PRI RESPONSE

UK TRANSITION FINANCE MARKET REVIEW

April 2024

To inform this briefing, the following investor group has been consulted: PRI Regional Policy Reference Group for the UK. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing.

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ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the Transition Finance Market Review's call for feedback on how the UK can become a market leader on the transition.

ABOUT THIS CONSULTATION

The Transition Finance Market Review was commissioned by HM Treasury (HMT) and the Department for Energy Security and Net Zero (DESNZ), following the 2023 Green Finance Strategy. The Transition Finance Market Review will consider what the UK financial and professional services ecosystem needs to do to become a leading provider of transition financial services and innovative instruments on the pathway to net zero by 2050. It will consider areas most impactful to create the conditions for scaling transition focused capital raising, maximising the opportunity for UK-based financial services, and positioning the UK's financial services ecosystem as a global hub supporting this innovative activity. The call for evidence is intended to engage stakeholders and will inform the Review's recommendations.

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KEY RECOMMENDATIONS

The PRI welcomes the Transition Finance Market Review as an opportunity to explore how the UK can become a market leader on the transition. The Review seeks to strike a balance between being both **ambitious and fit for purpose**, looking into cross-cutting tools and instruments. The focus on principles that drive credibility and integrity, and a supporting ecosystem to scale the application of solutions, and how these are best implemented is also encouraged.

The PRI's key recommendations include:

- taking a **whole-of-government approach** to the transition, including, backed by sectoral roadmaps with clear pathways to decarbonisation and an investment strategy with time-bound commitments and incentives to crowd-in private finance;
- implementing **wider sustainable finance policies and standards**, such as mandatory transition plan disclosure requirements and a robust, evidence-based sustainable taxonomy, in a coordinated manner with clear timelines for delivery;
- as a crucial lever to build markets for solutions and enable finance for the transition, **blended finance solutions** should be scaled up to create a strong set of incentives, clarity, and help de-risk investments in low-carbon technologies; and
- **maintain ambition** on areas where the UK already sets a strong standard on transition planning globally, through climate legislation and regulation, cross-sector collaboration, and good practice on stewardship and governance.

Given the scope of the Review, the PRI's response will explore the following issues:

- the scope of transition finance;
- links to broader sustainable finance tools;
- barriers to transition finance;
- opportunities on transition finance; and
- global leadership.

DETAILED RESPONSE

SECTION 1: SCOPE OF TRANSITION FINANCE

This section will cover PRI's response to Questions 1, 3, 4, 5, 6, 7, 9.

The Review will explore where additional clarity on the scope of transition finance is needed to address market and stakeholder concerns. The call for evidence seeks input on developing the definition of transition finance. It also asks for views on what sectors of the economy, types of financed activity and financial products and services, should be considered transition finance.

Given the scope of an economy-wide application of transition finance, it is important to avoid creating perverse incentives and unintended consequences, such as negating the importance of issues such as social impacts and nature. To this end, our response will focus on the following elements:

- the overarching definition of transition finance;
- ensuring a whole of government approach; and
- the inclusion of broader sustainability issues.

Definition of transition finance

The transition to a sustainable and equitable economy that benefits both economic growth and natural and social systems has become an increasingly urgent policy objective in many countries and within international forums.

The term "transition finance" should be understood more consistently by the financial ecosystem for it to be deployed effectively, and a high-level description would provide clear direction to policies and to delivery of transition finance, ensuring credibility and global alignment. Given the extensive work carried out on definitions of sustainability-related terms, this should remain a high-level effort for clarification.

For the purpose of this call for evidence, the PRI understands transition finance as encompassing all finance that contributes to the economic transition. As described in our Investing for the economic transition report, "the economic transition is the process by which the economy is transformed from its current extractive and unsustainable state to one that is sustainable and equitable, and that benefits both the economy and natural and social systems."

Given that the Financial Conduct Authority's (FCA) anti-greenwashing rule comes into force on 31 May 2024, there could be an additional burden on investors to demonstrate that "transition finance" is not misleading. Therefore, we recommend that the Transition Finance Market Review support a **broad, principles-based, government-backed definition** of transition finance.

A whole-of-government approach

Investors' net zero commitments and transition plans are contingent on a **clear and enabling policy framework.** A whole-of-government approach to the transition is required to guide the financial sector.

To support this work, the PRI has developed a [conceptual framework] for a whole-of-government approach, summarised below.

- **The economic transition must be a central goal of public policy.** This must be backed up by governance structures, notably through allocating cabinet or ministerial responsibility for the economic transition and making the transition an integral part of the statutory mandates of regulatory and oversight bodies and agencies.
- **Governments must adopt national transition plans** that are informed by science and international norms. They should include short-, medium- and long-term sustainability targets and define resource allocation. The specific details of each plan and its implementation will depend on a series of factors, including economic context, economic structure, political and institutional capacity and expertise, the sources and types of finance available to the country, domestic economic, social and environmental priorities, and the nature of the relationships between the various actors involved in the policy development and implementation processes.
- **The economic transition requires all major areas of government policy to be aligned.** Specifically, the economic transition necessitates coordinated and integrated action across three levers: addressing economic externalities, incentivising markets for solutions, and enabling finance to support the transition. This is elaborated further in Section 4.
- **Public and private finance to enable the transition**: This will require policy makers to provide policy certainty over the short, medium and long term, remove barriers to private finance, remove perverse incentives, set up green development banks, and support the private sector with concessional finance, grants, guarantees and other risk-sharing instruments, long-term credit lines and investment guidelines. In acknowledging the importance of private finance, it is also necessary to be realistic about the role that private finance can play. There are likely to be areas where there is no business case for action, where costs significantly outweigh benefits, or where the benefits accrue to actors other than those making the investment.
- **International collaboration to complement national transition policy reform**. While domestic legislation is the critical determinant of the level of capital flows into the economic transition, rules-based international regimes supported by governments are critically important to global capital markets. There are various reasons for this: international regimes are seen as important signals of intent and as providing a higher level of certainty that government commitments will be delivered; they can enable governments to work together, helping to address the reluctance of individual governments to act in a way that may undermine national competitiveness; and they can create the rules and markets necessary to incentivise private sector investment. In addition, collaboration across markets on transition policy will be essential to avoid fragmentation and costly competition between governments.

