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# A UK NET ZERO FINANCIAL SYSTEM KEY ELEMENTS FOR THE 2022 GREEN FINANCE STRATEGY

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## Summary

Maintaining London's position as one of the world's leading financial centres<sup>1</sup> will require it to innovate and reflect a changing world, and the UK has an opportunity to win the 'race for primacy in green finance, becoming the pre-eminent provider and organiser of capital and financial services' for transition.<sup>2</sup> This is one of the most positive actions the UK can take to tackle climate change<sup>3</sup> and stay internationally competitive.

The UK has led the way on green finance by committing to create the world's first Net Zero Financial Centre and a Net Zero Financial System,<sup>4</sup> and implementing several progressive green finance reforms. However, the UK is yet to set out a comprehensive plan for how it will deliver finance for the transition across the country. The 2022 Green Finance Strategy will provide an opportunity for the government to do so.

This briefing proposes 6 design principles for the Green Finance Strategy, together with 11 flagship policy commitments, underpinned by success indicators. The policies and indicators have been compiled using existing papers from thought leaders across academia, business, investors and NGOs.

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<sup>1</sup> **Of the major global financial centres**, London is ranked first for green finance according to the latest rankings from Z/Yen, far ahead of its major competitors including New York (ranked 13), Hong Kong (ranked 41), Singapore (ranked 16), Shanghai (ranked 14), Tokyo (ranked 22), Paris (ranked 10) and Frankfurt (ranked 44).

<sup>2</sup> Climate-related risks, including from the ever-increasing frequency and severity of extreme weather events, require insurance and reinsurance, as well as advanced data analytics and sustained investments in climate adaptation. BusinessGreen, 6 April 2021, **Green Finance Strategy 2.0**

<sup>3</sup> Recent analysis shows that 25 large UK financial firms are responsible for 1.8 times more CO<sub>2</sub>e emissions than the territorial emissions of the UK itself. The UK finance industry would rank as the 9th largest emitter in the world. New Statesman, May 2021, **The City of London would be the ninth largest emitter of CO<sub>2</sub> if it were a country**

<sup>4</sup> HM Treasury, October 2021, **Greening Finance: A Roadmap to Sustainable Investing**



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## Design principles

The table below sets out 6 proposed design principles to inform the development of the 2022 Green Finance strategy.

UK Green Finance Strategy sets out a national financing strategy for the UK net zero transition.<sup>5</sup> This means that it:

- > Is a financing plan to get on track to the UK's 2050 Net Zero and Adaptation targets.
- > Clearly sets out how public investment and policy will be used to leverage in private finance, including aligning public budgets with net zero.
- > Includes analysis of financial flows to identify investment gaps in the net zero transition and establishes an independent institution to carry out this function on an annual basis, such as the OBR or CCC.
- > Sets science-based standards and requirements for financial regulation to align financial flows with limiting global heating to 1.5 °C.
- > Fully integrates Nature Positive and Levelling Up principles.
- > Sets out clear objectives for UK international leadership and cooperation.

## Flagship policies and success indicators

The UK government announced its intention to create a world-leading net zero financial system in the Greening Finance Roadmap.<sup>6</sup> This will require a plan that integrates the public policy and regulatory tools in the government's toolkit with private market signals and regulations that inform the decisions of private finance actors. However, an essential part of delivering this sustainable system lies in how the government supports private finance in going green – i.e., creating a Net Zero Financial Centre.

The UK government has already taken several leading steps, including announcing a science-based UK Green Taxonomy, mandatory net zero transition plans for listed financial institutions and companies from 2023, and the new UK Infrastructure Bank with a dual mandate of net zero and levelling up. However, more will need to be done if the UK is to plug the investment gap and become

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<sup>5</sup> E3G, May 2021, [Financing the net zero transition](#)

<sup>6</sup> HM Treasury, October 2021, [Greening Finance: A Roadmap to Sustainable Investing](#)



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world-leading in its approach to green finance. There is a strong case for reforming public finance around net zero, as strategic public investment will be critical to leveraging in private sector investment and maximising the new economic opportunities.

