UKSIF
UK Sustainable Investment
and Finance Association

2nd September 2013

Environmental Audit Committee Inquiry
Green Finance
Submission from the UK Sustainable Investment & Finance Association (UKSIF)

Introduction

1. The UK Sustainable Investment and Finance Association (UKSIF) supports the UK finance sector as a global leader in advancing sustainable development through financial services. We promote and support responsible investment and other forms of finance that advance sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments.

2. UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 250+ members and affiliates include pension funds, institutional and retail fund managers, banks, financial advisers, research providers, consultants and non-governmental organisations. For more information about UKSIF and its members, please visit www.uksif.org.

Summary

3. UKSIF welcomes the Select Committee's inquiry into Green Finance. It is increasingly recognised that the 'green economy' is a key source of UK jobs and growth and that investment in low carbon technologies and infrastructure is vital if we are to meet the terms of our national, regional and international climate change agreements.

4. Our answers focus on the issues raised in questions i), ii), iii), v) and vi). The submission draws on consultation with our members, as well as our report *The Future of Investment: Green Infrastructure* (June 2012), our work as part of the Transform UK Alliance on the Green Investment Bank and our submissions to: the recent European Consultation on the *Green Paper on the Long-Term financing of the European economy* (July 2013) and the *Kay Review of Equity Markets and Long-Term Decision-Making* (November 2011). All these responses and papers can be found at www.uksif.org.

5. Feedback from our members indicates that it is primarily financial risk and return factors that underpin their investment decisions, including in green investments. However, sustainable and responsible investment practitioners have long understood that it is not always possible to decouple financial risk and return from the long-term social and environmental challenges arising from mega-trends such as climate change. This is becoming an increasingly popular method of investment.

6. Industry feedback suggests that there remains a gap between the amount of money investors have available to put into green projects and the actual level of investment in these projects. This would indicate that financial markets are not working as effectively as possible in matching available finance to the required investment in renewable energy and other green products. We would agree that the "carbon bubble" is a real risk.

7. Some of the key issues highlighted by our members in terms of Government action to redirect finance to fill the green finance gap include the lack of a stable, coherent policy framework and 'political risk' more generally. We would also support boosting the Green Investment Bank's powers to raise capital, although we feel that it currently undertakes an effective job given the relative limitations of its strategy and powers. In addition, we have suggested some activities the Government should look into undertaking in order to boost asset owner demand for responsible investment practices which would arguably in turn boost investment in renewable energy and other green projects.

8. We would be happy to give oral evidence to the Committee on this issue.

<u>Response to the questions</u>

i) What are the main drivers behind institutional investors' decisions on the type of investments they include in their portfolios? Where they contemplate supporting energy or environmental projects, what relative weights do they give to questions of possible financial return, environmental/carbon impact, energy security or other factors?

9. Feedback both from our members, statements in our *Future of Investment* publication and information from research like the CDP's recent Carbon Action Report, indicate that it is primarily financial risk and return factors which underpin decisions made by all investors. Therefore any government, regulator and industry-led activities which seek to boost investment in green finance should focus on the risk and return profiles of a given green investment.

10. Sustainable investors as a group have been among the first to consider the risks and opportunities from the long-term social and environmental challenges arising from mega-trends such as climate change and have therefore been historically keen to invest in energy and environmentally friendly assets. There are now a range of sustainable investment strategies which seek to take these risks into account, including the integration of ESG (Environmental, Social and Governance) factors into financial analysis, sustainability-themed investments, best-in-class investment, engagement and voting on sustainability matters, and screening (be it norms-based, positive or negative). Further information about the different types of sustainable investment practices can be found at www.uksif.org.

11. Research[1] shows that sustainable and responsible investment is becoming increasingly popular owing to growing awareness that it is difficult to separate issues of financial return and risk from topics such as the environmental/carbon impact, energy security or other factors. We would therefore question the implicit assumption in the phrasing of question i) that financial return – which feedback from our members would indicate remains the primary consideration when it comes to investment decisions – can in all cases be separated from other broader factors such as climate change, energy security, resource depletion etc. In fact, the experience of investment practitioners, as demonstrated in our *Future of Investment* report would show that investors are looking to invest in projects related to e.g. energy security *because* they offer good returns.

12. Another central factor that our members highlighted was the shape and length of return horizons; pension funds and life insurers, for instance, are alert to the need to match their future income streams against the shape of their future liabilities and it is partly for this reason – as well as the fact that these investment returns tend to be non-correlated to returns on other assets and so provide useful portfolio diversification – that investment in infrastructure, including green infrastructure and other energy projects, is looking increasingly appealing to investors.

ii) How effective are the financial markets in matching available finance to the required investment in renewable energy and other green projects? To what extent is a potential "carbon bubble" a real risk?

