22 June 2022

FIA response to the UK government's Call for Evidence to support its update of the Green Finance Strategy

FIA welcomes the opportunity to provide feedback on the UK government's Call for Evidence to support its update of the Green Finance Strategy. Furthermore, FIA members welcome the actions and responsibilities taken by the UK Government during COP26 in Glasgow and ongoing efforts to reach climate neutrality by 2050. FIA stands ready to assist the UK government's efforts and emphasise the need for government to work in partnership with the financial services industry to meet the UK 2050 commitment.

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers. FIA's mission is to:

- support open, transparent and competitive markets,
- protect and enhance the integrity of the financial system, and
- promote high standards of professional conduct.

A 2021 study, published in the *Climatic Change* journal has projected an increase in frequency and severity for hot weather, droughts and flooding in the UK. These high-impact weather events are likely to cause significant disruption across the UK affecting sectors such as health, transport, agriculture and energy. Financial markets can help unlock the capital required to fulfil the UK's net zero commitment and manage the risks associated with the transition to a more sustainable economic framework.

Q1. What are the key characteristics of a leading global centre for green finance?

FIA members believe key characteristics of a leading global centre for green finance include:

- The existence of an **open, transparent and competitive derivatives market** which is essential to unlocking capital necessary to meet the UK's net zero commitment. Derivative markets play a vital role in managing risk and discovering prices. These are crucial functions across various assets and commodities, including derivatives contracts on legacy fossil fuels like crude oil, renewable energy sources like a megawatt of solar power, or emissions markets via a tonne of CO_2. This risk-management and price discovery is essential to help businesses and stakeholders make knowledge-based investment decisions as they have the ability to understand and quantify the true costs of climate change. Furthermore, the derivative futures market provides an efficient mechanism for managing price risk. This helps buffer the impact of price volatility on corporate balance sheets, which allows intermediaries such as swap dealers and commodity trading firms to offer fixed-price contracts to their customers.

- In addition to the existence of an open, transparent and competitive derivatives market a leading global centre for green finance should seek to foster **market-led innovation**, through the creation of new products and solutions which will help meet the challenges and opportunities posed by climate change and the transition to a net zero economy. Innovation should be supported and complimented, not curtailed, by robust regulatory and governance frameworks. This is best achieved through the creation of **principle-based regulation** involving a range of stakeholders, including market participants and domestic academia.

- **Interoperability with other leading global centres for green finance** is key to mobilising investment. FIA members commend the UK government's efforts to create a gold standard for transition planning through the UK Transition Plan Taskforce. That said, it is equally important for the UK government to work with existing platforms (for example, International Sustainability Standards Board (ISSB)) and, where applicable, other global regulatory authorities, to produce consistent and principle-based frameworks and standards. This is essential to limit market fragmentation. Derivatives markets are global in nature and can play a vital role in tackling the borderless challenges posed by climate change. Regulation must be coherent, principle-based and reflect common standards across multiple jurisdictions.

- Finally, a leading global centre for green finance must establish the necessary foundations to enable the transition. These building blocks must have the backing and confidence of market participants. One of the primary foundations is the **creation and deployment of a Green Taxonomy** which is accessible and user-friendly. We recommend the UK government works with a wide range of stakeholders to create a UK Green Taxonomy, ensuring that the taxonomy does not restrict investment to activities which are vital to the transition.

Q4. What are the UK's comparative strengths and weaknesses in its green finance offering compared to other international financial centres? What are these are for: a) Asset management b) Capital markets c) Banking d) Insurance e) Professional services f) Fintech.
FIA's response focuses on b) Capital markets, but some comparative strengths and weaknesses may also apply to other areas of the financial industry.

<u>Strengths</u>

- The UK is well-positioned to leverage off the existence of a well-established, open, transparent and competitive derivatives market which includes a diverse range of products

and participants. As previously noted, this is key to price discovery, risk management and unlocking the capital necessary to fund the transition.
- The UK boasts a wealth of regulatory experience, with a track record of delivering on a robust regulatory framework. This will be key to engaging with stakeholders throughout the supply chain in transition planning as well as reporting, disclosures and stress testing.
- The UK may benefit from second-mover advantage when establishing policy and regulation governing the green transition in the UK. For example, the UK government may wish to consider ways of improving existing taxonomies to improve their capabilities and ease-of-use. That said, the UK has demonstrated its potential and ability to lead the green transition, for example, in writing the Paris Agreement into law.

<u>Weaknesses</u>
- There is concern that as major jurisdictions are moving at different speeds, there is a risk of fragmentation and diverging rules. This is particularly concerning for FIA members and other stakeholders with a global presence. Interoperability of regulatory frameworks is essential. We encourage the UK government to maintain lines of communications and cooperation with international partners and regulatory authorities in different jurisdictions and at the supra national level (in particular ISSB disclosures as a baseline).

Q6. What areas for potential growth – for example emerging financial products and instruments – are there in green finance for the UK financial services sector?
Environmental markets and innovative market-based solutions offer opportunities for companies to quantify, manage and value the environmental impact of their activities. The emergence of new financial products and instruments is a key area for potential growth.