- **Monitoring and review processes.** There is much that we do not know about the economic transition. Priorities may change. Technologies that do not exist today may be developed. The relative economics (the cost curves) of technologies and solutions will change over time. In addition, our understanding of policy interventions – what is needed, what works, what doesn't work, what the costs are – will further develop. Robust and regular monitoring is critical to ensure that the policy interventions adopted are meeting their goals, and to ensure that the spillover and knock-on effects – whether social, environmental or economic, relating to processes and institutions or to outcomes and impacts – are identified and addressed by policy review processes. These processes should not only consider performance against defined short-, medium- and long-term goals, but should also consider the effectiveness of actions taken, the factors that have shaped or influenced performance, and changes in the political, economic, social and environmental context of the country (which may shape the types of policy interventions that can be adopted). An important corollary to this point is that policy makers need to retain the flexibility to change course if policy is not as effective as it needs to be or if the social, environmental or economic impacts are not acceptable. This need for flexibility may, at times, conflict with the demand from investors for policy certainty.

The PRI recommends that the UK government take forward these elements of a whole-of-government approach to support the transition of the economy.

Broader sustainability issues

The transition should not be solely focused on climate but seek to tackle wider sustainability issues as well. Climate change and environmental degradation are widely recognised as some of the most pressing threats to humanity's future. The economic transition may also have negative social and human rights implications, including by increasing pressure on employment in high-emitting sectors and critical raw material value chains.[1] Moreover, the economic transition may directly affect socio-economic factors such as extreme inequalities, posing systemic risks that should not be ignored.[2]

To this end, **broader sustainability issues should be fully integrated into a whole-of-government approach to the economic transition**, extending beyond financial policy to include a wider range of issues and policy tools. Policymaking never occurs in a vacuum, and the success of the transition will therefore hinge on the full integration of broader sustainability issues into its design.

Policy interventions in the real economy are also urgently required. These should ensure that the economic transition does not exacerbate inequalities by building support across the whole of society. They may also include fiscal policy interventions and should be part of a coordinated, whole-of-government approach to the transition.

Consultation with affected stakeholders (such as communities, workers along the value chains, and consumers of companies' products or services) should be at the centre of these interventions. To limit

[1] World Economic Forum, [Global Risks Report 2024.]

[2] UNDP (2023) [From fragmentation to integration: Embedding Social Issues in Sustainable Finance]

and, where possible, contribute to reducing regional disparities, a focus should be kept on the spatial and place-based dimensions of the transition.[3]

[3] PRI, Investing for the economic transition: the case for whole-of-government policy reform, (2023) See page 6 for key elements of the just transition.

SECTION 2: LINKS TO BROADER SUSTAINABLE FINANCE TOOLS

This section will cover the PRI's response to Questions 10, 11, 12, 15.

The call for evidence focuses on core environmental credibility and integrity, particularly in relation to the growing number of broader frameworks, guidelines, or other tools for classifying sustainable and transition finance. The questions explore key benefits and challenges of international alignment and interoperability for transition finance standards and frameworks.

To support the transition and underpin the objective of maintaining the credibility and integrity of transition finance, it is crucial that **wider sustainable finance policies and standards**, such as transition plan requirements, taxonomies, and disclosure requirements are developed in a coordinated manner. This is key to ensuring that investors have the **information and tools** needed to transition, rather than just guidance, which will ultimately enable the transition to accelerate more comprehensively across the wider economy.[4]

The sections below detail the role of different sustainable finance policies and standards in accelerating transition finance; a UK Green Taxonomy as a performance benchmark on what economic activities can be considered green; a credible transition plan framework to detail short- medium- and long-term actions on how companies and financial institutions will transition; and harmonisation with broader frameworks to achieve global alignment.

Alignment with a UK Green Taxonomy

The PRI has called for the development of a **robust, evidence-based sustainable taxonomy** to support the acceleration of the transition. A UK Green Taxonomy will offer greater transparency on the alignment of economic activities with the UK's climate objectives.[5]

As the PRI and World Bank's Policy Toolkit on Taxonomies of Sustainable Economic Activities highlights, a well-designed, effectively implemented sustainable finance taxonomy can help investors plan and report on a transition towards sustainability by setting the **objectives and direction of travel** for different economic activities. For example, the ASEAN Taxonomy for Sustainable Finance is used as a tool for transition for high emission sectors and a tool for providing access to funding for sustainable projects, assets, and activities.[6]

The GTAG paper Applying the UK Green Taxonomy to wider policies explores how various policy tools can be used to boost transition finance flows. As per GTAG's advice, current and planned taxonomy-alignment and eligibility should be a key component in the developing transition plans framework.[7]

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[4] PRI response to the FCA's anti-greenwashing guidance consultation (2024)

[5] PRI's response to the FCA's Sustainability Disclosure Requirements (SDR) and investment labels consultation (2022)

[6] PRI and World Bank, Policy Toolkit on Taxonomies of Sustainable Economic Activities (2022)

[7] GTAG, Applying the UK Green Taxonomy to wider policies: the value case and options (2023).

In developing an approach to implement the UK Green Taxonomy, the UK government should consider whether an **extended taxonomy,** encompassing activities that can be classed as transition activities, should be implemented, either immediately or in a second phase. This could increase transparency over transitioning economic activities, allowing a more detailed breakdown of how companies are implementing their transition plans by allocating capital to transitioning their economic activities. By increasing transparency over what counts as a transitional activity, an extended taxonomy could increase the **robustness of transition finance products**, addressing concerns that transition finance will simply enable business as usual investment.[8]

The Monetary Authority of Singapore (MAS) has launched a multi-sector transition taxonomy, which sets out detailed thresholds and criteria for defining green and transition activities and recognises the role that certain economic activities have in the energy transition, without having to label them as inherently sustainable or green activities.[9] Defining credible transition thresholds is particularly important for hard-to-abate sectors that have a more challenging pathway to meet a 1.5°C aligned outcome.

