Environmental, Social, and Governance

APPG on ESG submission

Update to Green Finance Strategy: call for evidence

Introduction

In April of this year, the All-Party Parliamentary Group on Environmental, Social and Governance published a report: Recommendations on standardising and regulating ESG performance and assessment, and defining impact in the UK. Contained within the report were ten headline recommendations to the Government that would facilitate the growth of reliable and comparable non-financial information, thus enabling both the UK and global economies to transition to net zero carbon emissions along with a host of other environmental as well as social objectives.

Expanding data disclosures and improving comparability of metrics were key themes of the report. The APPG's submission to the Department for Business, Energy and Industrial Strategy's Green Finance Strategy (GFS) consultation is principally concerned with these two priorities. In addition, the group has added recommendations regarding UK leadership in green finance and policies to support small and medium sized businesses.

Having consulted its advisory board for the purposes of the GFS call for evidence, the APPG is keen to emphasise that markets operate efficiently when they are fed consistent and comparable information. Individual investors will have different attitudes towards risk, but they all require access to the same body of information to inform their decisions.

The APPG recognises the UK has an excellent opportunity to become a green finance and ESG world leader. The next and vital frontier in ESG and net zero transition is building legislative and regulatory frameworks to encourage wider and deeper disclosure, it is here that the UK has an opportunity to lead, the APPG strongly urges BEIS and other government departments to take full advantage.

Enclosed below are the APPG's responses to questions 2, 7, 9, 10, 13, 20, 28, 30, 31, 32 and 33 of the consultation. Where appropriate, we have indicated those issues that apply to several lines of enquiry within the consultation.

We sincerely hope the positions and examples presented in this document will prove to be valuable contributions to the department's important work in adapting framework conditions to help divert a greater volume of private capital towards greener projects.

Capturing the opportunity

2. Do you consider the UK's green finance regulatory framework to be world-class?

The APPG is greatly encouraged by the policy commitments made before and after COP26, however, there needs to be a strong commitment towards simplicity, minimising red tape while transitioning towards net zero, among other environmental (not to mention social objectives). Timeliness is essential as innovations and new technologies emerge quickly; green finance needs to be in lockstep. Transparency of information is critical too, we need to know on a quarterly basis how much green finance is being committed.

On that basis alone, the UK's green finance regulatory framework has some way to go before it can consider itself world-class. In any case, ESG and green finance is simply too nascent to make such a judgement.

Financing the UK's energy security, climate and environmental objectives

7. How can the UK support a financial system that leverages private investment to meet the UK's climate and environmental objectives?

The UK's climate objectives are ambitious, which the APPG welcomes. However, the group is concerned that without a stronger focus on impact, opportunities will be missed and targets will be in danger of not being met.

Article 9 of the EU's Sustainable Finance Disclosure regulation defines a specific category of fund that "has sustainable investment as its objective or a reduction in carbon emissions as its objective."

We anticipate the UK will go in this direction in some form, but the important issue at hand is to consider how such a financial mechanism should change the flow of capital and what that means for net zero and other environmental objectives.

Article 9 is ambitious, but it is not revolutionary. A green fund will invest in renewable energy assets that already exist. Such a fund should ideally be pushing boundaries much further.

A true impact fund would invest in new and innovative renewable projects, actively reducing emissions by helping to switch energy from brown to green, and delivering double materiality.

The European Union is widely viewed as taking leadership in global environmental policy. On the back of COP26, the UK is catching up fast and has an opportunity to move ahead of Brussels by creating framework conditions for true impact funds.

9. What barriers are there to unlocking private investment to support the UK's energy security, climate and environmental objectives?

In brief, the UK does not have a framework for measuring and reporting data transparently, this needs to be resolved, not just in the UK, but globally (see response to question 33).

As things stand, there is a mixed landscape of reporting requirements across various sectors. As a starting point, the APPG calls for international bodies, such as the TCFD and ISSB, to enhance mandatory disclosure needed to improve investors' understanding of a company's ESG risks and opportunities.

But at a granular level, the UK has an important task to fulfil in unravelling and amending existing rules and regulations that block the availability of important environmental data.

One of the APPG's partners, an investment manager in real estate, consulted for this call for evidence, cited energy consumption by tenants. This data is measured easily and accurately, but unlike financial information, which ESG data and metrics are trying to catch up with, is not recorded, tracked, aggregated, and delivered to businesses and investors.

This leaves market participants faced with the unenviable task of accumulating whatever data that they can and then extrapolating it to form an estimate that can veer wildly from reality and notably, from other metrics calculated by other participants.

