Environmental Audit Committee

The Environmental Audit Committee is appointed by the House of Commons to consider to what extent the policies and programmes of government departments and non-departmental public bodies contribute to environmental protection and sustainable development; to audit their performance against such targets as may be set for them by Her Majesty's Ministers; and to report thereon to the House.

Current membership

Mary Creagh MP (Labour, Wakefield) (Chair)
Colin Clark MP (Conservative, Gordon)
Dr Thérèse Coffey MP (Conservative, Suffolk Coastal)
Geraint Davies MP (Labour (Co-op), Swansea West)
Mr Philip Dunne MP (Conservative, Ludlow)
Zac Goldsmith MP (Conservative, Richmond Park)
Mr Robert Goodwill MP (Conservative, Scarborough and Whitby)
James Gray MP (Conservative, North Wiltshire)
Caroline Lucas MP (Green Party, Brighton, Pavilion)
Kerry McCarthy MP (Labour, Bristol East)
Anna McMorrin MP (Labour, Cardiff North)
John McNally MP (Scottish National Party, Falkirk)
Dr Matthew Offord MP (Conservative, Hendon)
Dr Dan Poulter MP (Conservative, Central Suffolk and North Ipswich)
Joan Ryan MP (Labour, Enfield North)
Alex Sobel MP (Labour (Co-op), Leeds North West)

Powers

The constitution and powers are set out in House of Commons Standing Orders, principally in SO No 152A. These are available on the internet via www.parliament.uk.

Publications

Committee reports are published on the Committee’s website at www.parliament.uk/eacom and in print by Order of the House.

Evidence relating to this report is published on the inquiry publications page of the Committee’s website.

Committee staff

The current staff of the Committee are Lloyd Owen (Clerk), Leoni Kurt (Second Clerk), Nicholas Davies (Committee Specialist), Laura Grant (Committee Specialist), Laura Scott (Committee Specialist), Jonathan Wright (Senior Committee Assistant), Baris Tufekci (Committee Assistant), and Anne Peacock (Media Officer).

Contacts

All correspondence should be addressed to the Clerk of the Environmental Audit Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 5776; the Committee’s email address is eacom@parliament.uk.
Eleventh Special Report

The Environmental Audit Committee published its Seventh Report of Session 2017–19, *Greening Finance: embedding sustainability in financial decision making*, (HC 1063) on 4 June 2018. The Government response was received on 26 July 2018 and is appended below.

**Government Response**

1. The Government welcomes the Committee’s inquiry into green finance and their report on embedding sustainability in financial decision making.

2. Green finance is a key priority for the Government – to support delivery of our ambitious Clean Growth Strategy, to drive economic growth as part of our Industrial Strategy, and to enable the global transition to a low carbon economy.

3. The UK is a world leader in delivering clean growth. We have cut our emissions by more than 40% since 1990, whilst growing our economy by more than two thirds over the same time period – the best performance in the G7 on a per person basis.

4. We have a globally renowned financial services sector, providing £119 billion to the UK economy, 6.5% of total economic output and employing more than 1.1 million people. We are also a global hub for the environmental sector, home to an extensive ecosystem of NGOs, consultancies and world leading universities.

5. Green finance is where these strengths come together, and we are committed to further consolidating these strengths, and ensuring UK businesses are at the forefront of the markets of the future.

6. The Chancellor of the Exchequer further demonstrated this commitment through announcing the establishment of a new Green Finance Institute at Mansion House on June 21st. This new Green Finance Institute will be a key facility for future Government collaboration with industry on green finance and will promote the UK’s green finance offering.

7. The report’s findings are closely aligned with our analysis and stakeholder engagement, particularly the work of the Green Finance Taskforce and the Advisory Group on Growing a Culture of Social Impact Investment in the UK. Both of these expert groups identified the importance of embedding sustainability in financial decision making, and their work will be a valuable resource in setting the direction of travel for longer term Government policy.

**Chapter 2 – Pension saving & environmental risk**

*Recommendation 1 (paragraph 35)*

The Government should clarify in law that pension schemes and company directors have a duty to protect long-term value and should be considering environmental risks in light of this.
8. Pension scheme trustees have a fiduciary duty to take account of risks, whether over the long or short term, wherever they are financially material. Pension schemes will often have long investment horizons, holding members’ savings for many decades. Consequently, it is particularly appropriate that pension scheme trustees do consider risks over the long-term.