Whilst a taxonomy is a useful tool, it cannot enable the transition to a sustainable economy on its own and should be developed in parallel to other instruments (i.e. sectoral roadmaps and corporate transition plans) to ensure a coordinated and effective approach, as well as interact with other policy instruments such as stewardship and broader disclosure requirements.[10]

Alignment with credible transition plans

Good quality transition plans, aligned with the Transition Plan Taskforce's (TPT) disclosure framework, will play an important part in securing increased provisions of transition finance. A credible transition plan should be actionable, measurable, focused on the near term, based on climate science, and there should be accountability and appropriate transparency against this plan.[11]

Transition plans should not be a standalone output, they should build upon existing reporting frameworks. They should be used as both a strategic tool and a practical action plan, setting a precedent for accountability and the necessary steps in the journey towards a net zero economy. The PRI supports strengthening the connection between the **strategic ambition of transition plans with achieving real economy outcomes** by making it explicit that entities should consider how their actions and the metrics and targets contribute to limiting global warming to 1.5°.[12] Here, the interaction between corporate transition plans and real economy transition plans can enhance the consistency and effectiveness of transition plans overall.

[8] GTAG, Developing a UK taxonomy adapted to the UK's needs in the short and medium term (2023)

[9] Monetary Authority of Singapore (MAS) Press Release: MAS Launches World's First Multi-Sector Transition Taxonomy (2023). PRI response Singapore Green Finance Industry Taskforce consultation on a Green and Transition Taxonomy (2023)

[10] PRI's response to the Australian Treasury's consultation on Australia's Sustainable Finance Strategy (2023)

[11] PRI response to Transition Plan Taskforce: A sector-neutral framework for private sector transition plans. (2022)

[12] PRI response to Transition Plan Taskforce: A sector-neutral framework for private sector transition plans. (2022)

Given that transition finance relies on **forward-looking climate commitments** by companies, actionable, practical, and credible transition plans can be used as a tool to mobilise sustainable investment. This is likely to increase the provision of transition finance, as investors will be able to understand the climate risks and opportunities that companies are exposed to and make investment decisions based on this information.

The Transition Finance Market Review can play a role in driving forward the TPT's outputs, ensuring that they are fully operationalised in the UK's financial ecosystem.

Ultimately, investors' role in the transition is contingent on a **clear and enabling policy framework** that guide and signal the financial sector to not only reduce their financed emissions, but also finance greater emission reductions in the transition. Net zero transition plans should not be seen as a substitute for effective sectoral policies, nor should the responsibility and accountability of creating such an enabling policy environment be entirely delegated to the private sector. Concerted efforts are needed from both public and private sectors for an orderly and equitable transition.

Alignment with broader frameworks[13]

In a global economy, alignment across jurisdictions is an operational imperative. To ensure the UK remains an attractive place for transition finance, alignment with broader frameworks should be sought to promote internationally coherent solutions, share best practices, and avoid market fragmentation. To scale up transition finance, **clarity and harmonisation** should be sought by implementing consistent frameworks across the economy, building on the work of the TPT, the Green Technical Advisory Group's (GTAG) guidance on implementing a green taxonomy, and International Sustainability Standards Board (ISSB).

Relevant government departments and regulators should swiftly rollout a comprehensive and credible transition plan disclosure regime under the FCA's Sustainability Disclosure Requirements and investment labels regime (SDR) which incorporates and builds on the TPT disclosure framework requirements.[14] As highlighted in PRI and IIGCC's briefing on sustainable finance policy priorities, transition plan disclosures should move from operating on a "comply or explain" to a **mandatory basis** at the earliest possible opportunity, with adequate signposting of timelines provided. This should include the anticipated consultation on transition plans for the UK's largest companies.

More broadly, aligning UK reporting requirements to international standards offers the transparency investors need to manage climate and sustainability-related risks and opportunities. Adoption of the ISSB standards in the UK is crucial to achieve **interoperability of corporate sustainability**

[13] GFANZ identifies four strategies necessary for financing a whole economy transition to net zero, defined as financing or enabling: the development and scaling of climate solutions; assets or companies already aligned to a 1.5 pathway; assets of companies committed to transitioning in line with 1.5 aligned pathways; and the accelerated managed phaseout of high-emitting physical assets. This framework offers broad structure and clarity around the areas of financing and enabling, considering specific climate solutions as well as the complexities of transitioning hard-to-abate sectors, at a global level.

[14] IIGCC's response to the TPT's consultation on sector-neutral transition plan disclosures (2023)

disclosure requirements – promoting comparable data across investment portfolios – and to build on existing progress in reporting on sustainability-related risks and opportunities.[15]

The PRI has called for **economy-wide implementation of the ISSB Standards** across jurisdictions by 2025 at the latest.[16] We support an **endorsement mechanism** for current and future ISSB standards to become part of UK law, and continued engagement with the ISSB Jurisdictional Working Group to promote interoperability.

In the EU, the Platform on Sustainable Finance's (PSF) report on A Compendium of Market Practices looks at how the EU's sustainable finance framework can be used to support and inform the transition efforts of economic actors beyond mere regulatory compliance. This work highlights that a sustainable finance framework needs to address the challenge of **financing meaningful and credible interim steps towards the transition**. Providing tools and policies that enable market actors across the economy to finance their transition plans and reach their sustainability targets is required.

Adequately measuring companies' and investors' role, performance, and impact on sustainability matters is a crucial foundation for successfully redirecting capital to support the transition, which relies on ensuring consistent and comparable data. Through the development of transition plans, taxonomies, and wider disclosure requirements, a strong foundation of transparency can be created, serving as a framework to drive capital towards the transition.

