Aldersgate Group response: Financial Services Growth & Competitiveness Strategy

November 2024

Background

The Aldersgate Group represents an alliance of major businesses, academic institutions and civil society organisations which drives action for a competitive and environmentally sustainable UK economy.[1] Our corporate members represent all major sectors of the economy, and include Associated British Ports, Aviva Investors, BT, CEMEX, the John Lewis Partnership, Johnson Matthey, Michelin, Nestlé, Siemens, SUEZ, Tesco, and Willmott Dixon. Aldersgate Group members believe that ambitious environmental policies make clear economic sense for the UK, and we work closely with members when developing our independent policy positions.

You can find the consultation, along with the full list of questions, here: https://assets.publishing.service.gov.uk/media/6735f4670b168c11ea82311d/Financial_Services_Growth___Competitveness_Strategy_-_Call_for_Evidence_.pdf

Questions

3.1 Do you agree with the proposed objectives set out in paragraph 3.6?

Yes, we agree with the proposed objectives of the 10-year Financial Services Growth and Competitiveness Strategy, with one important clarification.

The objective of retaining the UK's position as a "world leading sustainable finance centre" should not only be focused on the volume of green capital raised, but also on the reduction of financed emissions and nature-negative finance flows over time. The UN Environment Programme, for example, has estimated global nature-negative finance flows from private sources to be $5 trillion per year, 140 times larger than tracked private investment in nature-based solutions.[2]

As we have previously argued in relation to the government's modern Industrial Strategy,[3] decarbonisation must be positioned at the centre of the Financial Services Growth and Competitiveness Strategy. In the future, all finance will be sustainable finance.

3.3 What do you consider to be the most important trends or changes likely to affect the financial services industry over the next 10 years?

One of the most important trends over the next 10 years is the global transition to net zero.

[1] Individual recommendations cannot be attributed to any single member and the Aldersgate Group takes full responsibility for the views expressed.
[2] UNEP, 2023, State of Finance for Nature 2023
[3] Aldersgate Group, 2024, Placing Decarbonisation at the Heart of Industrial Strategy

The transition to net zero will require a significant mobilisation and reallocation of capital. According to McKinsey, capital spending on physical assets for energy and land-use systems will need to increase to $9.2 trillion annually. This includes $3.5 billion of new spending on low-emissions assets and enabling infrastructure as well as $1 trillion of spending reallocated from high- to low- emissions assets.[4]

The financial services industry will have a critical role in facilitating the transition to net zero, through underwriting, lending capital, and investing in low-carbon technologies and sectors, and is well placed to capitalise on it. Low-carbon financial services in the UK are estimated to generate an export opportunity of £7.5 billion per year in 2030, rising to £17 billion per year by 2050.[5]

The transition, however, will also pose systemic risks to the financial services industry which will need to be mitigated. The shift away from a carbon-based economy, for example, risks stranding a large number of assets, particularly in the oil and gas sector. More broadly, climate change and nature-loss pose material financial risks to financial services and the wider economy. Research by the Green Finance Institute has found that the deterioration of the UK's natural environment could lead to an estimated 12% loss to GDP. This is equivalent to wiping around £150-300 billion off GDP.[6]

4.6 What is your assessment of the UK's current regulatory environment?

The UK government has made steady progress in developing a first-in-class sustainable finance regulatory framework. This includes becoming the first G20 country to mandate Task Force on Climate-Related Financial Disclosures (TCFD)-aligned disclosures, supporting the creation of a gold standard for private sector climate transition plans through the Transition Plan Taskforce, and setting out a process for endorsing and adopting the ISSBs standards through the UK Sustainability Disclosure Standards.

Whilst there has been progress in these transparency-based initiatives, there has been limited progress to date in embedding climate and nature-related financial risk within financial regulation. As the Aldersgate Group has previously set out, regulators (like the FCA and PRA) have taken initial steps to integrate climate and nature-related financial risk management into their policymaking, but greater attention is required to more comprehensively address environmental risks and support the government's net zero objective.[7] The Bank of England, for example, does not yet formalised rigorous stress-resting exercises that incorporate climate scenarios and there are very few policies integrating climate (and nature) risk into the relevant rulebooks for solvency and liquidity.

4.11 What is your assessment of the UK's ability to effectively upskill and reskill domestic workers for roles in the financial services sector?

[4] McKinsey & Company, 2022, The net-zero transition: What it would cost, what it could bring
[5] Social Market Foundation, 2022, Financial services and net zero: Seizing the opportunity
[6] Green Finance Institute, 2024, Assessing the materiality of nature-related financial risks for the UK
[7] Aldersgate Group, 2023, Managing climate risk: The role of financial regulators in the net zero transition

As is the case in other economic sectors, skills gaps in the financial services sector are impacting productivity, growth, and competitiveness.

