

Written evidence submitted by TheCityUK

1. About TheCityUK

- 1.1 TheCityUK is the industry-led body representing UK-based financial and related professional services. We champion and support the success of the ecosystem, and thereby our members, promoting policies in the UK, across Europe and internationally that drive competitiveness, support job creation and ensure long-term economic growth. The industry contributes over 10% of the UK's total economic output and employs more than 2.3 million people, with two thirds of these jobs outside London. It is the largest taxpayer, the biggest exporting industry and generates a trade surplus exceeding that of all other net exporting industries combined. It also makes a real difference to people in their daily lives, helping them save for the future, buy a home, invest in a business and protect and manage risk.
- 1.2 This response to the *Call for Evidence: The financial sector and the UK's net zero transition* has been prepared on the basis of collated responses across our membership.

2. Executive Summary

- 2.1 In March 2022, TheCityUK published landmark research to quantify green finance trends over the past decade.¹ Our research shows that globally, green finance has grown rapidly from a low base. Green finance remains a very small part of overall financing activity, representing less than 2% of total finance over 2012-21 cumulatively, and currently at slightly more than 4% in 2021. As of 2021, green bonds account for almost all of green finance. Green finance in the UK has risen rapidly from a low base. UK green bond issuance grew from \$1.1bn in 2012 to \$37.4bn in 2021; cumulative issuance over the ten years was \$65bn².
- 2.2 The UK financial and related professional services sector plays a critical role in scaling up and moving capital to finance the transition to net zero, both in the UK and globally. Transforming the UK financial and related professional services (FRPS) ecosystem to one that is net zero aligned will be challenging. The FRPS ecosystem needs to work in partnership with wider government, corporates and wider society to develop and implement net zero policies and regulations which impact both the financial sector and the real economy. However, for the UK to have the world's first net zero aligned financial centre which also reduces emissions, ensuring a just transition will be key. For a just transition to take place, we consider that the following themes urgently need to be delivered:
- A. A robust and clear real economy, sector wide framework to support the transition to net zero, and in particular for energy security in the UK;
 - B. Internationally aligned regulatory policy and development of frameworks and standards (including the UK taxonomy) in a manner which supports global coherence;
 - C. Increased support and guidance for SMEs and retail customers to assist with data gathering, understanding and awareness;
 - D. Encouraging and instilling market confidence, whilst supporting innovation and technological developments which are essential to the transition;
 - E. Increasing awareness and understanding of the importance of transition finance and transitioning activities throughout the economy – by helping corporates and financial

¹ <https://www.thecityuk.com/our-work/green-finance-a-quantitative-assessment-of-market-trends/>

² <https://www.thecityuk.com/our-work/green-finance-a-quantitative-assessment-of-market-trends/>

services to develop credible transition plans, through recognising the work being conducted by the Glasgow Financial Alliance for Net Zero (GFANZ) and the Transition Plan Taskforce.

2.3 We consider that, for the UK government to deliver these themes:

- I. The UK needs to drive regulatory coordination towards a pragmatic, useable taxonomy and a principles-based regulatory framework that can adapt with time and avoid unintended consequences.
- II. The UK also needs to accelerate green and transition investments by focusing the deployment of its own financing toolkit and ensuring that sufficient economic, regulatory and tax model incentives are in place to attract 'green' companies to list in the UK and invest in the UK.
- III. The UK also needs to signal its intent and engagement to the FRPS ecosystem through improving the UK government's expertise and knowledge of financing through upskilling and better coordination.

3. Green Finance Growth – 2012 to 2021

3.1 In March 2022, TheCityUK published landmark research to quantify green finance trends over the past decade (2012-21).³ Using indicative data, the research shows that globally, green finance has grown rapidly from a low base, rising from \$5.2bn in 2012 to \$540.6bn in 2021. Nevertheless, it remains a very small part of overall financing activity, representing less than 2% of total finance (on a like-for-like basis) over 2012-21 cumulatively. The share of green finance in total finance has steadily increased from around 0.1% in 2012 to slightly more than 4% in 2021.