[15] PRI's response to the FRC's call for evidence on ISSB standards (2023)

[16] PRI's response to the FRC's call for evidence on ISSB standards (2023)

SECTION 3: BARRIERS TO TRANSITION FINANCE

This section will cover PRI's response to Questions 19, 20, 21.

The call for evidence seeks input on barriers to scaling up transition finance, both globally and in the UK. This includes unintended consequences, barriers limiting access to capital or financial services for achieving net-zero transitions, and obstacles faced in providing or accessing investments, products, and services for transition finance.

The lack of a supportive policy environment to facilitate the flow of capital towards the transition is one of the main barriers to accelerating the UK's net zero transition. There are also actions that market participants can take to develop a conducive environment for transition finance. To this end, the PRI recommends addressing the following barriers in the UK to create the right framework to support transition finance flows:

- the interpretation of fiduciary duty;
- inconsistent signals from government;
- a lack of industrial strategy; and
- market practice risk measurement.

Interpretations of fiduciary duty

There are inconsistencies in the interpretation of fiduciary duty due to a lack of clarity around how fiduciary duty interacts with sustainability and climate change considerations. The 2021 report A Legal Framework for Impact, which includes extensive analysis of the UK legal framework, shows that investors are generally permitted to consider sustainability impact goals where this would contribute to their financial objectives.[17] Following on from A Legal Framework for Impact our UK specific report, UK: integrating sustainability goals across the investment industry, explores how policymakers can support investors' abilities to invest for sustainability impact. The report finds that because the UK legal framework relies on broad interpretation of regulation, which evolve through practice and precedent, the concept of financial interest is routinely narrowly construed and subject to confusion. Many UK investors remain hesitant to change their established practices and pursue sustainability impact goals, even when this is required to achieve financial objectives.[18] This can lead to shorter-term factors being prioritised, whilst sustainability issues, including the transition, considered as less relevant for investment decisions.[19]

In February 2024, the Financial Markets Law Committee published Pension Fund Trustees and Fiduciary Duties: Decision making in the context of Sustainability and the subject of climate change,

[17] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative (UNEP FI), Generation Foundation A Legal Framework for Impact: Sustainability impact in investor decision-making (2021)

[18] PRI, UNEP FI, Generation Foundation A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry (2022)

[19] Persad, Xu, Greening, Institutional investor behaviour and the energy transition: A complexity framework for accelerating sustainable finance from UK investors, *Energy Economics* (2024).

which examines the legal uncertainties surrounding the inclusion of sustainability and climate change when taking decisions as pension fund trustees. The paper **clarifies the interpretation of the law**, underscoring that sustainability issues should first be considered as a financial factor by pension fund trustees and then assessed for materiality.[20] It is also highlighted that "*it may be necessary to consider whether a strategy should reject shorter term gains because they create identifiable risks to the longer-term sustainability of investment returns in the fund*."[21]

By updating standards and guidance, policymakers can provide clarity on when investors' legal duties enable or require them to consider pursuing sustainability impact goals such as invest in the net zero transition.[22]

The FMLC paper helps to clarify uncertainties around fiduciary duty, which in turn can help to shift trustees' practices in line with sustainability risks and objectives. To facilitate this shift across the wider investor community, policymakers should integrate the findings of the FMLC paper into relevant guidance and make clear that **the requirement to consider sustainability risks encompasses an obligation to consider taking active steps to pursue sustainability impact goals** when this would help achieve financial risk/return objectives.

Guidance is required not just to understand fiduciary duties but also their application: this should address **how investors can assess sustainability risks and impacts and how to set and pursue sustainability impact goals**. Lastly to ensure that the relevant time horizons for sustainability risks and impacts are being considered, policymakers should clarify that investors **should take into account not only long-term sustainability impacts but also short- and medium-term sustainability impacts**, since these may affect financial risk and returns over a range of timescales.[23]

Consistent policy signals

Whilst incentives, tools, and frameworks are useful for the UK's transition, there is no substitute for **long-term, stable government signals**. The government needs to ensure that the policy signals it sends provides investors with confidence and certainty to invest in the growth of sectors in the long-term that will drive the UK's transition.

The UK market has seen delays on all key elements of the Green Finance Strategy. This delay fails to deliver the necessary framework and policy signals to investors. The prerequisite of a leading green financial centre is a regulatory environment that encourages and enables alignment towards net zero and sustainable economic development. This should be supported by an equally ambitious, whole-of-government approach on the economic transition.

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[20] Financial Markets and Law Committee (FMLC) Paper-Pension-Fund-Trustees-and-Fiduciary-Duties-Decision-making-in-the-context-of-Sustainability-and-the-subject-of-Climate-Change-6-February-2024.pdf (fmlc.org) (2024).

[21] PRI, UNEP FI, Generation Foundation A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry (2022)

[22] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative (UNEP FI), Generation Foundation A Legal Framework for Impact: Sustainability impact in investor decision-making (2021)

[23] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative (UNEP FI), Generation Foundation A Legal Framework for Impact: Sustainability impact in investor decision-making (2021)

In the absence of strong policy incentives and consistent, clear, and continuous signals, the capacity for industry to invest in the net zero transition will be at risk. As the PRI, IIGCC, and UKSIF wrote in our letter to the UK government, for the net zero ambition to be upheld, the starting point must be policies that transform the real economy, prioritising sectors whose transition will contribute most to the UK's economic, social and climate goals and sending the right policy signals to investors.

The role of industrial strategy

To meet the UK's legally binding climate commitments, an additional £50- 60 billion of capital will be needed each year.[24] Private finance will make up the bulk of this capital, but the government needs to **crowd-in this finance** by introducing supportive policies that can help create a pipeline of investible projects and boost supply.

To capitalise on investment opportunities, the role of government policy in creating the conditions for investment is crucial to building channels for investable projects, as demonstrated by the US' Inflation Reduction Act (IRA), the EU's subsequent Net Zero Industry Act (NZIA), or more recently Australia's Future Made in Australia Act.[25] Without a clear industrial strategy, increased asset allocation towards the UK's transition is at risk.