Research by PwC, in partnership with the Aldersgate Group and the Financial Services Skills Commission has found the demand for green skills is quickly outpacing supply. Between 2019/2020 and 2022/3, the percentage of green job vacancies out of total job vacancies in the sector grew from 0.25% (4,900 jobs) to 2.2% (16,700 jobs).[8] Given the scale of green investment needed, in the UK and globally, the demand for green skills is expected to accelerate further still.

Graduates alone will not be able to fill the green skills gap within the financial services sector. In 2022, approximately 11,500 graduates were recruited into the financial sector and only about 900 of those graduates will have a sustainability related degree. Since 80% of the expected workforce in 2030 is already in the workforce now, upskilling and reskilling is urgently needed.

There are examples of financial services firms upskilling and reskilling their workforce to support their net zero ambitions. Lloyds Banking Group has partnered with the Cambridge Institute for Sustainability Leadership (CISL) to provide green upskilling for its employees. By the end of 2022, all 60,000 staff had completed a sustainability foundation level training programme covering the Group's net zero ambition and strategy. In addition, more tailored and in-depth programmes have been developed for specialists on sector-specific matters such as the impacts of the transition on the agricultural sector, as well as for the Responsible Business Committee and Group Executive Committee.

The UK government and regulators can further support the financial services sector to upskill and reskill domestic workers by providing further clarity on the skills that will be needed to capitalise on future trends (e.g., the net zero transition and digitalisation). One example of international good practice the UK could draw from is Singapore. To support Singapore's target of becoming a 'leading centre for green finance and services to facilitate Asia's transition to a low-carbon and sustainable future', its central bank (the Monetary Authority of Singapore) worked with the Institute of Banking and Finance Singapore to identify 12 technical skills and competences – including natural capital management, green lending instrument structuring, and sustainability reporting – needed for finance professions to perform various roles in sustainable finance.

Like Singapore, the UK government and regulators should look to work closely with industry and professional bodies – such as the Sustainable Finance Education Charter – to provide them with a strong sense of direction on the skills and competencies needed for the future economy.

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[8] PwC, in partnership with the Financial Services Skills Commission and the Aldersgate Group, 2023, [Job greening in the UK Financial Services Sector]

5.5 In the UK's sustainable finance framework, as set out in the Chancellor's Mansion House package, do you see barriers or gaps that would support the growth and competitiveness of the UK sustainable finance market?

The Aldersgate Group was encouraged by the sustainable finance framework, as set out in the Chancellor's recent Mansion House package. Together, we think these measures will help mitigate greenwashing risks, provide much-needed transparency, and equip both investors and corporates with consistent, comparable information to embed climate considerations into their decision-making.

We believe there is a gap within the sustainable finance framework on nature and biodiversity-related issues. While the publication of a set of principles for voluntary carbon and nature markets integrity is welcome, greater policy measures are needed to help integrate nature within financial and business decisions. The Aldersgate Group has previously called for the government to set out an iterative roadmap towards mandatory Taskforce on Nature-related Financial Disclosures (TNFD).[9] We believe mandatory TNFD disclosures will enable corporates to identify and drive action on nature-related risks, opportunities, impacts, and dependencies, and support financial institutions to shift towards nature-positive capital allocation decisions. The 2023 Green Finance Strategy committed to "explore how best the final TNFD framework should be incorporated into UK policy and legislative architecture", but there has been little development since.

More broadly, a barrier preventing the growth and competitiveness of the UK sustainable finance market is the lack of long-term policy certainty about the real economy transition. As set out in the Transition Finance Market Review,[10] "finance follows incentives in the real economy, as that is what drives the perception of future returns." The UK government can help scale the sustainable finance market by providing long-term policy and regulatory certainty, through the publication of clear sectoral decarbonisation pathways, and by strategically deploying public funds and public financial institutions to de-risk investment into emerging sectors and technologies.

The forthcoming Industrial Strategy, updated Net Zero Strategy, Clean Power Plan, and Industrial Decarbonisation Strategy are all important upcoming policies to provide the sustainable finance market with greater clarity. The government should consider how to best communicate with financial services sector to ensure the range of policies are well understood to further increase confidence in the sector to invest and grow.

5.6 What do you think should be the UK's priority when engaging with the global sustainable finance agenda, both bilaterally and at a multilateral level?

The UK's priority should be driving harmonisation of the sustainability disclosure landscape.

