Written evidence submitted by Green Alliance

Green Alliance is an independent think tank and charity focused on ambitious leadership for the environment.

As part of our greening the economy workstream, we have launched a green finance programme. This programme aims to support parliamentarians to shape government and Bank of England policy to align the financial system with a 1.5°C world

To inquire into the initiatives and their impact, with particular regard to:

- Corporate approaches to the financing of existing and planned fossil fuel projects

ANSWER:

To date, the government's approach towards green finance has been to wait for the private sector to raise the ceiling, in terms of voluntary best practice, before raising the floor through mandatory standard-setting. This can be seen with the voluntary pledges on climate-related financial disclosure before mandatory reporting became government policy, and more recently on net zero transition plans. Corporate approaches to financing existing and planned fossil fuel projects, therefore, must be considered in relationship with government policy.

In recent years, the government has played a key leadership role internationally on fossil fuels. For example:

- Ending all financial support for overseas fossil fuel projects through the UK Export Finance.
- Phasing out unabated coal from the UK's energy mix by 2024.
- Pledging to decarbonise the electricity system by 2035.
- Securing a 190-coaltion of countries at COP26 to commit to phase out coal power and end support for new coal power plants

To reduce the contribution of fossil fuels to the UK energy mix further, the government must introduce stronger, underpinning rules. (*See pathways to reducing investment in fossil fuels section)*.

- The potential effectiveness of the financial sector, including through alliances such as GFANZ, in encouraging the decarbonisation of the economy in time to limit global temperature rises to 1.5°C

ANSWER:

Over the past decade, the financial sector has adopted a more joined-up approach towards encouraging the decarbonisation of the economy. Some examples include:

- The **Network for Greening the Financial System** (2017). This network is composed of central banks and supervisors who share best practices and contribute towards the development of climate risk management.
- The **International Sustainability Standards Board** (2021). This is an independent,

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private-sector body that is tasked to set an internationally consistent, high quality, and reliable baseline standards for disclosure of sustainability-related information.

- The **Glasgow Financial Alliance for Net Zero** (2021). This alliance covers 450 firms across 45 countries and claims to commit "over $130 trillion of private capital" to transporting the economy for net zero. It should be noted that GFANZ consists of voluntary initiatives, meaning that whilst members commit to a set of guidelines there are no mechanisms to ensure accountability. According to Reclaim Finance, only 60 out of 240 of the largest members have any policy excluding support for companies developing new coal projects. Of these, just 11 have adopted robust policies to end financial services for all companies building new coal mines, plants, and related infrastructure.

Despite improving coordination on net zero, the financial sector continues to fund environmental breakdown. The financed emissions of the City of London, for example, make it a larger emitter than Germany or Canada. Since 2016, the five largest British banks – including those with net zero targets – provided £275 billion in finance for fossil fuel companies.

In terms of financing net zero, the level of private investment still falls well short of the CCC's investment target of £50 billion per year from 2030 to 2050. Financing gaps are particularly stark in certain sectors. In the natural capital sector, for example, GFI's Finance Gap for UK Nature Report estimates a £44 to £97 billion funding gap requirement to meet the UK's key nature-related goals over the next decade.

To harness the collective power of the financial sector, a degree of policy intervention is needed to fix gaps and foster the right environment to crowd-in investment in net zero:

- **Align UK standards internationally.** Whilst individual governments (such as the UK) have begun mandating disclosure requirements and transitions plans for large companies and financial institutions, there is a risk of *carbon financing leakage* if these standards are not aligned internationally. This is where firms move production or operation to countries with lower environmental standards to reduce exposure to regulatory risk. Aligning standards internationally will create a level playing field.

- **Introduce active regulation to shift financial flows.** Whilst reporting and disclosure standards are welcome, relying on investor behaviour will not move the dial fast enough. These standards must be embedded into a robust legal and regulatory framework to ensure firms and financial institutions act on the climate-related risks they identify and make progress against their transition plans. Active regulation is needed to shift the flow of capital both towards nature positive and nature aligned economic activities and away from carbon intensive ones.

- **Provide policy certainty.** Clear, long-term plans and commitments help provide confidence for the financial sector. Governments must set out (and adhere to) granular sector-by-sector roadmaps to reaching net zero. Developing a roadmap to achieve near zero emission steel production by 2035, with industry and other stakeholders, for example, would help to create a supportive policy environment for attracting private investment.