3.2 As of 2021, green bonds account for almost the entirety of green finance. Sovereign green bond issuance seems to spur private-sector green bond issuance. In addition, the US and China—the world's two largest economies, and both with large financial markets—dominate green finance markets by virtue of the scale of their financing offerings. Green finance in the UK has also risen rapidly from a low base. UK green bond issuance grew from \$1.1bn in 2012 to \$37.4bn in 2021; cumulative issuance over the ten years was \$65bn. The largest UK green bonds issued over the past decade were the green gilt issuances in autumn 2021. These accounted for one-third of the UK's total green bond issuance over 2012-21.

4. Characteristics of a net zero aligned financial centre

4.1. We consider that the key characteristics of a net zero aligned financial centre to be:

- i. One that is open, internationally aligned, clear and competitive;
- ii. A market that encourages innovation and competition, with a diverse range of market participants and product offerings;
- iii. Governed by a robust regulatory framework, supporting industry initiatives, and governance to enhance the integrity of markets and promote the highest standard of professional conduct;
- iv. Backed by clear net zero policies for the real economy and financial services; this would include:
 - a. Having a clear and robust regulatory framework as an underlying foundation;

³ <https://www.thecityuk.com/our-work/green-finance-a-quantitative-assessment-of-market-trends/>

- b. Implementing sustainable disclosure requirements;
 - c. Focussing on investments that are both sustainable and transitioning;
 - d. Setting out environmental objectives as standard;
 - e. Having strong commitment to decarbonise the fossil industry;
 - f. Implementing robust net zero policies across the economy;
 - g. Incentivising sustainable investment and finance.
- v. Supported by long term, predictable tax regimes;
 - vi. Supported with competitive investment policies;
 - vii. Supported by competitive infrastructure, such as transport links;
 - viii. Supported by competitive trade policy with reduces trade barriers for the movement of capital.

4.2 These characteristics cannot be developed alone by the UK FRPS ecosystem just through green finance regulations and policies. For such a net zero financial centre to flourish, the following policies and actions must develop in partnership with the wider economy, wider society and wider government, beyond the financial services sector and its sector-specific regulators:

- A. A robust and clear real economy, sector wide framework to support the transition to net zero;
- B. Internationally aligned regulatory policy and development of frameworks and standards (including the UK taxonomy) in a manner which supports global coherence;
- C. Increased support and guidance for SMEs and retail customers to assist with data gathering, understanding and awareness;
- D. Encouraging and instilling confidence in the market whilst also supporting innovation and technological developments which are essential to the transition;
- E. Increasing awareness and understanding of the importance of transition finance and transitioning activities throughout the economy – by helping corporates and financial services to develop credible transition plans, through recognising the work being conducted by GFANZ and the Transition Plan Taskforce.

5. Energy security in the UK and the transition

5.1 The UK needs to develop and implement clear real economy net zero policies if it wants to attract capital and help to achieve its objectives from an energy security perspective. The financial services industry needs to understand the UK government's position on the role of nuclear, hydrogen, carbon capture and storage (CCUS) and domestic oil and gas production, to reduce the UK's reliance on imported fossil fuels as part of a smooth energy transition. If such policies result in energy projects being seen as dependable, with emerging low carbon projects being supported by blended finance, then it is very likely that levels of capital will be available.

5.2 A significant barrier to private financing is the high investment risk associated with emerging/nascent low carbon technologies. UK and/or local government-supported schemes providing incentives to private investors investing in emerging low carbon technologies [which are currently less competitive vis-à-vis mainstream technologies (e.g. hydrogen replacing fossil fuels)] would contribute to overcoming this barrier – through blended finance solutions.