The Institute for Public Policy Research (IPPR), which found that a lack of a central industrial strategy in the UK is holding investors back.[26] Whilst the UK has a published a number of policy documents such as the Green Finance Strategy or Powering Up Britain, delayed implementation of policies (e.g. Sustainable Disclosure Requirements, Transition Plans, UK Green Taxonomy) and contradictory government policy decisions (including last Autumn's roll back on climate policies, delays to the Clean Heat Market Mechanism, and awarding new oil and gas licences) undermines investor confidence that carbon budgets will be met and enabling policies will be taken forward.[27]

While the government have provided some commitments to increasing investment in the UK's transition, the amounts pledged continue to fall far short of what is needed, particularly in the context of the US' IRA and the EU's NZIA.[28]

The UK's emphasis on market-based least-cost approaches to delivery of net-zero has had many successes, for example the growth of the offshore wind sector. However, the recent failure to secure offshore wind investment in the UK by failing to adapt strike prices in the 2023 CFD auction round points to the need for a more agile policy environment and engagement with the market to address investment barriers (such as rising costs of capital) faced by investors.[29] It is vital that the 2024 round secures significant additional capacity to compensate for the 2023 round's failure. Offshore wind is

[24] Climate Change Committee (CCC) Independent Assessment: The UK's Net Zero Strategy (2021)

[25] Prime Minister of Australia, A Future Made in Australia, (2024)

[26] IPPR, Making markets: The City's role in industrial strategy (2024)

[27] HM Government, PM Speech on Net Zero (2023). HM Government, Hundreds of new North Sea oil and gas licences to boost British energy independence and grow the economy (2023)

[28] PRI, IIGCC, UKSIF UK Sustainable Finance Policy Event summary (2023)

[29] Energy & Climate Intelligence Unit, Offshore wind: government failure in next renewables auction could mean Britain misses chance to cut foreign LNG gas dependency by half (2023)

central to decarbonising the UK's electricity network, which risks derailing plans to triple offshore wind capacity by 2030 and establish a net zero electricity system by 2035 on which the decarbonisation of end use sectors depends. [30] This risks impacting the wider green economy, energy security, and energy bills. A stronger, more embedded UK industrial strategy, underpinned by clear investment plans, focused on private capital mobilisation should be developed to catalyse the green economy.

Market practice risk measurement

PRI signatories have highlighted that the lack of a consistent, accurate approach to pricing risk represents another barrier to scaling up transition finance. Measuring climate financial risks can be done through backward-looking proxy metrics, forward-looking metrics, and using scenario analysis metrics[31] such as the International Energy Agency (IEA) scenarios, Intergovernmental Panel on Climate Change (IPCC) scenarios, Network for Greening the Financial System (NGFS) scenarios, and the PRI's Inevitable Policy Response. However, as the OECD notes, a lack of comparability of financially material metrics and analytical tools to measure and manage climate transition risk has led to market confusion.[32]

Financial institutions are responsible for taking decisions on how to factor in the risks and opportunities related to climate change, consistent with their responsibility to manage such risk in the long-term interests of their beneficiaries.[33] However, risk measurement can be inconsistent across the market, which poses challenges to pricing transition risk. These challenges relate to both the lack of agreed metrics to measure firms' climate risk exposure and a difficulty in identifying climate risk measures.[34] The Net Zero Asset Owner Alliance (NZAOA) has highlighted that a systemic lack of reliable information about key issues, such as project risks, yields/ returns, and historic defaults/losses, pushes private-sector investors to price the perceived risks at disproportionately high levels.[35]

The UK government could support accurate risk pricing by providing **access to core credit risk data**. This would help market actors to develop more consistent methodologies on measuring risk to factor in long-term climate considerations, as this fragmented landscape can have a destabilising effect on transition finance. Instead, the availability of long-term, comprehensive track record data could further facilitate the rating of blended finance structures and crowd in more private capital investment.[36]

Additionally, implementation of a **robust, evidence-based sustainable taxonomy** in the UK could simplify and harmonise risk evaluation by setting a performance benchmark on the alignment of economic activities with the UK's climate objectives.

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[30] HM Government, Offshore transmission network review (2023). HM Government, Offshore Wind Net Zero Investment Roadmap (2023). HM Government, Plans unveiled to decarbonise UK power system by 2035 (2021)

[31] Bank of England, Measuring climate-related financial risks using scenario analysis (2024)

[32] OECD, Financial Markets and Climate Transition: Opportunities, Challenges and Policy Implications (2021)

[33] PRI, Net zero alliances and the way forward for our industry (2023)

[34] OECD, Financial Markets and Climate Transition: Opportunities, Challenges and Policy Implications (2021)

[35] Net Zero Asset Owner Alliance (NZAOA) Scaling Blended Finance (2022)

[36] NZAOA, Scaling Blended Finance (2022)

SECTION 4: OPPORTUNITIES ON TRANSITION FINANCE

This section will cover PRI's response to Questions 14, 16, 17, 18, 28, 29, 33, 34, 35.

The call for evidence also recognises the scale of opportunity associated with the transition to net zero. To this end, it seeks insight on innovative use cases for transition finance, the role of UK government and other public bodies, and the role for regional or national transition pathways.

Transitioning to meet net zero goals could reduce costs for the economy, attract £10 billion per year of investment into the UK and create 600,000 new green, decent jobs by 2030.[37] If the UK is to remain a credible actor in the transition to a net zero future, the government needs to follow through with clear, consistent policies that will effectively shift financial flows, public and private, towards achieving net zero goals that support the low-carbon economic transition.[38]

To maintain credibility and integrity in capturing the opportunity on transition finance, the PRI recommends the following:

- taking a whole-of-government approach to develop **comprehensive sectoral roadmaps** with clear pathways to decarbonisation; and
- utilise **policy levers** to build markets for solutions, address economic externalities, and enable finance for the economic transition.