Financial markets are global in nature and businesses operate across borders and jurisdictions. The fragmented landscape of sustainability reporting, comprising of both

[9] Aldersgate Group, 2024, Redirecting finance to nature: The case for mandatory TNFD-aligned disclosures
[10] TFMR, 2024, Scaling Transition Finance: Findings of the Transition Finance Market Review

voluntary standards and growing mandatory requirements, adds cost, complexity, and risk for companies and investors – restricting the international flow of capital.

The government's continued support of the UK Sustainability Reporting Standards, which will be based upon the ISSB's global sustainability disclosure standards, is positive. Supporting the adoption of the ISSB's standards as a global norm, in line with other jurisdictions such as Australia, Brazil, China, South Korea, Kenya, and others, will help to advance the harmonisation of the sustainability disclosure landscape. According to the ISSB, nearly 55% of global GDP and over half of global greenhouse gas emissions are now represented by ISSB.[11]

The UK should also look to continue to support transition plans internationally, including through the promotion of the Transition Plan Taskforce's Disclosure Framework as a 'gold standard' that other jurisdictions can draw upon. In a similar vein, the UK should continue to champion the TNFD framework. The UK was the first government to fund and fully support the creation and progress of the TNFD and, at COP28, announced £2 million of funding to support the uptake of the TNFD recommendations. As with TCFD, the Aldersgate Group would like to see the UK demonstrate global leadership by becoming the first G20 country to mandate TNFD-aligned disclosures – starting with the UK's largest companies and financial institutions.

5.7 What are the opportunities and barriers for the financial services sector in developing the products and/or services necessary to facilitate investment into the net zero transition?

The net zero transition offers the financial services sector a substantial commercial opportunity. As the world's largest net exporter of financial services, the UK is well-placed to take up the opportunity as the demand grows for green and transition finance-related products and services. It is estimated that low-carbon financial services in the UK could generate an export opportunity of £7.5 billion per year in 2030, rising to £17 billion per year by 2050.[12]

There are several barriers preventing the financial services sector developing the protects and services necessary to facilitate investment into the net zero transition.

First, there is a lack of demand for green financial products and services. Green mortgage products, for example, which aim to incentivise homeowners to invest in and improve the energy efficiency of their homes, have experienced limited uptake since major UK mortgage lenders first offered them in 2018. Research commissioned by the Department for Energy Security and Net Zero identified several barriers related to stimulating demand for green home finance including limited awareness of retrofit measures available, poor understanding of the benefits of investing, an unwillingness to take on additional debt, and a lack of innovation by financial institutions because of

[11] IFRS, 2024, ISSB delivers further harmonisation of the sustainability disclosure landscape as it embarks on new work plan

[12] Social Market Foundation, 2022, Financial services and net zero: Seizing the opportunity

uncertainty of consumer demand and future government policies. [13] Here, the government can help stimulate demand for low-carbon financial products and services by creating a supportive policy environment and strategically deploying public finance and blended finance solutions through public financial institutions (such as the National Wealth Fund) to de-risk investment into emerging sectors and technologies. The government should consider how to best to communicate with firms on the range of policies set out in the forthcoming strategy documents (such as the updated Net Zero Strategy and Clean Power Plan) to increase confidence in the sector to invest and grow.

Second, the risk of greenwashing – both actual and perceived – is preventing financial services firms from developing and offering products and services. This is a particularly significant problem for financing activities or entities aimed at decarbonising high-emitting sectors (otherwise known as 'transition finance'). Sustainability-linked financial instruments, such as sustainability-linked loans and sustainability-linked bonds, have seen a sharp drop in issuance in recent years largely as a result of greenwashing concerns. According to Bloomberg, sustainability-linked loan issuance fell by 56% in 2023 and fell by 74% in the first quarter of this year. [14] The government can help to support financial services firms to scale up the provision of transition finance by reducing the risk of greenwashing. Improving the transparency and accessibility of reporting and disclosure through the UK's Sustainability Disclosure Standards, for example, will help to mitigate greenwashing risks. There is also a strong value case for a UK green taxonomy, which will help financial institutions and corporates to identify economic activities which are environmentally sustainable, as well as those which are 'transitional'.

Finally, skills gaps in the financial services sector are acting as a barrier to the development of innovative financial products and services (see answer to 4.11). According to a Chartered Banker survey of UK financial services firms, 'transition finance' and 'natural capital markets' are considered to be the largest skills gaps. [15]

[13] Department for Energy Security and Net Zero, 2024, Green Home Finance: Expert Analysis from a Behavioural Perspective
[14] Bloomberg, 2024, A $1.5 Trillion ESG Debt Market Has Started Bleeding Clients
[15] Chartered Banker, 2023, State of the nation – building green and sustainable finance capacity and capability in UK financial services