5.3 Timely delivery of investment (revenue) models (whether for hydrogen, CCUS or others) which are genuinely investable therefore need to be in place. During the scaling up of such technologies, the UK government needs to adsorb sufficient risk until there is a market track record and sufficient liquidity for each type of technology. The UK government also needs to

work more closely with the FRPS ecosystem and upskill its own knowledge, to address any gaps in the UK government's investment capability/drive on such projects.

6. The UK's just transition to net zero and the role of a net zero aligned financial centre

6.1 A robust and clear real economy, sector wide framework to support the transition to net zero -

The UK FRPS ecosystem is critical in the transition to net zero. It is imperative that the UK government optimises its broader financial, professional and regulatory environment. There are huge benefits of the clustering effect that brings so many financial and professional services businesses to the UK. It is because we have extensive financial and technological capabilities, reliable legal and regulatory systems, a deep talent pool, flexible labour markets, a globally central time zone, an international language, and expertise across all aspects of financial and related professional services (banking, insurance, capital markets, FinTech, asset management, law, accountancy, and management consultancy) that the UK is well positioned for green finance.

6.2 But green finance policy cannot be viewed alone. As responsible custodians and stewards of capital, the financial services industry cannot by itself deliver the UK government's green finance objectives; the risks of selecting and scaling up emerging green technologies need to be appropriately and proportionally shared in a financially responsible way. It also means that the best green finance regulatory package in the world cannot operate effectively in isolation. Therefore, it will be essential for the UK government to adopt a bold, consistent and clear approach for an economy-wide transition. A robust finance-specific framework must be complemented, and form part of, a stronger real economy framework.

6.2 Mobilising finance for the transition requires a sector-by-sector framework to support the necessary changes. There is a need for clear, consistent and committed strategy and co-ordination between and across the relevant government departments. Regulatory bodies are also vital for delivery and enforcement, including the Financial Conduct Authority (FCA), Prudential Regulation Authority (PRA) and various other public bodies. The UK FRPS industry therefore needs to see better coordination, communication, and delivery of real economy net zero policies from the UK government. It is not clear to the UK FRPS industry: (i) where the alignment of policies between government departments and regulators is and; (ii) where the responsibility for coordination/policy delivery lies.

6.3 We also must recognise the on-going efforts by financial services and other industries, including the various Net Zero alliances (such as GFANZ), trade associations and cross-industry interest groups, in deploying policy implementation, and monitoring outcomes once achieved. The extensive public/private engagement has been encouraging and this needs to continue for the UK to become world leading in green finance.

6.5 There continue to be market barriers to the integration of environmental-related factors into financial decision-making. An **internationally aligned regulatory policy and development of frameworks and standards (including the UK taxonomy) in a manner which supports global coherence** will be key to unlocking some (but not all) of these barriers.

6.6 The **lack of clear regulatory policy or framework has been a key challenge**. We welcomed the UK government's early support for the Taskforce on Climate-Related Financial Disclosures (TCFD) and the development of international reporting standards through the International Sustainability Standards Board (ISSB). Since introducing its mandatory TCFD-aligned disclosure rules, the UK has made strong progress in closing the disclosure gap. The UK government needs to move at pace to introduce its Sustainability Disclosure Requirements (SDRs) across the

economy, especially for smaller and privately held companies. Moreover, the UK continue to work with international partners to promote the introduction of mandatory disclosure requirements in other jurisdictions, and to promote international interoperability of regulations and standards. This will help to attract cross-border financial flows to the UK green economy. We also recommend that the UK deploys mutual recognition frameworks as well as unilateral equivalence rulings on taxonomies. We also support the UK government's plans to make transition plan publication mandatory so that transition is seen as integral to the journey to net zero.