The following table sets out 11 flagship commitments central to delivering a world-leading net zero financial system,<sup>7</sup> together with more granular indicators of success. The policies and indicators have been compiled using existing papers from thought leaders across academia, business, investors and NGOs, including Aviva and WWF<sup>8</sup>, E3G<sup>9</sup>, CGFI<sup>10</sup>, UKSIF<sup>11</sup>, CCC<sup>12</sup> and Aldersgate Group<sup>13</sup>.

Flagship Policy	1. Fulfil the commitment in the Net Zero Strategy by establishing a permanent, independent observatory to track public and private financial flows across the economy against the UK’s Net Zero and Adaptation targets. Use this analysis to help develop a comprehensive net zero investment strategy.
Success Indicator	Establish a Net Zero Finance Strategy setting out a national investment plan to get on track to net zero, and a roadmap of concrete steps including policy, regulation, public investment, and incentives.
	Annually measure public and private financial flows for compatibility with net zero and adaptation (i.e., a 1.5 °C-aligned UK Green Taxonomy), using CCC investment targets as a baseline. <sup>14</sup> Create new independent institutional capacity <sup>15</sup> to measure progress including short-term compatibility of financial flows, e.g. OBR, CCC.
	Establish a robust governance process to monitor progress on government plans to finance the net zero transition, for example a cross-governmental committee.

<sup>7</sup> These recommendations have been adapted and developed from previous joint briefings: E3G, November 2021, **A net zero UK financial centre**; E3G, May 2021, **Financing the net zero transition**

<sup>8</sup> WWF and Aviva, 2022, **Aligning the UK Financial System to Net Zero**

<sup>9</sup> E3G, May 2021, **Financing the net zero transition**

<sup>10</sup> Business Green, 2022, **Green Finance Strategy 2.0: Here's what an ambitious UK plan should look like**

<sup>11</sup> UK Sustainable Investment and Finance Association, 2022, **Delivering a Net-Zero Financial Centre**

<sup>12</sup> Climate Change Committee, 2020, **The Road to Net-Zero Finance**

<sup>13</sup> Aldersgate Group, June 2022, **Building a UK Net Zero-aligned Financial Centre: what next?**

<sup>14</sup> Figure 5.1 in Climate Change Committee, 2020, **The Sixth Carbon Budget**

<sup>15</sup> For example, this could be an extension of an existing institution’s functionality, such as the Office for Budgetary Responsibility, or a new function/institution.



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Flagship Policy	2. Commit to integrating climate change into UK economic management and public finance and delivering strategic public investment to key sectors across the economy to support the transition.
Success Indicators	Align the UK Infrastructure Bank with a 1.5 °C-aligned UK Green Taxonomy.
	Commit to increasing the capitalisation of the UK Infrastructure Bank over time in line with UK net zero and levelling up investment needs.
	Ensure the Green Gilts align as soon as possible with a 1.5 °C-aligned UK Green Taxonomy.
	Reform budgeting and fiscal policy to embed net zero and adaptation into decision making at major fiscal moments, including the following practical steps: <ul style="list-style-type: none"> <li>&gt; A UK Green Balance Sheet to assess the UK’s environmental assets and liabilities, building on existing tools. This could be included in the Balance Sheet Review process.<sup>16</sup></li> <li>&gt; A Net Zero Delivery Tracker<sup>17</sup> to assess the UK’s green budget and balance sheet concerning the UK’s stated targets. This could be included in the Annual Report and Resources account.</li> <li>&gt; Fulfil OBR’s recommendation to regularly stress test the UK’s fiscal outlook to 2050 as part of the Managing Fiscal Risks report. This could help make the economy resilient to shocks.<sup>18</sup></li> </ul>
	Future government policy for energy and finance should explicitly consider the cost of stranded assets, including the opportunity cost where new fossil investments may have diverted investment from clean energy. <sup>19</sup>

