SFDR will need to be remedied as a priority in the UK's regime, meaning a degree of divergence will be necessary in certain cases and this will outweigh the potential costs of regulatory divergence we believe.

At the global level beyond Europe, harmonisation of sustainability standards is very important and we want the UK to continue to play a proactive leadership role in this respect, including contributing to the work of the International Sustainability Standards Board (ISSB). Common sustainability standards are vital, with current sustainability disclosures inconsistent across companies and not providing investors with the data necessary to make well-informed financial decisions. We are hopeful the ISSB's work will deliver robust and consistent global sustainability reporting standards that can meet the overwhelming and pressing demand from our members and wider society for meaningful sustainability data.

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