13. Member feedback would suggest that investors perceive there to be significant opportunities to be gained from investment in renewable energy and other green projects. For instance, in our Future of Investment Report, it was suggested that opportunities arose from, amongst other factors, "the fact that the world's population will grow by 2 billion plus by mid-century [which will] put more stress on our already constrained natural resources" with "massive investment in water infrastructure needed to assure its adequate provision globally" and that "there are a number of EU and UK drive policies which play an important role in driving the growth of green infrastructure" as well as the fact that "infrastructure investment is increasingly attractive to investors because it presents a low-risk, long-term investment opportunity with inflation-linked positive cash flows".

14. Research by Bloomberg New Energy Finance[2] also states that annual investment in new renewable power capacity is forecast to rise by between 2.5 to more than 4.5 times between now and 2030. However, even though the UK has recently been ranked as the 4th most attractive place for investment in renewables, the amount of predicted investment still lags behind

[1] For further evidence on this, please see the joint UNEP FI and Mercer report on *Demystifying Responsible Investment Performance* at: www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf or look at the growth in the number of signatories to the UN-backed Principles of Responsible Investment: www.unpri.org/news/pri-fact-sheet/

[2] http://about.bnef.com/press-releases/strong-growth-for-renewables-expected-through-to-2030/

Germany (invested £22bn in 2012 following two consecutive years with investment at the $30bn mark) and elsewhere.

15. Feedback from our members and the industry more generally indicates that there is a gap between the amount of money that investors have available to put into green projects and the actual investments made. We also note figures that state that while total investments in the UK comprised 14% of GDP in the UK in 2011 – the lowest level of investment recorded in the UK for about 40 years – the UK private sector generated a surplus [net lending] of £99bn. The gap between the level of potential demand and the money available, as opposed to the actual level of investment in green projects, suggest that financial markets are currently not operating as efficiently as possible. We examine the reasons for this shortfall in our answers to questions iii) and v).

16. The consensus in the sustainable investment and finance industry appears to be that the carbon bubble is a real risk; we would direct the Committee's attention to some excellent recent Carbon Tracker reports, as well as the CDP's Carbon Action work and the research done by the Smith School at Oxford as part of their Stranded Asset Programme. The risks posed have been well-documented and we understand both the CDP and Carbon Tracker will go into this in further detail in their own submissions to the Committee.

17. However, one question that both we and our members feel has not yet been examined sufficiently is precisely who will end up bearing the cost once the price shock hits? Will it be those savers and other investors who have money tied up in, for instance, coal, gas and oil assets? Or will it be the government of the day – and, ultimately, taxpayers – who are forced to step in?

iii) What should the Government be doing to help redirect finance to help fill the £-multi-billion green finance gap?

18. A key issue highlighted by our members is the lack of a stable, coherent policy framework to support green investment, where Government departments take a joined-up approach both to working with each other and to co-ordinating their work with the relevant regulators on renewable energy, infrastructure and green investment.

19. For instance, the apparent lack of communication between the Department for Energy and Climate Change (DECC), The Department for Business, Innovation and Skills (BIS) and HM Treasury on issues such as energy policy or support for 'green growth' appears to be deterring some investors. The recent news[3] that the Treasury Chief Economist failed to support a cross-departmental Resource Depletion Review which explicitly considered the impact of resource security on economic growth and was backed by economists from other departments including DECC, BIS, the Foreign and Commonwealth Office and the Department for International

[3] http://uksif.org/wp-content/uploads/2013/07/Resource-Security-letter-to-Treasury-Select-Committee_July-2013.pdf

Development, is one recent example. UKSIF, the Aldersgate Group, and Friends of the Earth recently co-ordinated an investor and business-led letter to the Treasury Select Committee urging an examination of the reasons behind the Treasury's attitude to this decision. We have not as yet received a response.

20. Feedback from our members also indicates that one of the key risks faced by investors is 'political' i.e. the uncertainty inherent in policy decisions which affect relevant markets. Recent specific examples mentioned include the changes to the Feed-In Tariffs for Solar PV systems; the lack of a decarbonisation target in the Energy Bill (despite the recommendation of the independent Committee for Climate Change to do so) and the speed of changes to energy market policy including the shift from Feed-in Tariffs to Renewable Obligation Certificates (ROCs) to the changes to be introduced under Electricity Market Reform (EMR).

21. The seeming understatement of the financial risks inherent in climate change issues such as stranded assets and water and energy security by the Treasury is in stark contrast to the attitudes displayed in other countries and could well have an impact on the City of London's current position as a global leader in sustainable investment and finance. For instance, several French government ministries recently sponsored the 'Drago-Brovelli-Molinié' report which examined, amongst other issues, the case for encouraging responsible investment and recommended some fiscal measures which could boost its take-up by actors across the investment chain. This is just one of various supportive statements from key ministries which underline the impression that France is serious about the value of green, social and sustainable investment to its strategy for long-term economic growth. Although no systematic study has been made of the consequences for the UK financial services industry, the anecdotal evidence is that this is affecting the decisions of e.g. American investment banks when it comes to deciding where to base their RI team in Europe.