<sup>16</sup> Public Financial Management Blog, 24 June 2019, Reviewing the UK Balance Sheet – **Proving its (Net) Worth**

<sup>17</sup> Climate Change Committee, 2021, **Independent Assessment: The UK’s Net Zero Strategy**

<sup>18</sup> Office for Budget Responsibility, 2022, **Fiscal risks and sustainability**

<sup>19</sup> The **Office for Budget Responsibility’s July 2022 Overview of Fiscal Risk and Sustainability** points out that the recent doubling of oil and gas prices and the rise of inflation rates have underscored the economic and fiscal risks associated with the UK’s continued dependence on fossil fuel imports. It has also brought into sharper focus the fiscal choices and trade-offs involved in shifting the UK’s energy mix to one which is compatible with net zero by 2050.



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	Align with international definitions of fossil fuel subsidies (e.g. IMF) and reform the fiscal regime for oil and gas extraction to phase out tax incentives for investment in new oil and gas fields.
Flagship Policy	3. Tackle greenwash by creating a 1.5 °C-aligned science-based taxonomy for what is and is not considered a green economic activity. Use this to underpin guidance for private finance and public budgets.
Success Indicators	Ensure the UK green taxonomy remains science-based, <sup>20</sup> excluding gas from its list of sustainable economic activities, <sup>21</sup> and includes measures to avoid significant harm.
Flagship Policy	4. Support private sector appetite for transitioning. Set out a clear timeline for when transition plan requirements will be extended across the economy and deliver clear and specific guidance to support implementation.
Success Indicators	Update the Stewardship Code to strengthen guidance around net zero and offsets in line with Transition Plan Taskforce guidance by 2025. Implement the FRC’s recommendations, including increasing readability of reports and providing further guidance to SMEs. <sup>22</sup> The code should be mandatory for large companies and investors by 2025.
	Put in place legislation to ensure transition plan requirements are extended to all large companies in the UK from 2023, potentially with phased implementation. Publish clear timelines for when these requirements will be rolled out to other companies and SMEs.
	Embed private sector transition plans within a clear system of accountability and governance, including: <ul style="list-style-type: none"> <li>&gt; Regulators set clear expectations for transition plans and are given adequate enforcement mechanisms to support accountability</li> <li>&gt; The UK works with regulators such as the FCA to increase readability and access to data</li> </ul>

<sup>20</sup> E3G, June 2022, **United call for a gold-standard green taxonomy**

<sup>21</sup> UK Sustainability and Finance Association, June 2022, **UKSIF, IIGCC and PRI open letter to government: future of UK’s ‘green taxonomy’**

<sup>22</sup> Financial Reporting Council, 2021, **Effective Stewardship Reporting**



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	<p>&gt; Set out a clear pathway towards requiring mandatory AGM voting on transition planning,<sup>23</sup> likely from 2025.</p>
Flagship Policy	<p>5. Establish a robust, science-based regulatory and legislative framework to enable finance sector flows to be greened, and aligned with net zero and nature outcomes.</p>
Success Indicators	<p>Establish the UK listings regime as a green flagship internationally, including requiring net zero transition plans for listed companies by 2025. Set out clear enforcement mechanisms for listings agencies that don't comply after this time.</p>
	<p>Make climate change a statutory objective for UK regulators and set out a clear pathway for including nature and biodiversity risk. If competitiveness is included in the statutory objectives, it should be redefined as advancing the UK's net zero agenda.</p>
	<p>Update the Bank of England's capital requirements for financing fossil fuel activities to be increased in line with their risk profile.<sup>24</sup></p>
	<p>Ensure the Bank of England sets out a forward roadmap for how it will use the taxonomy, and transition plans to manage climate-related aspects of macroeconomic risk and monetary policy.</p>
Flagship Policy	<p>6. Embed UK adaptation targets and biodiversity goals in corporate, financial sector and government transition planning.</p>
Success Indicators	<p>Set out a forward pathway for ensuring that transition plans will over time include adaptation plans and nature recovery plans.</p>
	<p>Set out a clear timeline for the UK to adopt ISSB<sup>25</sup>, including nature and biodiversity protections such as the Post-2020 Global Biodiversity Framework.</p>

