

GREENING FINANCE TO BUILD BACK BETTER

A UK ROADMAP AHEAD OF COP26

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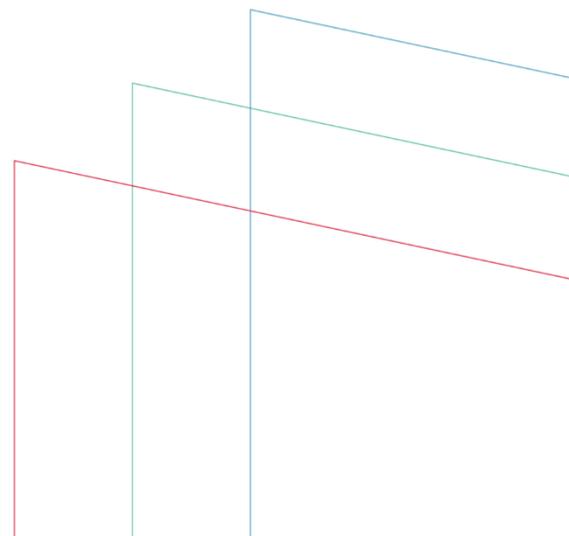
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EXECUTIVE SUMMARY

With the UK set to host the 26th UN Climate Change Conference of the Parties (COP26), there is an unprecedented opportunity to shape the green finance agenda and support a 'build back better' recovery. Chancellor Rishi Sunak has pledged to make the UK a world leader in green finance. The recent decision to green the Bank of England's mandate is a significant stride towards realising such an ambitious goal.

Indeed, this reform could not have come at a better time. Without a much more active approach by the Bank of England to re-align financial flows towards net zero (enabled by its new remit), existing policy measures will not be enough to align finance with climate targets in the timeframe required for transformative action. Nor will they help to boost the incomes, jobs, or economic prospects of the local communities to deliver the government's levelling-up agenda and the wider build back better programme.

Ahead of hosting the COP26 summit, and in the light of the Bank of England's new green mandate, this report lays out a bolder policy roadmap that reshapes UK finance and harnesses its power to genuinely build back better by supporting a green and socially just recovery.

Key messages:

- Policy attention is overwhelmingly focused on protecting the financial system from the risks posed by climate change, with scant attention given to protecting the climate from the risks created by finance.
- The financial system is currently misaligned with the goals of a green transition. Relying solely on market-led approaches risks both failing to manage material risks to the financial system and failing to sufficiently 'green' financial flows in the timeframe remaining for transformative action.
- With only 2%–5% of bank lending ahead of the pandemic going to small and medium enterprises (SMEs) – from which 60% of private-sector jobs in the UK come from – the set-up of the current financial system is not geared towards providing the vital patient strategic finance needed to support jobs, businesses, and local communities as part of a green recovery .
- With a new green mandate, the Bank of England has no excuse not to take action to stimulate green financial flows and regulate unsustainable private financial flows. But it cannot go at it alone; it will need to closely collaborate with public bodies and elected officials.

Key policy recommendations

Unleash green investment

The Bank of England, in coordination with the Treasury, needs to actively support a green build back better recovery by using the policy tools at its disposal. This should involve supporting green investment in the real economy by adjusting its lending schemes to provide cheaper credit to commercial banks, conditional on banks expanding their lending for sustainable projects, particularly SMEs. The Bank of England should also provide additional capital to the new UK Investment Bank by redirecting money it receives in repaid loans from financing facilities launched in response to the pandemic.

Regulate private finance

UK financial regulators need to ensure that private finance supports, rather than obstructs, the government's climate and levelling-up goals. The Bank of England and the Treasury should mandate that all UK financial institutions outline credible transition plans aligned with the Paris Agreement. They should introduce measures that require private financial institutions to fully account for climate-related financial risks, and push for Paris-aligned regulation of the financial system at the international level.

Reform the institutional ecosystem

The UK government needs to put in place the necessary institutional framework to deliver a green recovery and a just transition to net zero. This should involve establishing a coordinating task force of different public bodies to govern climate finance, as well as developing metrics and real-world targets to measure progress in shifting Britain's financial sector towards Paris alignment.

We outline these recommendations in more detail on the following page (see Table 1).

Table 1. Key policy recommendations.

UNLEASHING GREEN
INVESTMENT

1. **Green the Bank's targeted lending schemes (TFSME and iterations):** Use them to stimulate green financial flows by lowering the cost of borrowing for green activities, particularly those undertaken by SMEs and households.
2. **Repurpose the Covid Corporate Financing Facility (CCFF) to support the UK Infrastructure Bank:** Recycle and re-use the credit facilities created during the pandemic as well as funding from repaid Term Funding Scheme (TFS) loans to capitalise the infrastructure bank.
3. **Decarbonise corporate bond purchases:** Exclude the bonds issued by the most carbon-intensive sectors from the corporate bond purchase scheme, and add bonds that can be conducive to a greener economy.
4. **Provide monetary-fiscal coordination for build back better:** The pandemic has made clear the Bank can afford the Treasury significantly more fiscal potential than previously thought. Use this potential to support a build back better recovery.