- Pathways to reducing investment in fossil fuel extraction

ANSWER:

Between 2016 and 2020, oil and gas companies in the UK received £9.9 billion in tax relief for new exploration and production, and £3.7 billion in tax relief for decommissioning costs. To reduce private investment in fossil fuel extraction, a combination of taxation and policy measures are needed:

- As shown in *Green Alliance's* The last drop report, oil and gas market are artificially distorted by low tax rates and substantial tax reliefs – incentivising investment in the otherwise unprofitable British North Sea. The government's recent Energy Profits Levy sends a poor market signal about the government's net zero target. The levy nearly doubles the tax relief available by setting the Investment Allowance at 80 per cent, meaning that companies will get a 91p tax saving for every £1 they invest. **The UK government should remove its generous tax reliefs and subsidies for all new licences and developments.** By exposing accurate price signals, including the full risks associated with oil and gas infrastructure, investors' appetite for fossil fuel investments would be reduced significantly.

- Action to reduce domestic oil and gas extraction will impact the price of assets and potentially leave some stranded. The Government should use the North Sea Transition Authority to protect against asset stripping, especially by small, private equity funded companies which have lower environmental and social standards and no shareholder oversight. This is vital to ensure that obligations, such as decommissioning, are met and not passed onto the state.

- The government has finished consulting and is in the process of designing its Climate Compatibility Checkpoint for future oil and gas licensing. This will signal the government's view on whether new oil and gas extraction is compatible with the UK's commitments under the Paris climate agreement. This matters because, as the International Energy Agency (IEA) has made clear, global fossil fuel production must decline. To be within a 50 per cent chance of staying below 1.5C, the IEA suggests that no new developments and licenses can be granted globally after 2021. **Setting a high standard for the climate compatibility checkpoint would help to restrict lending to new fossil fuel projects**.

- The government can also reduce investment in fossil fuel extraction through regulation. Similar to France's ban in 2017 on all oil and gas drilling by 2040 in the country and overseas territories and President Biden's suspension of Arctic drilling licenses, the UK government could restrict leasing of the North Sea for oil and gas exploration. Setting limits on domestic fossil fuel production would also curb investment.

- Current and planned investment in renewable energy generation, distribution, and storage

ANSWER:

Largely, investment in renewable energy generation, distribution, and storage has been private investment led. Although, since *The ten point plan for a green industrial revolution*, published November 2020, the government has committed the following public funds storage:

- Current and planned investment in renewable energy generation, distribution, and storage

Nuclear

- The ten-point plan pledges up to £385 million in an Advanced Nuclear Fund and up to £170 million for a research and development programme on Advanced Modular Reactors. The government also committed an additional £40 million in developing regulatory frameworks and supporting UK supply chains.
- In the Autumn Budget 2021, the government committed up to £1.7 billion for a large-scale nuclear plant, with a further £200 million through the Future Nuclear Enabling Fund.
- The British Energy Security Strategy highlighted that the government is investing £100 million into Sizewell C to help develop the project and £210 million to develop Small Modular Reactors with Rolls Royce.

Offshore wind

- In the Autumn Budget 2021, the government committed £230 million of new funding for new port development for offshore wind through the Global Britain Investment Fund.
- The British Energy Security Strategy highlights up to £320 million in government support for fixed bottom and floating wind ports and infrastructure.

Hydrogen

- The ten-point plan pledged £240 million for a Net Zero Hydrogen Fund.
- The British Energy Security Strategy highlights the £7.5 million awarded to ITMs Gigastack Project, and up to £100 million of revenue support to initial electrolytical projects which the government is preparing to allocate.

To mobilise greater private investment in renewable energy, the government should:

- **Remove policy blockers**. Onshore wind has effectively faced a moratorium since 2015 due to restrictive planning laws. These planning laws, according to the University of West of England, led to a 97 per cent decline in the number of wind turbines granted planning permission between 2016-2021, compared to 2009-2014. In the British Energy Security Strategy, the government stated it would not 'introduce wholesale changes to current planning regulations for onshore wind'.
- **Send stronger market signals**. It is positive that the government has set out an ambition to decarbonise the electricity grid by 2035, but putting that target into law would send stronger market signals to private investors that clean energy will be an enduring part of the UK economy.
- **Offer greater household support for energy saving measures**. The government's five-year zero rate for the installation of energy saving measures is welcome, but with no additional measures low-to-middle income households will struggle to afford the upfront cost of energy saving measures, such as solar panels. Like with the Boiler Upgrade Scheme, the government should offer subsidies and grants to help partially cover the cost of solar panels.
- **Strategically invest in storage**. Strategic public funding is needed to drive innovation in storage and updating the electricity grid, which is integral to the successful expansion of renewable energy.