9. We agree that the Government should clarify that trustees have a fiduciary duty to consider risk and opportunities in the long-term, including environmental risks. We have therefore consulted on amendments to the Occupational Pension Schemes (Investment) Regulations 2005 and are analysing the responses. We are proposing that trustees will be required to set out how they take account of financially material risks and opportunities including those arising from environmental, social, governance and climate change considerations. The influence of these types of considerations will most often be felt over the long term.

10. Subject to the outcome of the consultation, the Parliamentary timetable, and Parliamentary approval we intend to make this clarification with effect from 1 October 2019.

11. These regulations apply to the fiduciaries of pension schemes, not company directors. However, they will clarify the expectation that institutional investors should consider the long-term risks and opportunities associated with the firms in which they invest. This will push consideration of long term value and environmental risks down the investment chain to investee firms.

12. Already, in 2016, Government amended the Companies Act to implement the EU Directive on Disclosure of Non-Financial and Diversity Information. This introduced additional requirements for company directors of large public interest entities to provide more detailed information on the environmental and societal impacts of their business within their Strategic Reports.

**Recommendation 2 (paragraph 36)**

_A worrying disparity currently exists in the guidance to trust-based pension schemes (regulated by the Pensions Regulator) and contract-based schemes (overseen by the Financial Conduct Authority) when it comes to considering environmental risks as a financial factor. This is a result of the FCA’s apparent reluctance to act on the Law Commission’s recommendations on clarifying the duty of contract-based schemes in relation to environmental, social and governance factors. The FCA should rectify this by the end of the year._

13. The Government was pleased to see that in its final response to the Law Commission’s report ‘Pension Funds and Social Investment’, the FCA committed to consult on guidance for providers, to similar effect to the guidance proposed by the Law Commission, as part of the package of proposed rule changes in the first quarter of 2019.

14. We understand that the FCA will be responding to the Committee’s report separately.
**Recommendation 3 (paragraph 46)**

In its forthcoming consultation the Department for Work and Pensions should propose a change in the law to require pension fund fiduciaries to actively seek the views of their beneficiaries when producing their Statement of Investment Principles or Investment Strategy Statements. The DWP must set out guidance on how to ensure that evidence of members’ views is gathered robustly.

15. We agree that it is good practice for pension scheme trustees to inform the design of investment strategies with an understanding of their members. Engaged members have an important role to play in ensuring that trustees make decisions about investment with members’ best interests in mind, and are able to justify those decisions when asked to.

16. We consulted on a proposed change to require trustees to set out how they will take account of the views of members in the development of investment policies. For defined contribution pensions, in which members bear the investment risk, this statement would have to be published online. These types of schemes would also have to publish their statement of investment principles and an annual implementation report describing how the investment policies have been applied, and inform members via their annual benefit statement of where it might be found.

17. These measures to increase transparency will enable members to understand how their money is being invested and empower them to make their voice heard.

18. However, we have decided not to require trustees to seek members’ views. Pension scheme trustees’ primary concern is to deliver a return to members over the length of their investment. If trustees were expected to act in line with members’ views this could lead to conflicting objectives where trustees would have to trade delivery of their own fiduciary duties against members’ preferences. For this reason, the Law Commission concluded that trustees are never required to act on members’ concerns. It would therefore place a disproportionate burden on schemes to require a particular approach to seeking them.

19. There are a variety of ways that trustees can establish the views and interests of their members. The Law Commission has also highlighted that they are able to make investment and divestment decisions on the basis of what they might reasonably assume about the membership, without actively surveying their members at all. It is for trustees to decide which approach is most appropriate for their scheme.

**Chapter 3 – Climate risk reporting**

**Recommendation 4 (paragraph 59)**

*The full range of financial entities listed by the TCFD should be making climate-related financial disclosures. We need to see a green thread running through the investment chain. This would ensure that climate risks and opportunities are considered at every point in the investment chain. The Government should set out in its response to this report what specific actions it will take to encourage take up.*
20. We welcome the report’s recognition of the excellent work carried out by the Bank of England and the Committee on Climate Change to examine the risk that climate change could pose to financial stability.

21. The UK Government was one of the first Governments in the world to formally endorse the TCFD recommendations, recognising that the TCFD recommendations have the potential to play an important part in aligning the financial sector with the global transition to a low carbon economy.