By way of example, since their launch in March 2021, combined volume across CME Group's voluntary carbon emissions offset contracts has surpassed 100,000 contracts traded, equivalent to 100 million metric tons of CO2 equivalent, with active participation by UK market participants. Intercontinental Exchange has also recently launched its first Nature Based Solution Carbon Credit futures contract (NBS). These futures contracts facilitate investment in verified carbon mitigating projects and raise standards and price transparency across the carbon credit-industry.

Similarly, the London Metal Exchange and CME Group have also sought to introduce sustainability initiatives to play a role in global decarbonisation and the circular economy. These include the introduction of new contracts such as “LME Lithium”, “CME Lithium” and “CME Cobalt”, which are designed to promote access to core components of electric vehicle batteries to support accurate, fair and transparent pricing and price risk management in emergent markets which are essential to the green transition. Furthermore, the LME has launched “LMEpassport” which provides a centralised data depository for all LME-listed brands (those that can be used to settle exchange contracts) to disclose their ESG metrics. This platform is free-to-view for all stakeholders, bringing together key ESG metrics in comparable and clear formats to allow better assessment of progress over time. Finally, both LME and CME Group have imposed mandatory requirements on all listed brands to meet globally accepted standards for responsible sourcing, based, in the case of LME, on the OECD Guidance and, in the case of CME, on guidance issued by the London Bullion Market Association (LBMA) and the London Platinum and Palladium Market (LPPM) for responsible supply chains. While not a financial product per se, these requirements provide assurances for those wishing to trade metals that the underlying commodity has been sourced responsibly and this is reflected in the price. This also demonstrates the positive impact that exchanges – and the UK – can deliver in the sustainability space.

In addition to the examples of new products and initiatives, another area of potential growth is to expand the profile and mandate of the British Business Bank and increase financing under the UK Infrastructure Bank. These institutions have the potential to play a greater role in greening the UK economy by providing financing for green projects.

Q12. Are there barriers to the mobilisation of private investment into transition activities? If so, what are they and how might they be overcome?

One potential barrier which would limit the mobilisation of private investment into transition activities is a poorly developed and deployed UK Green Taxonomy. When developing the UK Green Taxonomy, FIA members encourage the UK government to make this as expansive as possible in order to cover a large portion of the economy. It is the view of FIA members that transition activities should be reflected within the Taxonomy to support the mobilisation of private investment. The trajectory of eligibility of transition activities and clarity on grandfathering provisions should also pave the way for additional investment so that investors are aware of the likely longevity of the technology/infrastructure until zero carbon alternatives are available. It is also absolutely essential that the taxonomy is user-friendly and practical, otherwise, uptake will be unnecessarily limited.

Q16. How can the UK government best assess the progress and development of a natural capital investment market?

When considering how best to assess the progress and developments of a natural capital investment market, we remind government that the transition will take time and policy should be established to encourage this transition without disrupting markets. If investment in, or financing of, potentially harmful activities were discouraged in the short term, companies with assets that are not yet, or are perceived not to be, in line with environmental objectives (e.g. coal-fired power plants) will find it very difficult to obtain financing for their commercial groups. Finance is required for the day-to-day operations of these firms, but is also essential to adapt their business and transition to a more sustainable business model. Furthermore, companies may have already begun the transition, but the economy relies on a certain product output that perhaps is not yet 100% achievable through sustainable resources, therefore a transition period is required to develop sustainable technologies. As an example, in June 2020, the UK stated that it was able to rely entirely on sustainable resources to produce power for a period of 2 months. While this is an encouraging development, it also indicates that the UK, like many other jurisdictions, is some way off being in a position to rely on renewable sources as the primary source of its power.

Discouraging or prohibiting investors from financing in current technologies may lead to market disruption and a negative impact on end-users and the economy as a whole. Activities and companies could be labelled as "brown" too soon, which may harm their ability to change and they will lose the opportunity to attract investment to make a transition as asset holders who are looking to green their portfolios will delist companies that are not "green". Furthermore, if assets or commodities are excluded from legitimate supply chains or businesses, the UK will have curtailed its ability to further influence positive change in those areas.

Q24. How should the UK harness the economic opportunities associated with high integrity growth in voluntary carbon markets and ecosystem services markets?

The success of scaling VCMs ultimately rests on building a market with high integrity, transparency and sufficient liquidity. As with any emerging or evolving market, meeting these objectives will require the infrastructure supporting these markets to continue to mature and a greater degree of standardisation to facilitate increased participation. This will ultimately boost confidence of participants across the entire value chain and help to develop a successful market. The introduction of a resilient and secure trading and clearing infrastructure for carbon credit futures contracts in March 2021 has resulted in the establishment of a liquid market which promotes the efficient allocation of capital and risk transfer. UK market participants are already active in these contracts with more than 100 million metric tons of CO_2 equivalent traded. The continued growth of liquidity in these contracts will be key to the ongoing development and deployment of carbon reduction and removal solutions to reach net-zero greenhouse gas emissions in the UK.