Whole of economy approach to climate objectives and sectoral roadmaps

The UK government has set out a number of climate targets through its Carbon Budgets, 2030 Nationally Determined Contribution (NDC), Net Zero Strategy, and Net Zero Growth Plan. However, the 2023 Independent Review of Net Zero demonstrated that the government's Net Zero Strategy **has not provided "adequate certainty to business and investors"**. The Environmental Audit Committee recently highlighted the lack of consensus within government on the speed of transition away from fossil fuels despite endeavours to reach net zero by 2050.[39] A misalignment between these strategies and wider policy government decisions risks impacting the credibility of the government's plans to reach net zero.

There is a need for **further granularity from government**, including a **mapping of the investment required across sectors and regions** to ensure that solutions are targeted towards investment gaps that need to be filled. The UK government should develop **specific sectoral transition plans with clear roadmaps to decarbonisation** to this effect.

Aviva Investors' white paper on making financial flows consistent with the Paris Agreement highlights that transition planning across the global economy can provide a series of **self-reinforcing actions and information flows.** Signals from national strategies can inform workplans for financial regulators

[37] UK CCC estimates that £50bn per year of investment is needed to reach net zero (Sixth Carbon Budget report), UK government's Ten Point Plan outlines £12bn in public investment to mobilise £42bn in private capital by 2030. Oxford Economics (2021) Green Growth: Opportunities for the UK.

[38] PRI opinion in Net Zero Investor, Transitioning to net zero is cheaper than putting it off (2023)

[39] House of Commons Environmental Audit Committee (EAC) The financial sector and the UK's net zero transition (2023)

and supervisors and help to shape actions from the private sector. As the best available scientific evidence shows, some sectors (such as hard-to-abate industries or sectors critical for electrifying the economy) must decarbonise faster than others, requiring credible detailed decarbonisation pathways.[40]

The Net-Zero Banking Alliance offer additional guidance on a sectoral approach, setting sector-level targets for hard to abate industries, including agriculture; aluminium; cement; coal; commercial and residential real estate; iron and steel; oil and gas; power generation; and transport.

Sector-specific work is underway in the real-estate sector, with the cross-industry Net Zero Carbon Buildings Standard which brings together Net-Zero Carbon requirements for all major building types, based on a 1.5°C trajectory.[41]

In developing PRI's Investing for the economic transition: The case for whole-of-government policy reform, we interviewed leading policymakers and investors on the transition. Stakeholders stressed that **investors need confidence** that national governments will pursue a coherent approach to the economic transition, and that national strategies will not be jeopardised by changes in government or by wider social, political, economic, or environmental challenges.

Whilst the UK government has produced a number of technology-specific roadmaps, investors have noted that they do not go far enough in setting out how investment needed to deliver net zero will be secured.[42] Sectoral roadmaps need to set out more detail on the decarbonisation trajectories across key sectors of the economy, as well as the investment roadmaps required to unlock private investment, and associated tax, spending and regulatory/policy commitments to incentivise demand.

The European Commission and the EU's Industrial Forum have developed a blueprint for sectoral roadmaps, based on stakeholder feedback. This blueprint highlights that sectoral roadmaps should detail a shared vision and understanding of what the decarbonisation of economic sectors looks like; how and within what timelines different sectors, industries and specific technologies are expected to progress; and what role public and private finance and companies should play in enabling and accelerating this net-zero transition.[43]

Policy levers to build markets for solutions

Regulation alone is unlikely to mobilise the required capital on transition finance. Therefore, the UK government should draw on a broader range of policy levers to build markets for solutions.

In June 2023, the PRI, IIGCC and UKSIF held a UK Sustainable Finance Policy event. One session was devoted to transition finance and the decarbonisation of the real economy, focusing on how the UK government's sustainable finance policy framework can promote a supportive environment to

[40] Deloitte, Decarbonization of hard-to-abate industries. GFANZ, Guidance on use of sector pathways for financial institutions (2022). PRI response, Transition Plan Taskforce: A sector-neutral framework for private sector transition plans. (2022)

[41] Net Zero Carbon Building Standard.

[42] PRI, IIGCC, UKSIF UK Sustainable Finance Policy Event summary (2023)

[43] For example, the UN Race to Zero and the Glasgow Financial Alliance for Net Zero (GFANZ) have developed 17 investment roadmaps. PRI 2030 EU Policy Roadmap (2024)

facilitate transition finance flows at pace and scale. One takeaway was that whilst plans and disclosures were seen as a "key ingredient" to assess the credibility of corporate transition efforts, a number of attendees highlighted that more needed to be done to incentivise investment through stronger **sectoral policy initiatives**. If the government creates investable business models, private capital is likely to respond and finance these projects. For example, in the first 12 months since the Inflation Reduction Act was signed into law, the private sector announced more than $110 billion in new clean energy manufacturing investments in the US.[44]

A lack of price signals from policymakers (e.g. those created by the US Inflation Reduction Act – IRA – or the EU Net Zero Industry Act – NZIA) were seen as key barriers to catalysing transition finance flows by investors during the June 2023 event. Attendees suggested that helpful policy signals could include **anchoring transition plans in sector pathways or financing roadmaps,** which would provide a means of benchmarking company- and activity-level transition (e.g. through TPT and the taxonomy) against sectoral and economy-wide milestones.

While the UK may not be able to compete with the US and EU in terms of scale, it can **compete strategically**. The UK's response to initiatives such as the IRA and NZIA should focus on additional **targeted policy incentives and subsidies** for sectors where the UK has a clear competitive advantage.[45]

Policy levers to address economic externalities

Addressing economic externalities is also an important lever for the provision of transition finance. Our research identified a number of tools that could be used to that effect by the UK government, such as:

- pricing instruments (e.g., carbon pricing and emission trading schemes);
- adopting performance standards (e.g., for vehicles, buildings and household appliances);
- setting phase-out dates for polluting sectors (e.g., unabated fossil fuel power plants) and demand-side measures for hard-to-abate sectors;
- subsidy reform (e.g., phasing out harmful subsidies);
- requiring minimum social safeguards from economic actors (e.g., decent work) and highlighting good-job externalities (e.g., increased social cohesion); and
- regulation relative to public goods (e.g. affordability standards in the housing market, data protection regulation).

