The Impact Investing Institute's response to the Department for Business, Energy & Industrial Strategy's call for evidence: Review of Net Zero

26th October 2022

1. KEY RECOMMENDATIONS

- **The UK should adopt a 'Just Transition' approach**. The transition to net zero will require huge changes. Unless negative social consequences are mitigated, and opportunities for jobs and communities seized, these changes will not be possible – in particular, at a time when people are facing rising energy prices, inflation and a cost-of-living crisis. In other words, if it is not a Just Transition, it is not going to happen. For policymakers, this requires

    - establishing a Just Transition Commission to facilitate collaboration across the public, private and non-profit sectors;
    - embedding Just Transition considerations in regulatory frameworks, including the framework and guidance produced by the Transition Plan Taskforce;
    - expediting the development of a science-based Green Taxonomy and mandating alignment and disclosure against it across the economy;
    - developing a complementary framework for measuring and reporting social factors;
    - clarifying pension scheme fiduciary duties to make it easier to invest for positive impact; and
    - helping Local Government Pension Scheme funds reach their 5% local investment target, as well as to attract wider investment.

- **Individuals should be empowered to contribute to solutions**. Consumer preferences can strongly influence market activity, incentivising firms to improve their climate, environmental and 'social' footprint in return for higher returns and growth. To support this, policymakers can

    - create an 'impact' investment label; continue the development of retail green NS&I bonds with social co-benefits; and
    - provide more support for pension savers to invest with social and environmental impact preferences.

- **Community voice should be key to local investment decisions**. The engagement of local communities is key to ensuring that any investment in a place by financial institutions is not only viable but as beneficial as it can be to that specific place – ranging from job creation to infrastructure provision. This requires

    - adequate resourcing for local authorities, and
    - encouragement of institutional investors to ensure a strong, genuine community voice in all place-based investment decisions.

2. ABOUT US

The Impact Investing Institute was launched in 2019 with a simple mission: to accelerate the growth and improve the effectiveness of the impact investing market in the UK and internationally. Our aim is for capital markets to be fairer and work better for people and the planet, in order to deliver sustainable and inclusive economic growth.

We are an independent, non-profit organisation, which brought together two influential initiatives: the Government's Taskforce for Growing a Culture of Social Impact Investing in the UK, and the UK National Advisory Board on Impact Investing. We are part of the GSG – the Global Steering Group on Impact Investing Network, which brings together leaders from finance, business, and philanthropy to contribute to solving some of the world's most pressing social and environmental challenges. Our Theory of Change describes how we plan to achieve change in the short-, medium- and long-term. We run a series of research, education and advocacy programmes designed to bring about the market conditions to enable impact investing to flourish.

Our response below outlines how government can work with and unlock private capital at scale to reach Net Zero, while accelerating growth, expanding opportunity and reducing inequality.

3. A PRO-GROWTH, JUST TRANSITION TO NET-ZERO

This section responds to three questions in the call for evidence:

- *Question 3: What opportunities are there for new/amended measures to stimulate or facilitate the transition to net zero in a way that is pro-growth and/or pro-business?*
- *Question 5. Where and in what areas of policy focus could net zero be achieved in a more economically efficient manner?*
- *Question 30. Is there a policy idea that will help us reach net zero you think we should consider as part of the review?*

3.1 The transition to Net Zero will drive economic growth

The transition to Net Zero is a climate and ecological imperative for the UK and global community that has profound implications for people. Many of these are positive, in terms of the potential for greater growth and employment opportunities, as well as tackling wider social priorities – such as overcoming energy poverty and reducing regional inequalities. But it also creates challenges for carbon-exposed companies, sectors, and geographies, raising the risk of 'stranded workers' and 'stranded communities', as well as 'stranded assets.'

Managing these opportunities and risks requires a "Just Transition" approach, defined by the United Nations as "a transition towards a sustainable economy that is well-managed and contributes to goals of decent work for all, social inclusion and the eradication of poverty". There is a three-fold, strategic rationale for organisations to consider the just transition within climate change planning[1]:

[1] Making transition plans just: How to embed the just transition into financial sector net zero plans, Brendan Curran, Nick Robins, Sabrina Muller, Adithiya Subramoni and Sophia Tickell, 2022

1. It is **smart**, by building a net zero economy by developing the essential skills, capabilities and social institutions. It takes a people-centred approach to addressing the 'human capital' and 'social capital' required for Net Zero

2. It is **necessary**. Without conscious strategies to ensure no-one is left behind, concerns about the impact of climate action on jobs and livelihoods can result in political backlash, slowing or even stalling the process of decarbonisation.