22. As outlined in the Department for Work and Pension’s written evidence to the inquiry, we see pension schemes and other long-term institutional investors as having an important role in driving demand for TCFD disclosures, and these institutions may also wish to disclose in line with the TCFD recommendations in due course. However, the climate risks faced by a pension scheme are entirely determined by the firms in which they invest. For large institutional investors to be able to make meaningful disclosures in line with TCFD, there first needs to be widespread reporting by firms.

23. We explicitly asked the Green Finance Taskforce to consider Government’s role in facilitating and encouraging the implementation of the TCFD recommendations, and the Taskforce established a workstream dedicated to exploring this issue. Members of the Green Finance Taskforce, such as Aviva and HSBC, were also part of the TCFD, which ensured the Taskforce had direct access to the experience and expertise gained throughout the TCFD process. We will be responding to the Green Finance Taskforce’s report in due course.

24. We will continue to work closely with organisations already implementing the TCFD recommendations, to learn from their experiences, and to assess Government’s role in supporting their wider take up. The establishment of a new Green Finance Institute will ensure we can maintain this close collaboration with industry on green finance.

**Recommendation 5 (paragraph 72)**

*To ensure that climate-related financial disclosures are comparable and reduce the cost of reporting for companies and investors, the Government should work with the Committee on Climate Change to determine the appropriate way to produce a range of baseline policy and climate change scenarios that can be used as off-the-shelf reference scenarios by companies and asset owners.*

25. We recognise that Government could play a role in ensuring climate-related financial disclosures are comparable and cost effective. There is already a wide variety of private sector activity in this area, such as the TCFD knowledge hub, CDSB’s Climate Change Reporting Framework and the International Energy Agency’s future scenarios for climate change.

26. The UK is world leader in the production and collection of environmental data, and the Government currently invests more than £90 million each year in climate research.

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2. [https://www.tcfdhub.org/](https://www.tcfdhub.org/)
3. [https://www.cdsb.net/what-we-do/reporting-frameworks/climate-change](https://www.cdsb.net/what-we-do/reporting-frameworks/climate-change)
4. [https://www.iea.org/topics/climatechange/scenarios/](https://www.iea.org/topics/climatechange/scenarios/)
27. We are currently working with the Met Office Hadley Centre and the Environment Agency to deliver the UK Climate Projections for 2018 (UKCP18) to provide the most up-to-date assessment of how the UK climate may change over the 21st Century.

28. UKCP18 will use the IPCC Representative concentration pathways to model a range of greenhouse gas emissions scenarios. This updated evidence base can help underpin decision makers assessments of the physical risks arising from climate change.

29. We are grateful to the Committee on Climate Change and their Adaptation Sub Committee for their ongoing work to provide independent advice and expertise, and we will continue to work closely with them to ensure we meet our carbon budgets and adapt to climate change.

30. We also note the Green Finance Taskforce’s recommendation to establish a Centre for Climate Analytics that would develop tools and metrics to integrate climate and weather data and outputs into wider risk modelling frameworks that can be used within mainstream financial systems. We are currently considering this recommendation and we will respond to the Green Finance Taskforce report in due course.

**Recommendation 6 (paragraph 87)**

*The Government should set a deadline that it expects all listed companies and large asset owners to report on climate-related risks and opportunities in line with the TCFD recommendations on a comply or explain basis by 2022. The UK’s existing framework of financial law and governance could and should be used to implement climate-related risk reporting as the Green Finance Taskforce has recommended. For example, the Government should issue guidance making it clear that the Companies Act already requires companies to report on climate change where it is a material financial risk to their business. Companies and investors with high exposure to carbon intensive activities should already be reporting on climate risks in their annual reports as a matter of course.*

31. The TCFD recommendations have been backed by over 250 businesses worldwide representing more than $6.5 trillion in market capitalisation. Furthermore, the report identifies over 60 UK incorporated companies and financial entities that support the TCFD, demonstrating their widespread support.

32. The UK’s existing framework of financial law and governance already allows companies to disclose in line with the TCFD recommendations should they wish to do so, and most large organisations are already required to disclose material financial risks to their businesses, including those arising from climate change.

33. The report rightly recognises that it will take time for companies and financial institutions to develop the technical expertise required to report effectively in line with the TCFD recommendations.

34. In our recent Streamlined Energy and Carbon Reporting Consultation,5 we asked whether, in the long-term, any of the TCFD-recommended voluntary disclosures should

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become mandatory disclosures in companies’ annual reports. As outlined in our response to the consultation, there was mixed feedback from respondents, with many seeing benefit in a longer term move towards mandatory disclosure.