- 6.8 There are also **technical and operational difficulties in measuring and understanding the risks;** and this being accompanied by **insufficient data and resources**. Data gaps from incomplete disclosures mean the methodologies used by the financial services industry to allocate capital in line with sustainability targets often rely on diverging methodological choices and assumptions, which can cause confusion and hinder comparability.
- 6.9 **Real economy policies need to be introduced as well and in tandem with disclosure standards to address the demand and behaviours from consumers and investors.** There are potential costs and complexity in implementing environmental-related factors to financial decision making, which need to be underpinned by real economy policy and regulations to create a level playing field. Market resistance is also potentially challenging. Whilst client demand is a key driver in the growth of environment-related financial decision making, such demand is currently inconsistent. There are perceptions that investments that support the transition are too high risk, or that green investments do not generate sufficient returns.
- 6.10 There needs to be **increased support and guidance for SMEs and retail customers to assist with data gathering, understanding and awareness.** The UK financial services industry is at the forefront of helping SMEs and retail customers to align with sustainability objectives, by linking financing to sustainability targets. However, we are concerned about the overall lack of awareness and understanding by SMEs and consumers. For green finance to accelerate for local authorities, SMEs and retail customers, the UK government should provide (i) clear sectoral policy to provide clarity; (ii) campaigns to educate and inform the public, and; (iii) clear regulatory expectations with an aligned framework.
- 6.11 There needs to be **increasing awareness and understanding of the importance of transition finance and transitioning activities throughout the economy.** The UK government should promote the importance of transition activities as part of the net zero transition. In our view, the biggest financing opportunity for the UK economy is how brown or transitional assets / activities can be financed in line with the UK's climate targets. In some instances, this will imply accelerated phase down, retrofitting and/or repurposing – on top of 'green finance'.
- 6.12 There is a combination of factors such as technological, financial, economic, institutional and transition barriers that could slow down the mobilisation of private investment into transition activities. Those factors require adequate regulatory frameworks in order address such transition barriers. In particular, the UK's green taxonomy should distinguish between green and transitioning activities to recognise the necessity for transition.
- 6.13 The development of 'blended finance' schemes is critical. Such schemes would be enabled further by ensuring government policy does not exclude deserving projects from receiving grants if they also received blended finance. Such exclusions could put users off from trialling new financing methods. Green projects also need to improve their ability to generate cash flows and

track record for new business models. Decommissioning finance and/or phase down initiatives will also be essential to enable the transition and phase down of harmful activities.

6.14 The UK also needs to continue to engage with the Transition Plan Taskforce's work with GFANZ to help inform the creation and alignment of international private sector standards. This will assist with developing large-scale transition finance work and help maintain the right conditions for large international financial services businesses to be headquartered in the UK.

6.15 The UK needs to **encourage and instil market confidence, whilst supporting innovation and technological developments which are essential to the transition.** For a green finance framework to drive change in the real economy, we need both investability and impact. Investors of all types must have confidence to invest and this can be achieved through open, internationally aligned, clear and competitive framework for labelled investment products. To develop a competitive and net zero aligned finance centre that has real economy impact, we need to promote stability, policy and regulatory clarity for both FRPS and the wider economy, such as through commitment to the rule of law, to upholding international agreements, and to offering a level of relevant policy stability as previously described.

7. Conclusion

7.1 We consider that, for the UK government to enable UK FRPS to play its role to accelerate the transition to net zero:

- I. The UK needs to drive regulatory coordination towards a pragmatic, useable taxonomy and a principles-based regulatory framework that can adapt with time and avoid unintended consequences (e.g. learning from Solvency II and the EU taxonomy experiences).
- II. The UK also needs to accelerate green and transition investments by focusing the deployment of its own financing toolkit and ensuring that sufficient economic, regulatory and tax model incentives are in place to attract 'green' companies to list in the UK and invest in the UK.
- III. The UK also needs to signal its intent and engagement to the FRPS ecosystem through improving the UK government's expertise and knowledge of financing through upskilling and better coordination. Doing so will increase the UK government's own engagement and understanding of what is required to mobilise investment at scale, when looking to work with industry.

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