3. It is **right**. The Just Transition applies established social, labour and human rights standards to the transition to a net zero and resilient economy. It seeks to overcome the longstanding marginalisation of social factors in climate policy and climate action.

Impact investing can facilitate the Just Transition by aligning private capital with Just Transition principles, delivering greener growth for the benefit of people and communities. Impact investing could play an enabling role in key policy priorities, such as:

- Retrofitting: the Green Finance Institute's research estimates that around £360bn of investment will be needed to upgrade and decarbonise our homes by 2050. This is a huge opportunity for growth, but with many households unable to front the costs themselves, the report recommends **specific roles for public, private and blended capital**.

- The government's Growth Plan (point 3.14): **impact investing by pension schemes to invest in the UK's most innovative businesses, productive assets and pioneering science and technology companies** could turbocharge growth and finance entrepreneurial and scientific developments towards a greener future, while earning savers strong, risk-adjusted returns.

There is a growing consensus in favour of a Just Transition approach, supported by impact investing. For example, the UK's Financing a Just Transition Alliance (FJTA), convened by the London School of Economics (LSE), brings together more than 50 banks, investors and other financial institutions along with regional bodies, civil society, trade unions and universities. Its Just Zero report (2021) lays out the case for action, provides 18 examples of practical steps banks and investors are taking, and makes recommendations for action across three priority areas: finance, place and policy.

However, concerted government action is required to escalate the importance of the Just Transition as a policy, business and financial priority and ensure it is integrated throughout climate and economic growth initiatives. We recommend the **establishment of a Just Transition Commission** to facilitate collaboration across the public, private and non-profit sectors. Such a commission would also underline UK climate leadership, strengthen public acceptance of the need to transition to Net Zero, and aid institutions such as the British Business Bank and UK Infrastructure Bank to deliver growth and Net Zero.

Below, we outline further ways by which **government can catalyse private capital to finance a Just Transition to a greener, growing economy** for the benefit of people across the UK.

3.2 Transition Plans and supporting frameworks

It is critical that regulatory frameworks being developed to aid businesses and financial institutions in their planning, implementation, and reporting of climate activities incorporate Just Transition considerations. A holistic approach to environmental and social considerations ensures organisations fulfil their climate commitments by integrating a range of critical drivers of economic renewal and growth, including impacts on workforces, supply chains, consumers, and communities. Our work co-chairing the government-backed G7 Impact Taskforce in 2021 defines the three elements of a Just Transition approach: climate and environmental action; social-economic distribution and equity; and community voice. It also details the actions that each Just Transition element involves and the investable opportunities/strategies that investment vehicles might focus on to achieve them. By **subscribing to these Just Transition elements and integrating them into dialogue, policy-planning and legislation at all levels**, the UK can make clear what 'good looks like' and therefore help spur concerted, focused and effective action.

We are applying this work in our capacity as members of the **UK's Transition Plan Taskforce's** Delivery Group, helping government to design the 'gold standard' for climate transition plans, which will be mandatory for large UK companies and financial institutions to publish from 2023. Together with the Grantham Research Institute, we are co-leading work on how social, or Just Transition, considerations can be integrated into transition plans. **It is vital that Just Transition considerations are integrated in mandatory transition plan frameworks and guidance from the outset**, to aid preparers in anticipating, assessing and addressing the social risks of the transition; identifying and enabling the social opportunities of the transition; and ensuring effective dialogue and participation in net zero planning.[2]

We have also contributed to the FCA's proposals for Sustainability Disclosure Requirements (SDR) and Investment labels, as members of the Disclosures and Labels Advisory Group (DLAG). **We welcome the inclusion of social sustainability and impact considerations in the FCA's proposed label categories** (CP22/20). Our Just Transition Finance Challenge is designed to support financial institutions in fulfilling such sustainability requirements. Working with 20 global financial and academic institutions, we are **developing criteria to help investors integrate Just Transition considerations into their investment processes, allocations and engagement** and ultimately mobilise more investment that delivers a fair and inclusive transition to Net Zero.