Needless to say, the two are sets of data in this scenario and countless others are not comparable, herein lies the critical issue. Rather than having what you might call a single point of truth for a given set of environmental data linked to a given asset, there are several that can vary widely.

Over-application of GDPR is one barrier to the specific example of tenant energy use. Energy consumption data is freely available in both Germany and the Netherlands that, like the UK, are obliged to comply with the EU's data protection regulations. UK application of GDPR should therefore be amended to enable access to data in these circumstances, and others linked to the green finance strategy.

In other instances, GDPR will be less of an issue. It might be that there aren't any regulatory barriers, instead blockages are created by the absence of a system for recording and delivering environmental data, a task the Government should take charge of as a matter of priority.

Furthermore, as the Government and the private sector look to create more and more lifecycle assessments of individual goods and services, enabling market participants to make purchases based on environmental footprint as well as price, the need for more accurate and incontrovertible underlying data will expand exponentially. The need to address this issue is urgent.

A product environmental life-cycle footprint revolution will depend on massive volumes of metadata provided by suppliers at every step in a given supply chain. On that basis, businesses will need to provide metadata much like they do with financial data. BEIS and other departments in government should focus on this objective without causing excessive regulatory burden on enterprise, particularly smaller firms.

10. How can the UK Government assess and measure progress toward financing the UK's energy security, climate and environmental objectives?

The key question here, again, is data and its validity. The recent raid of asset manager DWS by German authorities is a worrying example of what can happen when the market is beset with data founded on as many estimates and assumptions as primary data. It is all too easy to commit misinterpretations – as may have been the case with DWS – without mandatory disclosures of the underlying data.

Put simply, if headline metrics such as carbon emissions, energy consumption, and water usage are not widely and systematically reported, it is hard to foresee how the UK will be able to measure progress.

13. How can the UK become a leading hub in structuring and innovating on transition finance?

Here, we emphasise our response to question 7. The principle of funds directed purely at impact equally applies to under subscribed transition funds raised in the consultation. If the UK is to succeed in powering the development of transitional technologies and their implementation at scale, frameworks need to be created to encourage funds that direct capital purely to innovation linked directly to net zero transition.

We would suggest incorporating these mechanisms in the existing menu of subsidies and tax inducements to help specific investments.

However, further to the DWS example cited above. Accurate, consistent and comparable data is an essential prerequisite.

20. How can the UK financial sector support SMEs and retail customers to align with the UK's climate and environmental objectives?

Involving the financial services sector in supporting educational programmes would be one important step. A good example is the Supply Chain Sustainability School, a scheme largely funded by participants in the construction sector that provides free courses linked to sustainability for tradesmen and professionals across the value chain.

A similar model should be adopted in financial services, specifically data analysis and ESG compliance. In the immediate term, such a measure would address the current skills gap, benefitting SMEs in particular (see response to question 28).

Greening the financial system

28. What should the role of the UK Government or regulators be to support the greening of the financial system? How could they go further?

In brief, the approach should be to expand disclosures, supported by wider standardisation and the introduction of greater transparency. An additional priority is to encourage sector-by-sector best practice as the environmental footprints of two sectors will never mirror one another, the precise data disclosures and the metrics stemming from them should reflect specific characteristics.

The APPG stresses that the need for transparency and best practice particularly applies to the nascent ESG rating industry where products vary wildly, leaving market participants struggling to understand and evaluate the environmental footprint of different assets.

The APPG recognises that the Government's three-phase approach of informing investors and consumers, ensuring they act on that information to help engineer a shift in financial flows, is the correct pathway.

The key issue, therefore, is *how to go further.* The APPG has two key recommendations in this regard.

The April report on assessment and impact identified a tension between standardisation and materiality in ESG reporting that calls for sectoral and sometimes qualitative analysis.

An illustrative example would be a professional services firm that chooses to reduce its water consumption. This measure would have far less impact compared to a bottling company undertaking the same transition. It is therefore essential that standards are accompanied by a sector-by-sector analysis of common environmental impacts, which need to be monitored and reported and fed back into sectoral best practice codes.

This touches on the important point articulated in response to question 7. There is a natural tendency to define new reporting frameworks and launch new standards from a preventive stance (lower water consumption, lower energy use, higher efficiency). In doing so, we all too easily neglect impact and innovation.

Reducing the level of environmental impact is important, but given the UK's net zero ambitions, it is paramount that BEIS and other government departments do not lose sight of the need to incentivise innovation in new technologies that actively reduce environmental impact and encourage their widespread adoption.

One solution to this end favoured by the APPG is for the Government to introduce and promote a central register of typical risks and impacts facing each sector.