22. As part of the Transform UK Alliance, we have always been supportive of the creation of a Green Investment Bank although we were disappointed that it has so far not been allowed to borrow on capital markets and so is unable to provide the leading-edge, accelerating funding that the green economy needs as well as the fact that there is no explicit link to the Climate Change Act in its remit. We address this issue further in our response to question v).

23. We would also support some Government- led activities which seek to raise institutional asset owner demand for responsible investment practices, which would arguably thereby also boost investment in 'green' infrastructure and elsewhere. It is asset owners who are best positioned to drive change through creating the commercial drivers for long-term and 'green' investment practices amongst their investment managers.

24.These activities to directly boost asset owner demand could include:

- The encouragement of provision of practical guidance for pension fund trustees and other fiduciaries on the effective implementation of their fiduciary duties. We were pleased to note that the Government has asked the Law Commission to examine the case for clarifying fiduciary duty in the wake of the Kay Review recommendations.

- Improved mandates; the ICGN has, for instance, developed a long-term investment mandate.

- The encouragement of greater use of support for investment consultants to develop their manager assessment techniques in the field of responsible investment.

- Leading by example; we are pleased to note that the Parliamentary Contributory Pension Fund has now signed up to the Stewardship Code. We feel that such steps could be enhanced by better government and local government procurement of investment services e.g. ensuring that all chosen asset managers have signed up to the UN-backed Principles of Responsible Investment.

25.However, we believe that government regulation by itself is insufficient and too great a regulatory burden can be counter-productive; an effective response that ensures better-functioning capital markets requires action from all parts of the investment chain – albeit with some government encouragement. It is with this in mind that UKSIF has, for instance, organised events such as National Ethical Investment Week[4] – now in its 6th year – and held its inaugural Ownership Day campaign[5] in March 2013, to try to raise awareness amongst institutional asset owners of the importance of good stewardship of assets and to encourage them to persuade their asset managers to engage with the companies they invest in over the longer-term.

26.We also believe that better information from companies about their corporate governance and the impact their business practices have on the environment and local communities, is vital to enable investors to include sustainability in their decision-making and help the economy move to a more sustainable and long-term footing by boosting green investment. For any such information to be useful to those investors who are seeking to invest in the low-carbon economy, it must be *material* and *comparable*. UKSIF is a member of the Corporate Sustainability Reporting Coalition (CSRC) which in March 2013 estimated that about 75% of companies did not report on sustainability issues at all[6]. However, UKSIF believes that better disclosure of information on sustainability is a key catalyst for the changes needed to ensure better long-term value of assets and macroeconomic health more generally. We are therefore cautiously optimistic about the

[4] Please see www.neiw.org for further details.
[5] For further details, please see: http://uksif.org/ownership-day/
[6] www.aviva.com/media/news/item/the-eu-in-2013-embedding-corporate-sustainability-reporting-15615/

measures proposed by the European Commission to make so-called 'non-financial' reporting mandatory for large EU firms.

v) What impact is the Green Investment Bank likely to have on the green finance gap? Does it have the right investment strategy?

27. UKSIF has always supported, as part of the Transform UK Alliance[7], the creation of a Green Investment Bank (GIB) as a way to ensure that the UK remains a global leader in green financial services and is capable of supporting what is a growing and successful part of the economy[8].

28. Both we and our members believe that the Green Investment Bank has done a good job given its limited, safe strategy and constraints under which it operates; its strategy has generally focused on the right industries, i.e. those which are under-capitalised, and it has worked well as a co-investor on key projects.

29. However, its currently limited strategy and the Bank's inability to borrow on capital markets so far have meant that the GIB has not yet been able to play the leading-edge, accelerating role in developing the 'green economy' that we, our members, and other partners in the Transform UK Alliance believe is necessary. It is important that the Bank leads and builds the first few major green projects so that further investment in future projects can follow. A good template for the GIB remains the KfW development and reconstruction bank in Germany where a high proportion of their funding is raised through the capital markets. We were pleased to hear that the UK Government has now committed to applying for State Aid for borrowing powers on the capital markets for the GIB but would like these powers to be 'uncoupled' from achievement of deficit targets as the forecasts regarding when the UK national deficit might start falling as a proportion of GDP are being pushed back ever further, which delays the necessary stimulation of the green economy.

[7] www.transformuk.org/en/

[8] For figures on the contribution of the 'green' business to the UK economy, please see the CBI's *The Colour of Growth"* report at www.cbi.org.uk/media/1552876/energy_climatechangerpt_web.pdf .

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vi) How should progress against that green finance requirement be monitored? While the CCC monitor progress on emissions reduction via the Carbon Budgets, and the Office of Budget Responsibility monitors progress on government debt reduction, who should monitor progress on delivering the necessary green finance?

30. We have no specific views or suggestions on this front, but one thing that we would want to see is the creation of appropriate mechanisms, which genuinely incentivize investment in green infrastructure and projects.

31. I trust that the comments above are self-explanatory but if you would like any further clarification then please do get in touch.

Yours sincerely,

Simon Howard

Chief Executive, UK Sustainable Investment and Finance Association