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[44] The White House, Press Statement: One Year In, President Biden's Inflation Reduction Act is Driving Historic Climate Action and Investing in America to Create Good Paying Jobs and Reduce Costs (2023)

[45] PRI and IIGCC, Briefing on key sustainable finance policy priorities for the UK (2024)

The PRI will be producing a more in-depth UK-specific economic transition report, analysing the policy instruments that exist in the UK against this, and areas where they could be further refined to address economic externalities, building on the case study presented in our initial report.[46]

Ensuring that transition finance does not lead to carbon lock-ins will also be critical. The OECD have published Mechanisms to Prevent Carbon Lock-in in Transition Finance, which showcases good practice to policymakers in developing comprehensive and credible transition finance policies (including standards on financial instruments). The UK government could use these recommendations to improve the standards of transition instruments.

Policy levers to enable finance for the economic transition

Scaling up blended finance could establish clear **pathways and standards.** By taking onboard some of the financial risk at the early stages of development, the UK government would send a signal that these projects are **investable and dependable**, which offers a strong incentive for further sources of capital to be deployed.[47]

As highlighted in PRI and IIGCC's briefing on sustainable finance policy priorities, the UK government should improve **strategic public investment and capitalisation** of public finance institutions through the **UK Infrastructure Bank and the British Business Bank.** This will require strategic coordination, better integration and stronger governance structures between central government funding programmes and the programmes of public finance institutions, using blended finance structures and identifying areas where blended finance models could be further deployed.

The UK government should **leverage the role of export credit** in supporting companies transition to net zero and shift financial flows through **UK Export Finance**. Greater access to financing for companies across the globe also provides a key supply chain opportunity for the UK. The government should also seek to unlock investment to scale innovation in climate solutions through **Innovate UK**, ensuring that net zero opportunities can be de-risked, supported, and visible to wider financing options.

A recent report from the LSE Grantham Institute set out a comprehensive, non-exhaustive list of public instruments and policy tools that can be used to catalyse private investment in blended finance models.[48]

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[46] PRI, Investing for the economic transition: the case for whole-of-government policy reform, (2023) See pages 17, 37, 38, 39 for a mapping of the UK's approach to the transition against this framework.

[47] House of Commons Environmental Audit Committee (EAC) The financial sector and the UK's net zero transition (2023)

[48] LSE Grantham Institute, Investing in our future: practical solutions for the UK government to mobilise private investment for economic, environmental and social policy priorities (2023)

SECTION 5: GLOBAL LEADERSHIP

This section will cover PRI's response to Question 31, 32, 36

As the call for evidence states, the international outlook of the UK's finance sector provides an opportunity to position the UK as a centre for transition finance globally, provided it can create the right ecosystem to support this. The opportunity to both showcase international leadership and learn from international examples of best practice should be captured.

The UK's market leading practice

The UK has a strong track record on climate change leadership, from the 2008 Climate Change Act to COP26 in 2021, decoupling carbon emissions from economic growth, and supporting international climate change initiatives. Building on this expertise, there is an opportunity for the UK to influence the provision of global transition finance to support the transition. This section will detail the UK's market leading practices, ranging from:

- climate commitments and regulations;
- cross sector collaboration; and
- good practice on stewardship and governance

Climate commitments and regulations

The UK has been a pioneer in developing robust climate legislation, with the 2008 **Climate Change Act** introducing legally binding emissions targets (carbon budgets) every five years and establishing the independent CCC, and in its strengthening of the legal framework in 2019 with a net zero 2050 target. Delivery of the Climate Act should rely on clear policies that transform the real economy, prioritising sectors whose transition will contribute most to the UK's economic, social and climate goals and sending the right policy signals to investors.

From the outset, the design and implementation of these policies should take into consideration the socio-economic effects of the transition. **Failing to deliver a just transition could slow or even stall climate progress**, while contributing to economic stagnation and political instability. In a cost-of-living crisis, policymakers must ensure that policies are designed following crucial principles such as stakeholder engagement and a focus on the spatial and place-based dimensions of the transition. In practice, this means prioritising policies that **reduce emissions while having co-benefits in terms of cost-of-living**, including fuel poverty and transportation, such as supporting better home insulation and public transport. In addition, it will be necessary to invest in workers, communities, and capabilities (including re-skilling of workers in vulnerable industries), to tackle both transitioning out of fossil fuels and transitioning into a green economy.

An Independent Review of Net Zero was published in January 2023, and presents policy recommendations centred around backing business, backing local action, delivering energy efficient homes, and using infrastructure to unlock net zero. In response to the Net Zero Review, the UK government agreed to take forward many of the recommendations, [49] however, many of these commitments have not yet been implemented or have been downgraded.[50] The PRI's mapping of the Net Zero Review presents our recommendations on areas to prioritise, including demand reduction and the heat transition, building investible business models for key net zero technologies and clear sectoral transition roadmaps, as well as a number of sustainable finance policy priorities.

From a financial regulation perspective, the UK has also made some good progress on new policies: the FCA's SDR and investment labels regime is a powerful regulatory tool to substantiate sustainability claims and disclosure against evidence and minimum safeguards. The FCA aims to improve how markets function by increasing the accountability of sustainable products and entities, while also reducing risks of greenwashing.

On the transition, the TPT aims to drive transition plans by setting clear expectations and creating a standard, ensuring that financial institutions and companies prepare rigorous transition plans and back up commitments with credible action. The UK government also committed to consulting on requirements for the UK's largest companies to disclose their transition plans if they have them.[51]

Cross-sector collaboration

The UK has a strong background of cross-sector collaboration, bringing together industry experts and government officials to drive innovative solutions to accelerate the transition. The TPT, GTAG, and Transition Finance Market Review are good examples of working groups bringing together industry experts, academia and regulators, with clear mandates, direction, and goals set by government. The UK also contributed to the development of international sustainability standards and establishment of private sector initiatives, such as the Net Zero alliances ahead of COP26.