<sup>23</sup> Financial Times, 21 January 2021, **UK urged to introduce mandatory climate votes at AGMs**

<sup>24</sup> The Basel Committee has already done this for cryptocurrencies: Finance Watch, 27 October 2021, **The one-for-one rule: A way for COP26 ambitions to manifest in financial regulation**

<sup>25</sup> **IFRS - International Sustainability Standards Board**



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Flagship Policy	7. Support cross-UK prosperity by centring just transition principles in the strategy, including supporting local authorities and investing in a fair transition for legacy industries.
Success Indicators	Set clear cross-UK prosperity targets, incorporating the Green Job Taskforce’s regional prosperity targets, <sup>26</sup> in line with Levelling Up objectives. Invest in local finance and skills to deliver these.
	Develop the Green Jobs Taskforce’s mapping of green skills gaps and commit to developing an investment plan for green skills, education, and training opportunities to support the net zero transition, including staff in legacy industries. This should include building green finance capacity across the UK.
	Build capacity and finance skills within the real economy to create a solid project pipeline of investible projects by: <ul style="list-style-type: none"> <li>&gt; Establishing Net Zero Hubs across the UK to deliver comprehensive support to local authorities for the transition including technical assistance and project development support, clarity on sources of finance, and incentives to transition.</li> <li>&gt; Building the UK Infrastructure Bank’s Advisory Function as soon as possible to provide technical assistance and pipeline support for new net zero sectors.</li> </ul>
Flagship Policy	8. Leverage the UK’s diplomatic influence to secure international ambition for private sector financial reform, including building on G20 language to secure a commitment at the G7 to create net zero financial systems.
Success Indicators	Leverage UK influence in G7 to secure adoption of Net Zero Financial System commitments by COP27.
	Ensure that the UK taxonomy is aligned to the International Platform on Sustainable Finance (IPSF) Common Ground Taxonomy and adopt a leading role within IPSF/G20 Sustainable Finance Working Group to drive forward international norms for categorisation of green economic activities.

<sup>26</sup> Department for Business, Energy and Industrial Strategy, July 2021, [Green Jobs Taskforce Report](#)



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	<p>Leverage the UK’s role in IOSCO to ensure strong ISSB global disclosure and reporting standards and take a proactive stance in calling for interoperability between ISSB and EFRAG adopted standards.</p>
	<p>Leverage UK’s role in G7 and G20 to champion the adoption of mandatory transition plan requirements in 2023, building on the standard-setting work of the UK’s Transition Plans Taskforce.</p>
	<p>Support the implementation of new Race to Zero criteria and push for the adoption of clear governance mechanisms to address non-compliant GFANZ members by COP28; for example, phased exclusion, tiered membership based on compliance. Encourage GFANZ to regularly report on international private financial flows to build accountability.</p>
	<p>Support the update of international standards on capital requirements for fossil finance by the Basel Committee.</p>
<b>Flagship Policy</b>	<p>9. As a key shareholder in international financial institutions, including Multilateral Development Banks (MDBs) and the IMF, support MDBs and Public Banks in mainstreaming net zero and resilience.</p>
	<p>Pursue holistic UK MDB shareholder climate strategy to ensure transformative Paris alignment and climate mainstreaming by MDBs and other international public development banks, with British International Investment (CDC Group) leading by example.</p>
	<p>Encourage British International Investment (CDC Group) to offer the International Development Finance Club (IDFC) to host the Finance in Common Summit in October 2023, building on the COP26 legacy.</p>
<b>Success Indicators</b>	<p>Lead a like-minded group of governments from Global North and Global South on climate reform of MDBs and IMF. Maintain and fully resource the FCDO–Germany like-minded group on MDB Paris alignment.</p>
	<p>Invest in and champion the new Joint MDB Long Term Strategy Facility.<sup>27</sup></p>
	<p>Assign responsibility within government for maintaining relationships with MDBs that the UK does not have a shareholding in, such as the European Investment Bank, Islamic Development Bank, Council of Europe Development Bank and New Development Bank.</p>