REGULATE
PRIVATE FINANCE

5. **Require all UK financial institutions to outline credible Paris-aligned targets and plans to reach them:** UK financial institutions should also disclose the 'greenness' or 'dirtiness' of assets.
6. **Introduce climate-calibrated capital requirements:** Existing fossil fuel exposures should be subject to a 150% risk weight, while exposures related to the production of new fossil fuels should be assigned a significantly higher risk weight to make them ineligible for bank lending not fully backed by equity.
7. **Implement climate systemic risk buffers:** Macroprudential tools can address the systemic risks emanating from climate change, protect the financial system and the planet.
8. **Encourage adoption of climate-related regulation at the international level:** Implement a dirty penalising factor for global systemically important banks and credit ceilings for international fossil fuel lending.

INSTITUTIONAL
ECOSYSTEM

9. **Establish a coordinated body to help govern finance:** Create a green finance action task force of different public bodies to properly govern climate finance.
10. **Develop a comprehensive taxonomy, including dirty activities:** Learn from EU mistakes and lessons: a taxonomy covering dirty activities is equally needed alongside a green one.
11. **Develop metrics and targets on progress in shifting the UK financial sector to be Paris-aligned:** Create metrics that indicate the UK's progress in greening the financial system, and targets to hold public officials accountable for them.

1. INTRODUCTION

In the run-up to hosting COP26, the UK government is ramping up its environmental pledges. Most recently it committed to a 78% reduction in emissions by 2035,¹ and the Environment Bill set to pass this year includes targets for improving air quality, biodiversity, and water and resource efficiency.² More broadly, in the context of recovering from the pandemic, the government has repeatedly pledged to ‘build back better’ towards a fairer, greener, and more resilient economy.³

Fiscal, industrial, and environmental policy should be the first priority to realise these endeavours, but financial policy can also play a role by re-aligning our financial sector with the goals of a build back better recovery programme. A return to finance as usual is fundamentally at odds with the government’s levelling-up agenda and a socially just recovery, let alone our climate goals.

Finance is not a silver bullet to fix environmental and climate challenges, but, due to its vast scale and influence, it is one of the single, most important things to get right. The International Energy Agency (IEA), in a watershed report on a transition to net zero, has called for a rapid upscaling of green investment, from around \$2tn globally at present to \$5tn a year by 2030, as well as an immediate stop to all new oil and gas exploration projects.⁴ As a facilitator of real economic activity, where finance is allocated will influence whether the green transition is successful.

Several significant steps have been made to help mitigate climate-related financial risks. But despite certain overlaps, ensuring the financial system is protected from climate risks is not the same as ensuring the climate is protected from the risks posed by finance. As argued by the Advisory Group on Finance for the UK’s Climate Change Committee (CCC), “the UK financial system must go beyond managing climate risk and focus on net-zero as a key goal.”⁵

The government’s green finance strategy falls short of aligning private finance with net zero goals, leading the CCC to conclude in its 2020 progress report to Parliament that “there is a clear case for a more comprehensive approach to harnessing finance for climate action.”⁶

2. GREENING FINANCE, BUILD BACK BETTER, AND THE BANK OF ENGLAND

Greening the financial system requires a comprehensive approach undertaken by an institutional ecosystem of different public authorities. Yet, as the primary public institution tasked with overseeing the financial system, the Bank of England must play a crucial role in a build back better recovery and the transition to a low-carbon economy. It has responsibility for large swathes of financial regulation and could, with support from the Treasury, heavily influence the allocation of financial flows. Its monetary policy operations also influence financial market prices, which consequently affects where capital is allocated.

The Bank has previously recognised that, because climate-related financial risks threaten financial stability, it falls squarely within its mandate to safeguard the financial system from these risks. While the Bank has begun exploring ways to operationalise policies to mitigate the effects of climate change on the financial system, it has often shied away from acknowledging any duty to protect the environment *from* the financial system. However, recent developments provide an opportunity to turn the tide.

The Treasury has updated the remits of the Bank's Monetary Policy Committee (MPC), the Financial Policy Committee (FPC), and the Prudential Regulation Committee (PRC) to explicitly reflect the government's environmental priorities.⁷⁸ The MPC's remit refers to "the government's economic strategy for achieving strong, sustainable and balanced growth that is also environmentally sustainable and consistent with the transition to a net zero economy"⁹ while the FPC is required to "support the government's ambition of a greener industry, using innovation and finance to protect our environment and tackle climate change".¹⁰

Supporting the transition to an environmentally sustainable net zero economy now sits firmly and unequivocally within the Bank's mandate and requires a robust strategy for zero-carbon-aligned financial policy to follow.¹¹ Rather than simply attempting to keep the financial system resilient to climate risks (which is not necessarily aligned with climate objectives), it must, with the support of the Treasury and elected officials, proactively use its powers to create and shape markets in support of the government's legally binding emissions reduction target.

