Institute and Faculty of Actuaries

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Possible Future Inquiries – IFoA response to the Environmental Audit Committee.

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Key points

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The IFoA welcomes the Committee's call for evidence to assist prioritising its programme of work. The Committee's remit touches on a number of areas relevant to the work of actuaries and the sectors they work in – including Green Finance and Investment. As such, we believe it would be beneficial for the Committee to deliver a follow up inquiry on progress made since the 2018 Green Finance inquiry. We have outlined below two key issues which we believe the inquiry should focus on to ensure progress on Government policy is made.

Should you want to discuss any of the points raised please contact Faye Alessandrello, Policy Manager (Faye.Alessandrello@actuaries.org.uk) in the first instance.

Improved climate-related financial disclosures

1. There were two strands of the inquiry, 'Greening Finance: embedding sustainability in financial decision making' and 'Green finance: mobilising investment in clean energy and sustainable development'.

2. Government has actioned a number of recommendations from the Greening Finance strand. Examples include the Department for Work and Pensions (DWP) 2018 amendments to legislation to provide greater clarity around requirements for pension trustees to consider climate-related financial risk, as well as the Governments publication of its Green Finance Strategy last year.[1][2]

3. Effective and thoughtful disclosure is essential to understanding the financial risks of climate change. However corporate disclosures currently fail to provide sufficiently comprehensive and consistent information for the purposes of informing investment decisions. Public disclosures should clearly inform customers of both a company's business approach and management of operational risks.

4. The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) provide a framework for companies to deliver such forward-looking disclosures. Using frameworks such as TCFD, we believe firms can develop an understanding of good practice with respect to climate change risk disclosure over the next few years.

5. Disclosures are currently voluntary and we are starting to see examples of good-practice emerging within the sector, for example, Aviva's Climate-Related Financial Disclosure, which their actuarial team were heavily involved in developing, undertook analysis using their Climate Value at Risk measure to enable them to more fulsomely assess the potential business impacts of climate-related risks and opportunities.[3] We note there has been a rapid increase in expectations and demands, as well as efforts to clarify their expectations of firms, by financial regulators and the Government over the past 12 months. This includes DWP's facilitation of the Pensions Climate Risk Industry Group (PCRIG) to develop guidance for pension trustees about assessing and disclosing their exposure to climate-related financial risk.

6. Introducing mandatory requirements will raise the standard of reporting over time as once the requirement is compulsory, regulators can then make steps to improve the framework. Requirements should become mandatory for firms, at least on a 'comply or explain' basis, within the next 5 years. This echoes commitments of the Green Finance Strategy and we would encourage steps to be made to ensure this is reached. We note that progress has recently been made in the pensions sector. During the committee stage of the Pensions Schemes Bill, the Government introduced new Clauses 73, 81 and 98 which would impose requirements on trustees and managers of certain occupational pension schemes to make climate-related financial disclosures. [4]

7. Mandatory TCFD reporting would also open the gateway for reporting against other, broader metrics including non-financial data. This would promote a more holistic way of thinking about the issue, one which considers this social impacts as well.

Policy clarity about green technologies

8. The Green Finance strand of the 2018 inquiry focused on mobilising finance to invest in green technologies and technologies that would bring about the transition to a low carbon economy. This is something we considered in our response to the Treasury Select Committee's inquiry into green finance and

[1] https://www.actuaries.org.uk/system/files/field/document/07-16%20IFoA%20response%20to%20DWP%20Pension%20trustees-%20clarifying%20and%20strengthenin.._.pdf
[2] https://www.gov.uk/government/publications/green-finance-strategy
[3] https://www.aviva.com/social-purpose/climate-related-financial-disclosure/
[4] https://publications.parliament.uk/pa/bills/lbill/58-01/004/5801004-I.pdf

decarbonisation of the UK economy, when considering the barriers to the growth of green finance in the UK.

9. We believe that one of the greatest barriers to the growth of the green finance market is a lack of policy clarity for investors. This includes a lack of consistency in messaging about how the Government views climate change, for example, announcing a climate emergency is inconsistent with approving plans to expand on a third runway at Heathrow. It also includes a lack of clarity from Government about which green technology and solutions it plans to support the scaling up of, and also provide subsidies for as a result. Inconsistency and lack of clarity present a concern for investors and will likely act as a barrier to considering green products, as there is unlikely to be any certainty that a good rate of return can be achieved.

10. Commitments within the Green Finance Strategy spoke to the recommendations in the 'Green Finance' strand. However, while the Strategy mentioned a number of ways it would look to support the funding of new technologies, it was not forthcoming about what these strategies were. For example, the Strategy included a commitment to establishing a clean growth venture capital fund to be invested on commercial terms in UK companies seeking to commercialise promising technologies.

11. Greater clarity around which technologies will be funded will also promote investment by private finance. A survey conducted by pensions consultant LCP, found that most people want their pension fund to invest across a range of environmental, social and governance (ESG) factors, with roughly 75 per cent responding that they want their pension fund to care about the environment. However, despite savers preferences for responsible investing, default funds, which staff are automatically opted into by employers, do not yet reflect this.[5] A significant amount of capital is invested in default funds. Scottish Widows Pension Portfolio Two Series 2 Pension Fund is one of the largest default fund in the UK. As of March 31 this year, it had a fund size, or assets under management, of £13.93billion.[6] Providing policy clarity around green technologies will increase the likelihood that they will increasingly be viewed as safe investments to be selected by fund managers for inclusion in default funds. This will support this capital being directed toward green products and have a transformative impact in the decarbonisation of the UK economy. It will also support greater alignment between investment and savers preferences. In the meantime, an opportunity exists for the Government to encourage pension savers to greater engage with their pension savings and where they are invested.

12. We are pleased that the Government has taken steps recently to articulate that addressing climate risk is an important priority. This could be further bolstered if the Government provides clarity around which technologies it will be supporting. The inquiry could seek to provide clarity around particular ones might be best for the UK Government to back and scale up.

13. A focus on these key issues is timely given the commitments made in the recent Budget announcement around the Government's promise to 'deliver green growth and protect the environment'. In particular the commitment of £10 m to support the design and delivery of net-zero policies and programmes. This inquiry could support the Government in making decisions about where this funding goes and then provide this clarity to investors. We note the Budget also committed to an £800m carbon capture and storage infrastructure fund. It would be good to have the same clarity around mitigation strategies as has been provided around adaptation strategies.

14. Finally, the Committee should consider how it can work in collaboration with other committees in the Green Finance area. This would have the added effect of providing consistency in the recommendations provided to Government, in a strong, collective voice. We note it would naturally fit with the Environmental Audit

[5] https://www.lcp.uk.com/our-viewpoint/2019/03/changing-the-world-one-investment-at-a-time/

[6] https://markets.ft.com/data/funds/tearsheet/summary?s=GB00B09CD637:GBP

Committee's prior Green Finance inquiry, and the Treasury Committee's current inquiry into decarbonisation of the UK economy and green finance.