We also welcome the UK's commitment to and progress on developing a green taxonomy, although note that, if it is to succeed fully in driving forward green economic growth, **it needs to be included within mandatory disclosures under the SDR**. A science-based, ambitious green taxonomy will be severely limited without the necessary framework to mandate alignment and disclosure across the economy. We also **oppose the possible inclusion of natural gas activities in the green taxonomy**, in alignment with a letter recently published by the Institutional Investors Group on Climate Change (IIGCC), Principles for Responsible Investment (PRI) and UK Sustainable Investment and Finance Association (UKSIF). Energy security considerations must not be conflated with the taxonomy, and any inclusion of gas risks sending misleading signals to investors at a time when they need greater clarity.

To complement the advances made via the green taxonomy, **we strongly support the establishment of a Social Technical Advisory Group** to advise on a framework for measuring and reporting social factors, comprising business, institutional investors and social investors. This would respond to significantly increased market demand for guidance on measuring and reporting social factors; anticipate the impact of the EU's work on a Social Taxonomy; and demonstrate how social factors can be given equal importance to green factors by government. We are undertaking a range of

[2] Making transition plans just: How to embed the just transition into financial sector net zero plans, Brendan Curran, Nick Robins, Sabrina Muller, Adithiya Subramoni and Sophia Tickell, 2022

relevant work, including our Just Transition Finance criteria and a project to map existing UK social disclosures (including legislation, voluntary codes, and market proposals) and identify those most appropriate for UK public policy priorities. We are also delighted to be appointed to DWP's new taskforce to **support pension scheme engagement with social factors in ESG investing**, which is another important initiative that would support any future Social Technical Advisory Group.

3.3 Fiduciary duty

Increasingly, investors are seeking to understand both how sustainability issues may affect a company, and how a company affects society and the environment – with a view to identifying and managing material impacts. This concept, enshrined in the EU Non-Financial Reporting Directive, is called 'double materiality.' We recommend that UK regulators **adopt 'double materiality' in financial reporting standards**, requiring market participants to report on outcomes that are material for society, the environment, and the economy, even if they are not yet material for enterprise value creation.

This concept of double materiality underpins our work on clarifying pension trustees' fiduciary duty. We have worked with leading law firms to publish a paper that explains how impact investing can help pension schemes manage the risks and opportunities presented by environmental, social and governance factors, and therefore deliver on fiduciary duties. Subsequently, through consultation with a range of UK pension schemes, we developed our Impact Investing Principles for Pensions, which have mobilised more than £20bn of assets, plus a range of investment consultants, to commit to embed an impact investing approach into their investments and advisory services.

However, due to prevailing widespread misunderstanding, many schemes, investment consultants and asset managers remain cautious of pursuing an impact investing strategy. Alongside other influential thought-leaders, including the Principles for Responsible Investing (PRI), we have developed **proposals for how the concept of fiduciary duty, and the supporting regulation and guidance, can. be clarified to make it easier for pension scheme trustees/administering authorities to consider the impact of their investments on society and the environment**. This could unlock significant amounts of capital to invest in assets that drive economic growth and deliver social and environmental impact across the UK.

3.4 Empowering local authorities to invest with impact

Place-based impact investing, where financial institutions invest in sustainable projects at a local level, contributes to solutions for challenges which are both local and global, as well as environmental and/or social. Our government funded place-based impact investing programme frames the involvement of private finance in regeneration and community wealth creation in a new way. It informed government's recommendation of a new **5% local investment target for the Local Government Pension Scheme** (LGPS), which could catalyse £16bn to kick-start growth across the UK.

Despite this, local authorities continue to face barriers to allocating capital for local environmental and/or social impact. As referenced above, revisions to pension scheme regulation and guidance would **ensure that definitions of fiduciary duty are not a barrier to** considering the impact of investments on society and the environment. Regulation can also **encourage and support institutional investment in transition activities**, particularly in private investments (private equity, debt, real estate and infrastructure), acknowledging in particular the illiquidity of these investments and the greater commitment of resources required for transactions and in maintaining them.

In addition to unlocking LGPS capital, government can play a key role in facilitating broader access to green finance for local authorities, by **providing the capability support they need to engage with financial institutions** with regards to information, capital, capacity and skills. Government can also support the following initiatives:

- **The Green Finance Institute's campaign on Local Climate Bonds** seeks regulatory change to the Innovative Finance ISA legislation that would allow local authorities access to a new pool of capital to further support financing for climate-friendly projects.

- **Deployment of tools and incentives to mitigate capital risks through blended finance**, via guarantees, subordinated capital or even making the leverage of private finance an explicit goal of investment by the UK Infrastructure Bank and of British Business Bank programmes.