Positive steps in greening the financial system

Off the back of a game-changing speech (2015), *Breaking the Tragedy of the Horizon*, former governor of the Bank Mark Carney put the issue of climate change firmly onto the agenda of central banks in western high-income economies. At the same time, the 2015 Paris Agreement was just being ratified, with a core goal of "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient

development” (Article 2.i.c).¹² These events led to the establishment of several important domestic (Table 1) and international initiatives linked to green financing climate change – primarily aimed at ensuring that the financial system is resilient to the risks posed by climate change and that there is an orderly transition to a low-carbon economy.

Table 2: Selected initiatives in greening the financial system.

Main Actor(s)	Initiative
Her Majesty’s Treasury (HMT) and the Bank of England	Net zero remit for the Bank of England
Bank of England	Commitment to align the Corporate Bond Purchase Scheme (Corporate QE) with net zero and the launch of a consultation on greening the scheme
HMT, Bank of England, Department for Business, Energy & Industrial Strategy (BEIS), Financial Conduct Authority (FCA), Department for Work & Pensions (DWP), and the Pensions Regulator	Climate-related financial disclosures to be made mandatory by 2025
HMT and the UK Green Technical Advisory Group	Commitment to launch a green taxonomy, with Technical Screening Criteria to be finalised by end of 2022
HMT	Establishment of a UK Infrastructure Bank with a mandate to “help tackle climate change”
Bank of England (Financial Policy Committee and Prudential Regulation Committee)	Climate Biennial Exploratory Scenario (Climate BES) launched in June 2021 to test banks and insurers for resilience to climate risks
The National Environment Research Council, Innovate UK, and the University of Oxford	Establishment of UK research hub: Centre for Greening Finance & Investment
HMT (National Savings and Investments – state-owned savings bank)	Launch of green savings bond for retail investors, alongside green sovereign bonds
Bank of England (Prudential Regulatory Authority) and FCA	Establishment of the Climate Financial Risk Forum to share best practices and build capacity
Assorted UK institutional investors	UK investors (eg Aviva and the Church of England) among members to pledge alignment of portfolios with a 1.5 Celsius warming target.
Company shareholders, BP and Shell	Investor pressure behind net zero goals of UK-listed oil and gas majors (BP and Shell).
Glasgow Financial Alliance for Net Zero (GFANZ), major banks: NatWest, Barclays, HSBC, Lloyds	Major UK banks pledge to align balance sheet and scale up green finance

Source: Author’s compilation.

Given these developments, one could argue that progress has been made and “finance is more engaged than ever before behind climate action.”¹³ However, there is a significant difference between ‘engagement’ and actually shifting capital allocation. The

evidence presented in the following sections suggests that outcomes and direct policy interventions still lag behind rhetoric and engagement. Thus, these developments must be considered as positive first steps, but much more needs to be done to align financial flows with the government's climate targets and a build back better recovery.

Over 120 experts have criticised the government's deregulated and market-led approach for being over-reliant on markets fixing themselves without broader government oversight and intervention. Arguing that this finance-led approach will fall wide of the mark, they called for "bolder policies that reshape finance and harness its potential to help build back better by supporting a green recovery and the government's levelling up agenda".¹⁴

The government's Advisory Group on Finance for the UK's Climate Change Committee (CCC) has taken a similar stance:

These steps are all welcome in terms of direction. But the UK's financial system is still far from alignment with the net-zero goal...there is a clear case for a more comprehensive approach to harnessing finance for climate action. This need has been powerfully reinforced by the COVID-19 crisis.¹⁵

Indeed, using its own metric – portfolio warming potential – the Bank estimated that its Corporate Bond Purchase Scheme (CBPS) portfolio's "implied temperature alignment is estimated to be 3.0°C" by the end of the century.¹⁶ Recognising the carbon bias in the CBPS, the Bank recently launched a discussion paper and a consultation on options for greening the programme.¹⁷

A recent paper that comprehensively reviewed the UK government's green finance strategy, Dafermos and colleagues (2021) suggests the government's approach "prioritises the development of green asset classes to increase the competitiveness of the UK financial sector, lacks penalties for dirty activities and is over-reliant on transparency and disclosures".¹⁸ The authors further suggest that the scale and urgency required for a successful low-carbon transition are inconsistent with the government's market-oriented approach given several issues. These include irreconcilability between private finance and environmental breakdown; a general opposition to rapid and significant changes in climate finance from powerful corporate players and vested interests; and the potential for greenwashing, ie the deliberate act of conveying false or misleading information regarding the greenness of a financial product/portfolio, due to idiosyncratic classification of green assets.

TCFD disclosures – all eggs in one basket?

A major issue with the government's current green finance strategy is its over-reliance on the recommendations made by the Task Force on Climate-related Financial Disclosures (TCFD). TCFD-aligned disclosures are important and welcomed but putting all eggs in the TCFD basket largely explains the lack of progress in greening the financial system and aligning it with a build back better recovery.