- The effect (if any) on the pace and scale of disinvestment plans of disruption to supply chains and energy markets arising from the 2022 Russian invasion of Ukraine, and what is being done to mitigate any such effects.

ANSWER:

Private investors require predictability from government policy to invest. It is exactly at times of turbulence, like we are currently experiencing, when the government must ensure policy remains consistent. If policy changes in a kneejerk manner, confidence will be damaged beyond the current crisis.

Supply chain and energy market disruption resulting from the invasion of Ukraine has undermined progress to move away from fossil fuels.

A good case in point is the letter that the Chancellor Rishi Sunak wrote to the Bank of England in April with recommendations for the financial policy committee. In the letter, the Chancellor wrote:

The Government is taking a balanced approach: committed to accelerated investment in low- and zero carbon technologies, while supporting our strong and evolving UK hydrocarbon industry. Where practical and relevant, the Committee should have regard to the Government's energy security strategy and the important role that the financial system will play in supporting the UK's energy security - including through investment in transitional hydrocarbons like gas - as part of the UK's pathway to net zero.

This new position towards increasing domestic oil and gas production has been demonstrated recently on several occasions:

- In mid-May, it was reported that the Business Secretary, Kwasi Kwarteng, is considering classifying natural gas as a 'green investment' under the Green Taxonomy to encourage investment.
- In late May, the government's announced its Energy Profits Levy, which raises the existing rate on the oil and gas sector from 40 per cent to 65 per cent on profits. Crucially, however, the levy set the new investment allowance rate to 80 per cent. This means the tax relief companies receive will nearly double, form 46p for every £1 of extra investment to 91p.
- In June, the government overruled Surrey County Council's decision to reject exploratory gas drilling on the edge of the Surrey Hills.

The government has responded to supply chain and energy market disruption by focusing primarily on increasing domestic fossil fuel production. This sends a poor signal about the government's net zero priorities. Whilst it will only have a marginal effect on investor behaviour, the government should be incentivising low carbon investment instead.

Domestic fossil fuel production is neither the most efficient means of reducing dependence on Russian fossil fuels nor compatible with the UK's net zero goal. Research by E3G shows that

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energy efficiency, clean heat and renewables can replace four times the gas we import from Russia by 2025. The IEA has labelled the failure to accelerate energy efficiency during this period as "utterly inexplicable".

- Likely pathways to the responsible retirement of fossil fuel assets, in a way which is compatible with the UK's national interest, reducing the risk of stranded assets and meeting the UK's international climate obligations

ANSWER:

Fossil fuel assets are exposed to significant levels of climate-related financial risk, both physical (e.g., infrastructure damage from increasingly frequent extreme weather events) and transitional (e.g., stranded assets as global economies make the shift to clean technology).

Research by the University of Exeter suggests half of the world's fossil fuel assets will become stranded by 2036 under a net zero transition. These assets are currently valued between $11 trillion and $14 trillion.

The scale of stranded fossil fuel assets represents a major risk to not only the financial system, but the state and taxpayers who might be left covering the costs. To avoid this, there are several regulatory approaches the government and Bank of England can undertake:

- *Finance Watch* have called for **'one-for-one' capital requirements for financial institutions funding new fossil-fuel projects**. Such requirements would increase the 'loss-absorbing capital' that banks and insurance companies must hold against fossil fuel assets to 1250 per cent. As a result, banks would have to fund fossil fuel extraction solely from their own funds. This would protect depositors, policyholders, and taxpayers from the high risk of stranded assets, as well as the wider financial system. The Bank of England has the powers to set capital requirements but made clear in the Climate Biennial Exploratory Scenario that "regulatory capital is not an appropriate tool to address the underlying causes of climate change" and that "the responsibility for addressing the causes of climate change ultimately lies with governments, businesses and households". Regulatory capital, however, should be considered within the Bank of England's remit as it acknowledges the financial risk of climate change in lending.

- *Green Alliance's* Last drop report recommends **oil and gas operators should pay a bond upfront covering expected decommissioning costs**. The size of the bond should be regulatory reviewed to account for changes in cost estimates. The shift in the North Sea away from large operators like Shell and BP towards small, private equity funded companies makes it much more important that the potential costs of stranded assets are not passed onto the state, in the event of insolvency.

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