<sup>27</sup> The MDB long-term strategy facility has the potential to create ambitious long-term strategies for almost 150 countries worldwide within the context of the UNFCCC.



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	<p>Work to resource the replication of country platforms (JET-Ps) to more countries</p> <p>Support the creation of an international financial architecture for country partnerships with a strong role for public banks and private sector and UK aid for building capacity and project pipelines.</p> <p>Restore ODA and maintain a 50:50 split of funding for mitigation and adaptation. This includes ambition to improve and address access to finance.</p>
Flagship Policy	10. Upgrade the international financial architecture that developing countries rely on.
Success Indicators	<p>Lead on convening a task force to review the IMF-WB debt sustainability analysis to incorporate climate risks.</p> <p>Support UN efforts to review the methodology and impacts of credit rating agencies and their implications for debt sustainability, particularly in emerging markets and developing economies.<sup>28</sup></p> <p>As a shareholder of the IMF, work with like-minded shareholders, including from the Global South, to encourage the newly established Trust Fund on Resilience and Sustainability to ensure that existing IMF programs and conditionalities do not discourage increased investment in the transition.<sup>29</sup></p> <p>Leverage UK diplomatic influence in G7/G20/UNFCCC, or other relevant international fora, to support international development of a shared outcome on loss and damage finance at COP27.<sup>30</sup></p> <p>Encourage all future COP Presidencies to run a ‘Finance Campaign’ outside of the UNFCCC negotiations, as was the case for COP26.</p>

<sup>28</sup> UN Department of Economic and Social Affairs, 2022, **Credit Rating Agencies and Sovereign Debt: Challenges and Solutions**

<sup>29</sup> BU Global Development Policy Center, 23 February 2022, **5 Design Features for a Transformational Resilience and Sustainability Trust at the IMF**

<sup>30</sup> E3G, June 2022, **Roadmap for progressing on loss and damage**



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Flagship Policy	11. Increase the mobilisation of public and private investment to achieve 2030 climate and nature targets in emerging and developing economies.
Success Indicators	Advance a new G7 global infrastructure investment push to shift trillions, building on learnings from prior UK-backed efforts such as the Climate Finance Accelerator and NDC Investment Plans supported by the NDC Partnership. This should include new regional platforms for development.
	Advance negotiation in the COP process for a New Collective Quantified Goal on Climate Finance (NCQG) <sup>31</sup> that is ambitious, feasible, and dynamic, including establishing a headline target for overall finance mobilisation in the post-2025 goal. This should be underpinned with: <ul style="list-style-type: none"><li>&gt; Sub-goals for mitigation and adaptation, and sub-goals for associated financed achievements: a GHG emissions reduction goal and an adaptation impact goal.</li><li>&gt; Dedicated sub-goals, with buy-in, for the ten leading MDBs (M10), DFIs/IDFC, ECAs, ODA, GFANZ, CIFs, GCF and for climate-focused recapitalisations and replenishments thereof, by contributor countries.</li><li>&gt; A commitment from contributor countries to (a) assign the responsibility for scaling and implementing NDC Investment Plans and JET-Ps to specific institutions, and (b) provide each non-Annex I country with support for an NDC investment plan plus a country package, adaptation package or JET-P by 2030 or 2035.</li></ul>

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<sup>31</sup> UNFCCC – New Collective Quantified Goal on Climate Finance



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## About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

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