The TCFD is the key plank of the government's green finance strategy and the Prime Minister's Ten Point Plan for a Green Industrial Revolution.^{19,20} The TCFD was set up by the Financial Stability Board (FSB) in the aftermath of the Paris Agreement to "improve and increase reporting of climate-related financial information", and outlined its recommendations in 2017.²¹ It calls for disclosures on how companies are managing climate-related risks across their governance, strategy, risk management, metrics, and targets. The premise is that, by ensuring better and comparable information on those risks becomes available, market actors will be able to correctly price and value assets and avoid the misallocation of capital.²²

While disclosures are welcome and should help financial actors to better understand climate-related financial risks, we should not mistake this first step for an end goal. An approach relying primarily on the TCFD is likely to fall far short of delivering a shift in financial flows either at pace or at the scale required to reach the government's legislated net zero target. Moreover, the TCFD will not necessarily stimulate financial flows and support the goals of the government's build back better recovery programme or the levelling-up agenda.

There are several reasons why reliance on climate risk disclosures as a key lever in aligning financial flows is insufficient.

First, the TCFD relies on the assumption that a primary obstacle to a net zero transition is the lack of sufficient information on climate risks linked to specific assets and companies, thus preventing investors from adjusting their portfolio accordingly. The evidence to date, however, suggests low levels of investor engagement with the TCFD metrics, with a recent survey of 2,000 investors by the HSBC finding that "just 10% viewed the climate related disclosures as a relevant source of information."^{23,24} Furthermore, with more than 50% of major European bank directors having affiliations to highly carbon-dependent companies and organisations according to recent research, it raises serious questions as to how effective any market-led approach to decarbonisation can really be.²⁵

Most damningly, while the Paris Agreement was signed back in 2015, and the TCFD outlined its core recommendations in 2017 (with their adoption growing since), funding for harmful fossil fuel projects has continued unabated, with **\$1.6tn** in loans and underwriting since January 2016 and, as of August 2020, **\$1.1tn investment** in bonds and shares in the **133 companies** driving the 12 major fossil fuel expansion projects analysed by non-governmental organisation (NGO) researchers.²⁶ Research by the Rainforest Action Network found "UK lenders have provided £158bn of financing for fossil fuel projects since the Paris Agreement" with the UK-based banks (and the TCFD signatories) HSBC and Barclays among the worst offenders.²⁷ A recent report by Greenpeace and WWF has estimated that indicative emissions financed by UK-based financial institutions amounted to 805 million tonnes CO₂e in 2019, equivalent to "almost 1.8 times the UK's domestically produced emissions".²⁸

There is no guarantee that even widespread coverage and perfect implementation would lead to a meaningful investment shift in the timeframe needed for transformative action, without explicitly targeting alignment with climate outcomes.²⁹ These findings are supported by the TCFD's status report, recent evidence collected by the FCA and the DWP, respectively, and a recent assessment by the UN's Principles for Responsible Investment.³⁰

Second, the effectiveness of disclosures and the TCFD largely relies on the notion that climate-related financial risks are quantifiable. This has, however, been challenged by leading green finance experts. In a recent report, the Bank of International Settlements demonstrates that the "radical uncertainty" associated with climate change impedes precise quantification of the risk it presents.³¹ The physical risks of climate change are subject to complex, nonlinear dynamics, including tipping points, which are unpredictable and difficult to quantify. The net zero transition also entails a structural economic shift affecting all sectors and agents in the economy. It is not possible to capture, or quantitatively estimate, all of the relevant interactions within a complex system, such as the global economic and financial system and the climate system. This radical uncertainty, or the presence of substantial unknown unknowns, means that financial markets may not be able to accurately 'price in' climate risks. Thus, an over-reliance on disclosure risks failing to manage material risks to the financial system, and the possible outcomes for climate goals could be heavily overstated.³²

Third, the TCFD takes a granular, micro-level approach towards risks at the individual company level. Depending solely on increased transparency assumes that markets are efficient and financial institutions can effectively self-regulate, which echoes the failed approach to financial regulation in the lead-up to the 2008 financial crisis. Whereas traditional financial regulation focused on the safety of individual institutions, the 2008 global financial crisis (GFC) made it clear that there were system-wide macroeconomic risks, including, for example, the build-up of mortgage debt and house prices relative to incomes across a whole economy, which also required monitoring and, where necessary, pre-emptive intervention. Thus, the TCFD on its own is unlikely to thwart the very real systemic climate-related financial risks; wider macroprudential policies will be needed.

Fourth, a disclosures-led approach fails in terms of the speed required to combat the deepening climate crisis. A recent study by ClientEarth found that more than 90% of FTSE100 and the 150 largest FTSE250 companies "made no reference to climate change and related factors in their financial accounts and audit reports".³³ The implementation roadmap by the Treasury outlined a five-year pathway for making disclosures mandatory for most companies, but this merely asks for publishing information without mandating any actual shift away from dirty and towards sustainable investments.³⁴ Thus, it risks almost half of a key decade to prevent a catastrophic rise in temperatures being squandered on an approach that may not produce any results.