Similarly, the UK Government should, in the APPG's view, make sector-by-sector resources available to businesses of all sizes enabling them to comply with reporting frameworks. For example, smaller businesses, in particular, are often unable to bring staff with the necessary skills to fulfil reporting requirements onto the payroll. It is incumbent on the Government to help fill that gap, whether through upskilling programmes or support with outsourcing.

The APPG is also conscious that compliance can easily turn into a box-ticking exercise rather than a force for transition. Businesses need to be aware of this and be persuaded of the benefits of diligent and accurate environmental reporting.

30. What steps can the UK Government take to support a robust investment data ecosystem to attract green finance flows.

As already emphasised repeatedly in this submission, consistent and comparable information is vital, which is why disclosures are such an important priority. The Government should introduce a disclosure standard that will enable base comparisons across portfolios containing companies in different sectors.

The most relevant information for investors is quantitative metrics as they allow for greater comparability. Investors look for consistent and relevant data that can address key dimensions of their portfolio such as exposure to climate change, minimising transition risk, capturing green opportunities, minimising physical risk and ensuring alignment with a world that constrains any increase in global temperatures.

The APPG notes that the FCA has already taken significant steps in this regard. Whitehall should be setting the agenda, however.

31. Are Scope 3 (supply chain) emissions data important for investors to assess and manage climate-related risks and opportunities?

Yes, scope 3 accounts for a huge proportion of emissions. This data should not only be disclosed from the perspective of combating climate change. From a market point of view, investors will also want this information to feed into the risk profiles of their assets.

Meanwhile, businesses, including SMEs, are able to score quick wins in reducing their supply chain carbon footprint, but achieving this is very difficult without the data.

32. Is there a role for the UK Government to support businesses (of different types and sizes) to make good quality Scope 3 emissions disclosures (including SMEs in the value chain of disclosing entities)? If so, what should this be?

One option worth considering is to split up Scope 3 as some metrics, such as waste, business travel and commuting travel, are easier to capture than the rest. Some information, provided it is accurate and consistent, is better than none at all.

Leading internationally

33. Up to 2030, how can the UK Government best support the global transition to a net zero, nature-positive financial system that is both inclusive and resilient?

The APPG foresees several opportunities for UK leadership. The group welcomes the introduction of mandatory TCFD disclosures for larger businesses, however this needs to go further over time, though proportionately.

Recapping our response to question 7, the UK has an excellent opportunity to drive the agenda closer to impact by encouraging innovation and adoption in that direction. Doing so would rear genuine nature-positive as well as net zero benefits.

Additionally, the APPG stresses that the UK must catch up with and take over the EU's head start. This process is well underway with the introduction of the forthcoming Sustainability Disclosure Requirements together with a green taxonomy. Other initiatives such as the UK

Transition Plan Taskforce and formal ambitions to create the world's first net zero-aligned financial centre will help the UK leapfrog progress made by the EU.

More important however is for the UK to lead in data and the development of standardised metrics recognised globally. The green taxonomy will contribute towards this objective, but much work is needed to ensure the reporting ecosystem is comprehensive and can be rolled out internationally.

All scenarios relating to the environmental footprint of every kind of asset must be considered carefully and defined rigorously. Take the example of a supermarket comprising a petrol station – how is an asset manager to determine the carbon footprint of that asset? The station's pumps will deliver petrol to vehicles, releasing carbon into the atmosphere, therefore, should the petrol station count as exposure to fossil fuels.

This touches on acquiring data that serves as a single point of truth. Without a comprehensive account of how assets and the environment interact together with widespread accurate disclosures, there is a constant risk of duplication of negative environmental outputs.

Without a regime to record power consumption, energy use data for a building with multiple tenants could easily be duplicated as analysts aggregate data drawn from disparate sources that may overlap with one another.

The same principle applies to the supermarket petrol station and the vehicles it fuels, that in turn release GHGs into the atmosphere. The exposure needs to be appropriately divided to help avoid duplication and anchor data aggregation and analysis.

The UK will make a strong claim to be a global leader if it accounts for such scenarios across the economy. Additionally, the Government must avoid ploughing its own furrow with an environmental standards regime that conflicts with existing international frameworks, like TCFD, and rival standard-setters like the EU. Doing so will make life harder for businesses and investors to comply with and further undermine data generation while stymying the adoption of ESG in both mature and emerging markets.

This latter point is critical. The Government should be mindful that the UK, specifically the City of London, lies at the centre of global finance. Assets purchased by UK-based investors are more likely to be located overseas, the metrics and methodologies used to assess those investments must therefore be universal.

Thus, it is incumbent on the UK to go out and collaborate with the rest of the world in defining the landscape that will then enable all market participants worldwide to deliver and access comparable metrics, KPIs, and ratings.