Co-designing solutions to investment barriers serves as a pivotal feedback loop to ensure policies are effective in mobilising capital towards important sectors for net zero.[52] This ongoing dialogue between practitioners and policymakers should continue to serve as a model for best practice on cross-sector collaboration, with a view to taking forward recommendations from these groups.

Good practice on stewardship and governance

The UK has a strong reputation on stewardship and governance, with the **UK Stewardship Code and UK Corporate Governance Code** setting a standard for other countries to follow. Maintaining high ambition should support investors to use stewardship practices to meet their fiduciary duties, sustainability objectives, and ultimately the transition to net zero.

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[49] UK Government, Independent Review of Net Zero: government response (2023)

[50] Prime Minister's Office and The Rt Hon Rishi Sunak MP, PM speech on Net Zero (2023)

[51] HM Government, Mobilising Green Investment: 2023 Green Finance Strategy. (2023).

[52] IPPR, Making markets: The City's role in industrial strategy (2024)

Stewardship is an important mechanism for investors to exercise their influence, whether as an independent tool, or in combination with investment decisions.[53] The UK should continue to showcase global leadership on stewardship through the review of the UK Stewardship Code. The Review should ensure that the regulatory framework encourages informed and engaged stewardship leadership practices, with stronger coherency between regulators. Clear guidance on reporting metrics for systemic stewardship will provide holistic insights for clients and regulators to monitor progress in addressing system-level risks.[54]

On governance, changes to the UK Corporate Governance Code should ensure that the UK remains a leading standard in sound corporate governance and achieve the government's ultimate objective of restoring trust in audit and corporate governance.

International examples of best practice

There are numerous examples of best practice in providing the right ecosystem for transition finance that can be drawn from. The PRI has drawn from three examples – the US, Europe, and Japan – which touch on **incentive structures, industrial strategy, longevity and policy certainty**, as well as alignment with the real economy.

US

The US has put in place landmark legislation that provides permanent incentives for investment in key sectors for the economic transition.

Since 2020, the US has passed three large-scale industrial and real-economy policies with transition implications. These policies are primarily incentive-based, covering specific economic sectors, including renewable energy, climate resilience, electrical grid improvements and electric vehicle adoption. The Inflation Reduction Act created permanent incentives to attract capital investment in renewable energy through 12 clean energy tax provisions, including Investment and Production Tax Credits. Over a period of 10 years, the Inflation Reduction Act is estimated to raise revenue of around $73 billion, primarily through tax credits and tax deductions as the main instruments.[55] The Inflation Reduction Act offers long-term certainty for green energy investments.

The EU was also reactive to the US' Inflation Reduction Act, producing its own Net Zero Industry Plan. Both offer strong subsidies and tax breaks, as well as clear policy signals on green industrial ambitions.

Other policies in the US cover infrastructure and industrial priorities, such as the Bipartisan Infrastructure Law, which allocates US$550bn for areas including electric vehicle infrastructure and climate resilience, and the CHIPS Act, which provides funding to encourage research into and development and manufacturing of net zero technologies. Further to this, the Biden administration has, through Executive Order 14057, established an official "whole-of-government-approach" to

[53] PRI 2030 EU Policy Roadmap (2024)

[54] Further guidance in How policy makers can implement reforms for a sustainable financial system: stewardship

[55] European Parliament EU's response to the US Inflation Reduction Act (IRA) (202

achieving net zero by 2050, with an interim economy-wide target of reducing net greenhouse gas emissions to 50-52% below 2005 levels by 2030.

European Union

The EU has adopted ambitious legislation on sustainable finance, climate change and nature under the banner of its EU Green Deal (EGD). The framework has put an increasing emphasis on transition, and steps have been taken to better integrate sustainability objectives into public finance instruments.

The EGD provides an overarching framework to help transition the EU economy towards a sustainable model. While the overall goal is to address climate change by reaching climate neutrality by 2050, the EGD addresses a range of interrelated economic, societal and environmental objectives. These include reducing emissions, creating jobs and growth, addressing energy poverty, reducing external energy dependency, and improving citizens' health and wellbeing.

Since the adoption of the EGD, the EU has adopted a set of strategies and real-economy policies with important transition features. These include: (i) the adoption of the EU Climate Law, which sets stringent climate goals for 2030 and 2050; (ii) the Fit for 55 package, which aims to accelerate the decarbonisation of key sectors of the economy; (iii) the Green Deal Industrial plan, to scale up EU's manufacturing capacity for net zero technologies; (iv) the 2030 Biodiversity Strategy that aims, among other things, to protect a minimum of 30% of the EU's land and sea area; and (v) a strategy for financing the transition, which seeks to reorient financial flows toward sustainable activities. To support the EGD's objectives, 30% of the EU's 2021-27 budget is to be spent on climate action.

Japan

Japan has taken important steps in integrating the economic transition at the highest levels of government, as well as putting in place policy tools that aim to enable the transition of the high-emitting sectors that make the greatest contribution to the country's emissions.

Japan's GX Basic Policy is a 10-year roadmap that positions the economic transition as a central policy goal: its main objectives are to develop markets in the areas of energy supply and decarbonisation, while strengthening Japan's industrial competitiveness and economic growth. The roadmap also encourages a just transition by simultaneously promoting the acquisition of new skills and the smooth movement of labour to growth sectors, including the green sector.

Furthermore, the economic transition is recognised at a high level in terms of governance: the GX Basis Policy was developed by the GX Implementation Council, which was chaired by the prime minister, and consequently adopted through a Cabinet decision.

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of the Transition Finance Market Review further to accelerating the provision of transition finance the UK.

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org