Fifth, a disclosures-led approach lacks a meaningful link with outcomes in the real economy. The only obligation the TCFD imposes is disclosing information but there are no targets for curbing harmful investments, increasing green ones, creating sustainable jobs, or achieving actual reductions in emissions. This is despite climate science demonstrating there are hard limits to additional emissions, and the CCC calculating carbon budgets the UK must reach to achieve its targets.³⁵ To reach net zero by 2050, the IEA has called for a “historic surge in green energy investment”.³⁶ The climate-aligned approach to finance should consider these real-world metrics.

Finally, and perhaps most importantly, the Treasury and the Bank implicitly assume that making the TCFD recommendations mandatory – with a staggered rollout until 2025 – will support “a clean, inclusive and resilient recovery” that will “drive investment in more sustainable projects and activities”.³⁷ Outside of the misaligned time horizons, the TCFD recommendations were specifically designed to protect individual firms and financial institutions from climate-related financial risks. They were not designed to provide the vital, patient, strategic finance needed to support jobs, businesses, and local communities.

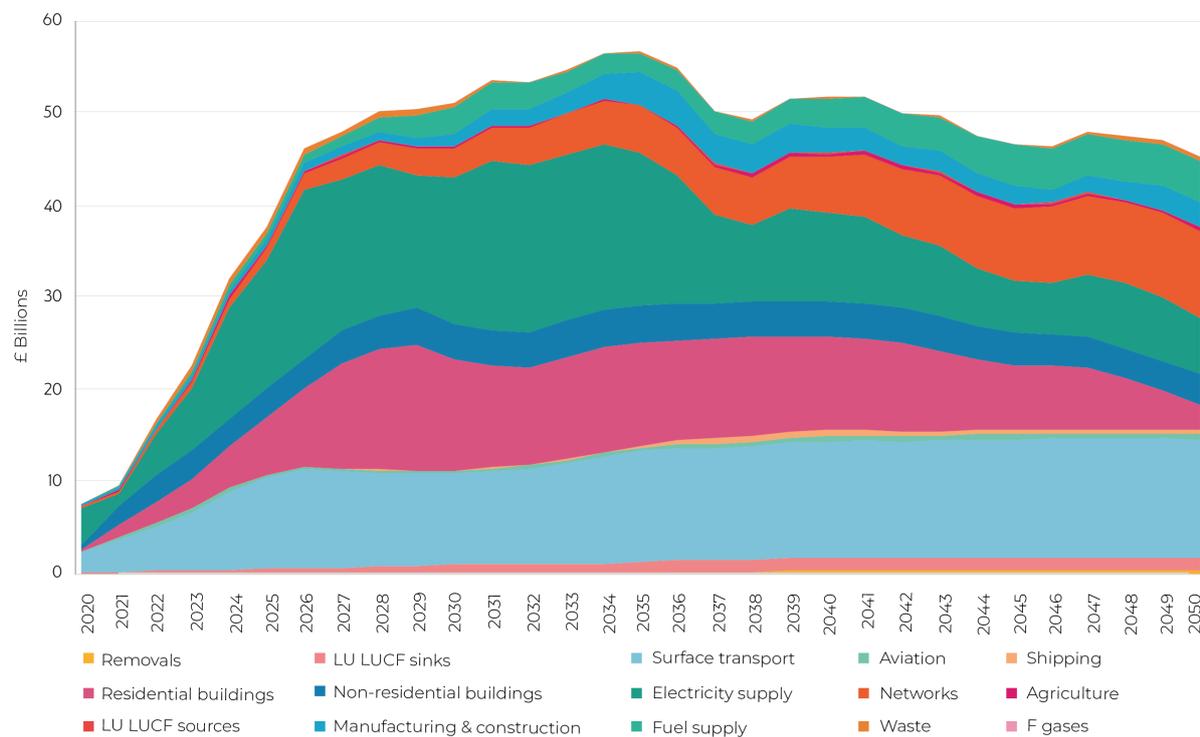
Further reasons to align finance with a build back better recovery

Outside of this policy analysis, evidence suggests that there are at least four other reasons the government and the Bank should take a more comprehensive approach to greening the financial system and supporting a green and fair recovery.

First, the green finance gap - the additional investments necessary to achieve the government’s climate goals - remains significant in the UK. As the IEA points out, “the path to net-zero emissions is narrow: staying on it requires immediate and massive deployment of all available clean and efficient energy technologies.”³⁸ However, according to the CCC, additional capital investment in net zero technologies and investments in the UK will need to scale up from around £10bn/year to nearly £60bn/year at its peak (Figure 1). The government’s plans fall short of meeting this required level.

Figure 1: Achieving net zero requires a large increase in capital investment.

Estimated additional capital investment by year (£bn, 2019 constant prices).