- **A clear mandate for local government in taking a local, place-based approach and reforming local funding** to address the delivery cost of funding public investments and building local capacity.

4. EMPOWERING BUSINESSES & CONSUMERS

This section responds to Question 4: What more could government do to support businesses, consumers and other actors to decarbonise?

4.1 Consumers

Government can further empower individuals – as both consumers and savers – to contribute towards decarbonisation.

The green taxonomy will likely enhance the power of consumers to influence market activity, incentivising firms to improve their climate and environmental impact in return for higher growth. The **development of a framework for measuring and reporting social factors** would have a similar effect, with many consumers already demonstrating a willingness to redirect their spending towards companies with stronger green and/or social credentials. Increased consumption of Fairtrade, vegetarian and vegan products are examples of this in the food and drink industry. The Ethical Consumer Markets Report 2021 found a 24% increase in UK ethical consumer spending and finance from 2019 to 2020, rising to a record £122bn, underlining the huge growth opportunity.

As a member of the FCA's DLAG, we are supporting the FCA's ongoing efforts to develop a sustainable finance labelling system, which should enable individuals (either directly, or through fund managers) to more accurately align their investments with environmental and/or social priorities. This includes **the creation of an 'impact' label**, which we believe can protect market integrity, improve communication between investment managers and consumers, and further underline the UK's leadership role in impact investing worldwide. We welcomed the FCA's proposal that the impact label should be applicable to both listed and private market investments (CP22/20).

Our research and engagement with UK financial services firms and policy makers was used by government in their design of the UK's inaugural, award-winning green gilt, the first in the world to report on social co-benefits, worth £16bn so far. We welcomed the **inclusion of a green, retail NS&I**

bond, allowing retail investors to align with the UK's climate and environmental objectives, while supporting projects which benefitted people and communities across the country. **We would encourage continuous development and support of such financial products, including the integration of investment in and reporting of social co-benefits.**

In August 2022, we responded to the Pension Dashboards Programme's call for input on the design standards for qualifying Pensions Dashboard Services. We welcome the introduction of Pensions Dashboards and believe the programme presents an opportunity to better **enable individuals to align their savings with desired social and environmental outcomes**, thereby benefitting people and the planet as well as delivering a healthy pension in retirement. To this end, our recommendations for the dashboard centred around four key areas: promoting financial literacy; the accessibility of investment data; facilitating investor engagement and selection; and incorporating impact certification and sustainability information as standards develop.

5. COMMUNITY VOICE

This section responds to Question 28: Are there any other implications of net zero or specific decarbonisation projects for… [a local community] that the Review should consider?

5.1 A community-led approach to investing in places

The engagement of local communities is key to ensuring that any investment in decarbonisation projects in a place by financial institutions is not only viable but as beneficial as it can be to that specific local community. Local authorities can play an important role in supporting the mobilisation of private and public investment, whilst also meeting local priorities by **articulating clear development priorities** to financial institutions; **committing resources to engagement with private sector partners**; and **ensuring the involvement of local people** at all stages.

Investors are also key to successful, community-led, place-based impact investments. Once such example is the English Cities Fund (ECF), a national development company based on partnership, focusing on sustainable place-making in disadvantaged areas to create opportunities for growth and development. In 2009, it partnered with Salford City Council to deliver a £1bn commercial and residential development project. Throughout, the ECF sought to be reflective of local needs and expectations, embracing this is critical to the economic viability and performance of the project. It worked with the Social Value Portal, University of Salford and Salford City council to develop a Social Value Development Framework and Social Delivery Strategy at the outset, in order to measure, monitor and report on local outcomes.

Our Impact Taskforce report outlined the **importance of community voice in a Just Transition Companies' transition plans must recognise the need for community voice, as should any underlying business and investment activity**. This is particularly crucial in infrastructure and real estate asset classes, which are typically grounded in local communities. Examples of community voice in action include: consideration of impacted workers and communities (internally and externally) within decision-making frameworks; dialogue with employees from across the organisation on the design and delivery of the plan; employee engagement, for example, worker satisfaction surveys/grievance policies; engagement with external representatives, such as business and trade unions; engagement with local stakeholders, particularly marginalised and deeply impacted stakeholders and community representatives; community representation on an advisory committee, panel or board; survey instruments or focus group surveys to gather end feedback; renewals data, for example, for insurance contracts; leadership with ‘lived experience’; and a community liaison officer or representative.