35. We have now published draft regulations that propose extending the number of organisations required to report on their energy use and emissions in their company annual reports, as well as an intensity metric and energy efficiency action in the previous 12 months. The mandatory reporting obligation would now fall on all large companies and large Limited liability partnerships [an estimated 11,300 organisations], increasing from an estimated 1200 quoted companies.

36. The report builds upon the recommendations of the Green Finance Taskforce and provides further evidence to support their findings. We will respond to the Green Finance Taskforce report in due course.

Chapter 4 – Financial regulators and climate risks

 Recommendation 7 (paragraph 103)

The UK could galvanise global momentum on climate-related risk disclosures by announcing at the G20’s leaders’ summit in November that it will implement climate-related financial disclosures fully and that disclosures will be mandatory for large companies by 2022. During this timeframe the FRC’s Corporate Governance Code and UK Stewardship Code the FCA’s listing rules should all be amended to require climate-related financial disclosures on a comply or explain basis.

37. The UK continues to lead the way in green finance through multilateral fora, including through co-chairing the G20 Sustainable Finance Study Group. Since 2016, this Group has explored a range of measures to address barriers to green finance, including increased disclosure for listed companies and green bond issuers, improved impact assessment and the innovative use of new and existing financial products.

38. A number of the companies which responded to the Financial Reporting Council’s (FRC) recent public consultation on updating the Corporate Governance Code, which notes the work of the TCFD, commented on the importance of environmental and social issues. BEIS will consider with the FRC what further action might be necessary to encourage companies to report fully on the broader non-financial matters that impact a company over the long term.

39. We value our positive relationships with the independent regulators and we are exploring regulatory recommendations from the EAC and the Green Finance Taskforce with them. We understand the FCA will be responding to this Committee’s report separately.

 Recommendation 8 (paragraph 104)

Embedding climate risk reporting in all relevant UK corporate governance and reporting frameworks could negate the need for new legislation. However, if UK regulators do not improve how they monitor the management of climate risk then the Government should pass new sustainability legislation similar to France’s Article 173.
40. There is widespread recognition amongst UK companies, their investors and other stakeholders, of the importance of corporate social responsibility to the long-term sustainability of their businesses. We also recognise this and have supported business efforts by setting the frameworks and market conditions for responsible businesses to prosper, including setting the corporate governance framework in which businesses operate and report.

41. The Government has already introduced legislative changes to encourage wider reporting on environmental and societal impacts by large companies. As outlined in our response to Chapter 2, in 2016, Government further amended the Companies Act to implement the EU Directive on Disclosure of Non-Financial and Diversity Information. This introduced additional requirements for large companies to provide information on the environmental and societal impacts of their business within their Strategic Reports. This framework permits the use of disclosures such as those set out by the TCFD to report their environmental impacts.

42. We are reviewing the early impacts of these changes to company reporting to evaluate the improvements in reporting on environmental and social issues. We want to see reporting by companies which is meaningful, genuinely informative for investors and aligned with management approaches to business planning and risk management. A voluntary, industry-led approach to climate risk reporting is encouraged. Best practice should evolve in this area and we will work with the FRC to monitor and learn from reporting companies’ experiences.

Recommendation 9 (paragraph 108)

The Secretary of State for Environment, Food, and Rural Affairs should use his Adaptation Reporting powers under the Climate Change Act to require the Financial Conduct Authority, Financial Reporting Council and the Pensions Regulator to produce Adaptation Reports.

43. Testing the consensus on the approach to reporting was a key plank of the Government’s consultation for the third round of the Adaptation Reporting Power. We proposed that reporting continues to be voluntary in view of early feedback from organisations that this would allow greater traction for engagement and flexibility to undertake future climate resilience work. Responses to our consultation also indicated a strong support for the continuation of voluntary reporting, with 60% of respondents favouring this approaching, this included the majority of reporting organisations. Government will therefore carry out the third cycle of climate change adaptation reporting on a voluntary basis, as set out in strategy, published as part of the National Adaptation Programme (NAP).

44. In the NAP, we have formally invited the Financial Conduct Authority (FCA), Financial Reporting Council (FRC) and the Pensions Regulator (tPR) to produce a climate change adaptation report under the third cycle of the Adaptation Reporting Power.

45. A list confirming all participating organisations will be published by the end of 2018.

8 /climate-change-arp-consult-sum-resp.pdf