Source: Reproduced from the CCC (2020).³⁹

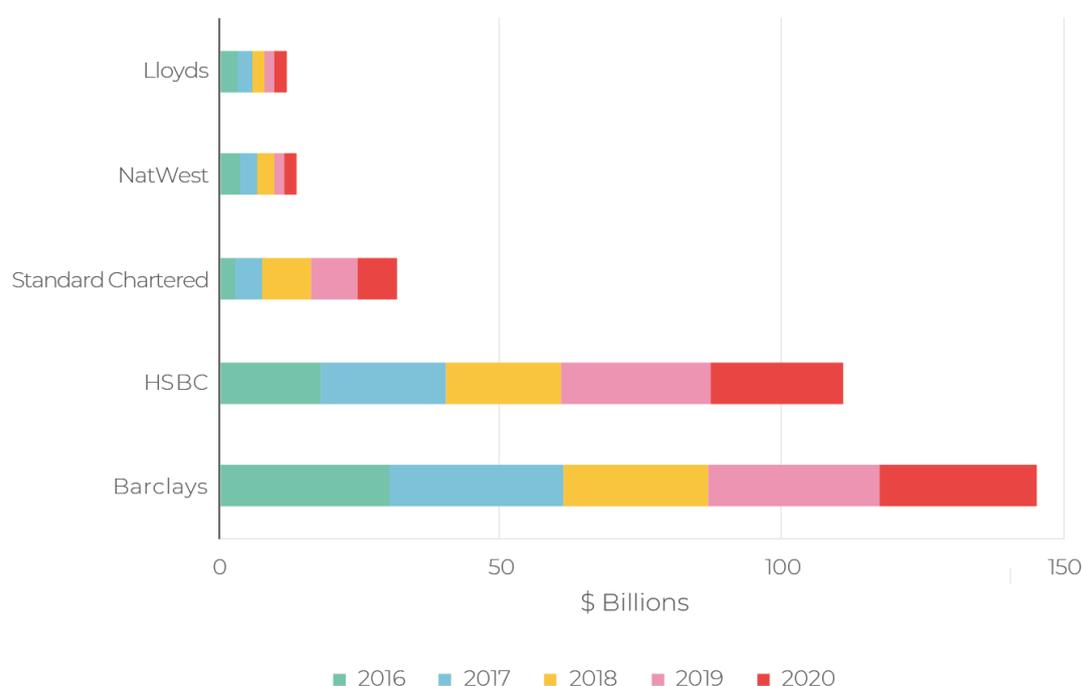
Second, **the UK financial system, through its size and lax regulation, plays a leading international role in hosting financiers of environmental breakdown.** The failure to price in the cost of greenhouse gas emissions in economic transactions and the subsequent overproduction of CO₂ has made climate change “the greatest market failure the world has ever seen”.⁴⁰ As noted by Dr Ulrich Volz at SOAS, University of London, banks contribute to this market failure: “The provision of credit by banks to socially undesirable activities, such as carbon-intensive or polluting businesses, can be characterized as a credit market failure.”⁴¹ Financial institutions benefit, at least in the short run, from the market failure that is climate change, and do not pay for the wider cost to society and the planet. This credit market failure is not recognised as an issue in the government’s green finance strategy.

Since the launch of the TCFD and the Paris Agreement in 2015, UK banks poured a disturbing \$312bn into fossil fuels, equivalent to about £225bn at the current exchange rate, with Barclays leading the way, as the ‘dirtiest’ bank in Europe.⁴² The City of London is the biggest centre of coal finance in Europe, with just the five major UK-based banks analysed by researchers having provided \$56 billion of support to companies on the Global Coal Exit List (GCEL) between October 2018 and October 2020.⁴³ In 2019, UK banks provided more than \$258bn in financing to sectors that the government and scientists agree are primary drivers of biodiversity loss.⁴⁴ With the large size of its

financial sector and lack of meaningful regulation, the UK is among the five worst countries in terms of the biodiversity-harming investments financed by its banks.⁴⁵

Figure 2: UK-based banks continue to finance billions in fossil fuel investments.

Fossil fuel financing by five largest UK banks between 2016 and 2020 (cumulative, \$bn).



Source: Rainforest Action Network.⁴⁶

On the environmental, social, and corporate governance (ESG) and institutional investor side, a recent report by the Common Wealth think tank analysed a cohort of over 10,000 mutual funds and exchange-traded funds (ETFs) registered for sale in the UK.⁴⁷ The author found 809 ethical funds, 150 funds marketed under an ESG theme, and 33 funds marketed according to a specific climate or low-carbon theme. Within the climate-themed funds, 12 funds (one-third of the cohort) held oil-and-gas-producing companies as of their recent filings (Q1/Q2 2020), of which three had stakes in oil giant ExxonMobil.⁴⁸

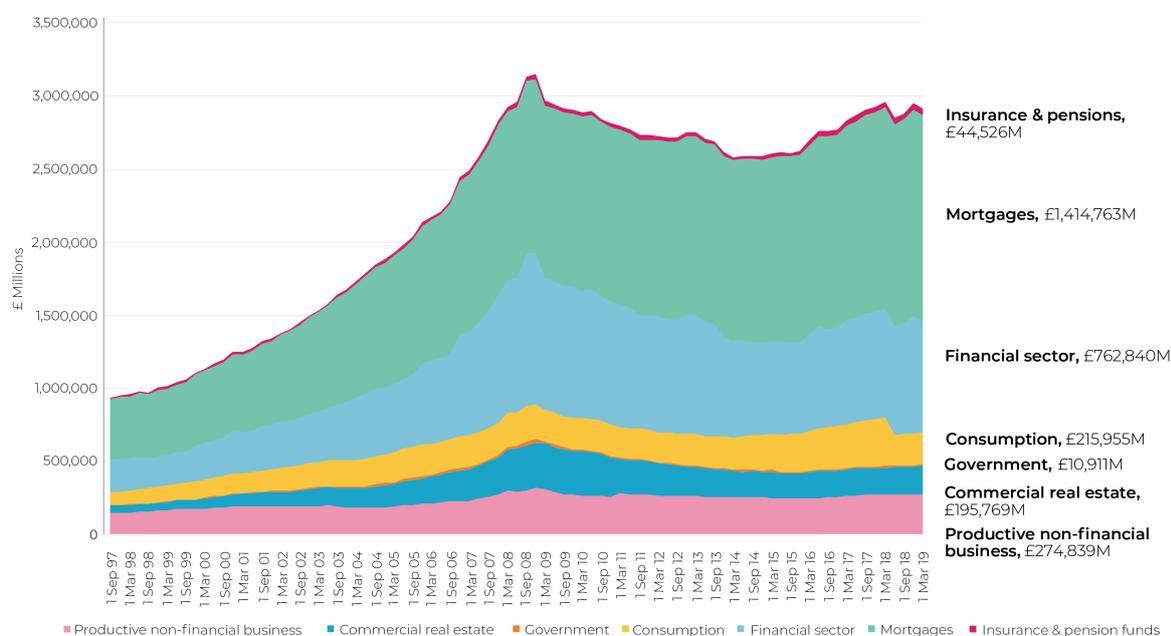
Third, **the continued financing of activities with a significant climate footprint will leave the UK financial system more exposed to climate-related financial risks.** A recent report by the Central Banks and Supervisors Network for Greening the Financial System (NGFS), of which the Bank is a leading member, estimated that the economic costs of climate-related transition risks materialising could range “from US \$1 trillion to \$4 trillion when considering the energy sector alone, or up to US \$20 trillion when looking at the economy more broadly”.⁴⁹ Given the UK financial system is at the heart of dirty financing, a significant proportion of these costs could likely materialise in our domestic system.

And fourth, **the set-up of the current financial system is not geared towards providing the vital patient strategic finance** needed to support jobs, businesses, and local communities in line with a green recovery.⁵⁰ Before the crisis, a significant share of bank credit was directed towards pre-existing assets in property and real estate (55%) and the financial sector (26%) with very little lending (8.5%) for non-financial businesses (Figure 3).^{51,52} Of equal significance, of the business loans that banks provide, only 2%–5% was for small and medium enterprises (SMEs) that form the backbone of our economy: 99.9% of UK businesses are SMEs, 60% of private-sector jobs come from SMEs, while 40% of gross domestic product (GDP) is derived from SMEs.^{53,54}

The problems with the supply of finance for productive investment, and particular challenges faced by the SMEs in accessing funding, are acknowledged by the Bank and the Treasury.⁵⁵ The Treasury's *Patient Capital Review* in 2017 found that smaller, innovative businesses struggle with barriers to obtain longer-term funding to achieve scale.⁵⁶ The Bank, in its August 2020 *Financial Stability Report*, echoed the particular problems with "investments that are longer-term, less liquid and more equity like than other types of instruments"^{57,58} – exactly the type we need for a green just transition to net zero.

Figure 3: Bank lending in the UK goes predominantly towards mortgages and the financial sector.

Quarterly amounts outstanding of resident financial institutions' sterling and all foreign currency net lending (in £mn) not seasonally adjusted. Based on data from the Bank of England Interactive Database.



Source: Bank of England, interactive database.⁵⁹

3. UNLEASHING GREEN INVESTMENT FOR A BUILD BACK BETTER RECOVERY

In the wake of the Covid pandemic, the Treasury and the Bank of England can build on existing policy toolkits to support a just transition to a net zero economy and turbocharge a job-creating and sustainable recovery from the current crisis. This requires a strategy composed of a combination of 1) stimulating green investment, 2) regulating private finance, and 3) designing a new institutional ecosystem capable of addressing the unprecedented scale of the challenge ahead. The following sections go through these in turn.

Recommendation 1. Green the Bank's targeted lending schemes

The first way to foster greater green financial flows is to design incentives that would encourage private banks to channel their lending for green productive purposes. The Bank could do so by implementing a “dual interest rate regime” differentiating interest rates according to its policy goals, as proposed by economist and macro fund manager, Eric Lonergan, and Global Economist and Senior Fellow at Harvard Kennedy School, Megan Greene.⁶⁰

Monetary policy operations are primarily enacted through the main policy interest rate tool, which operates both as a deposit rate, where the Bank pays out interest on deposits (central bank reserves, or central bank money) that commercial banks have with it, and as a lending rate, where the Bank charges interest on reserves that commercial banks borrow from it.

One variant of the latter is the Bank's Term Funding Schemes (TFSs). Where the interest rate on borrowing via a TFS varies from the main Bank Rate, it essentially represents a second rate, one at which banks can borrow central bank money from the Bank over a longer term and under specific conditions. This borrowing rate is currently set just above or at the policy rate. The Bank could establish a **green TFS**, with a borrowing rate deeply into negative territory, while keeping the main interest rate at close to 0%. Such differential lending rates would effectively subsidise the banking sector to channel lending towards green activities.^{61,62}

Implementing a green TFS could readily follow on from the existing and well-established Bank lending schemes. In March 2020, in response to the Covid-19 crisis, the Bank introduced the **Term Funding Scheme with additional incentives for SMEs** (TFSME) offering four-year funding to participating lenders “at interest rates at, or very close to, Bank Rate”, with more beneficial rates contingent on participants meeting the targets on additional lending to firms and households.^{63,64}

The TFSME followed the earlier **Funding for Lending** (FLS) and original TFS. These schemes are designed by the Bank to provide low-cost funding to commercial banks at a rate close to its policy rate to ensure interest-rate cuts are passed onto non-financial businesses and households. Such low-cost funding is only supposed to be available to banks committed and able to demonstrate an expansion in lending for particular types of activities.⁶⁵ The aim is to stimulate targeted economic activities by making borrowing cheaper, which should encourage more investment and spending.^{66,67}

The funding (lending) schemes are already designed to steer credit to specific sectors and agents in the economy for specific asset classes. In this respect, the Bank is already steering credit, so why not do so with a green lens?

To stimulate green financial lending, the Bank should expand and consider adjusting these programmes in four possible ways:

- 1) A **negative screening option** that screens out the dirtiest activities from support, beginning with coal and other extreme fossil fuels.
- 2) A **green tilting option** that seeks to align the TFS measures with a forthcoming green taxonomy, pushing the interest rate for green investment further down and ensuring it is passed onto borrowers, be it households investing in green retrofits, or firms investing in zero-carbon technologies.
- 3) A **combination of 1 and 2**, where eventually such an approach could align the TFSs with plans for a green and dirty taxonomy (further explained later – see Recommendation 10). This could also be implemented in a staged approach starting with lowering interest rates for green lending when the monetary policy is expansionary, and then adding dirty penalising measures with policy tightening.⁶⁸
- 4) **Applying different refinancing rates depending on the banks' lending profile in terms of climate consideration**, which could be implemented using existing climate metrics and would incentivise banks to rebalance their overall lending profiles, supporting economy-wide decarbonisation.^{69,70}

It should be noted that the principle of targeting credit flows and interest rates to serve specific national interests was extensively applied in many western countries after World War II.⁷¹ Such practices were also key to the East Asian economic miracle of the 1970s and 1980s and the more recent growth of the Chinese economy.⁷²

Recommendation 2. Repurpose the CCFF (and the TFS) to support the UK Infrastructure Bank

Alongside the TFSME, in their crisis response in March 2020, the Bank and HM Treasury set up the Covid Corporate Financing Facility (CCFF) to provide “funding to businesses by purchasing commercial paper of up to one-year maturity, issued by firms making a material contribution to the UK economy” and to “help businesses across a range of

sectors to pay wages and suppliers, even while experiencing severe disruption to cashflows". It also offered financing terms comparable to prevailing market rates before the Covid-19 crisis.⁷³

After operating throughout the first year of the pandemic, the CCFF closed to new drawdowns on 23 March 2021. Overall, it lent over £37bn to 107 different companies between March 2020 and March 2021, with a peak issuance of over £20bn in May 2020.⁷⁴ As of 26 May 2021, the outstanding volume of loans yet to be repaid was £4.58bn.⁷⁵ The plan is to wind down the facility once the final loans have matured in March 2022.

However, simply closing down the scheme would be a missed opportunity. The Bank could instead recycle the CCFF funds (and possibly a portion of £27.5bn of loans outstanding as of 26 May 2021 under the TFS⁷⁶ as these get repaid by borrowers) in support of the net zero transition. The operation is quite simple. The Bank has lent these funds out over the short term, and – subject to potential share of defaults – they will eventually be repaid. As the loans mature, the Bank could reinvest these repayments, either by 1) transferring them to the newly created UK Infrastructure Bank (UKIB)⁷⁷ to increase its seed-level funding, or 2) the CCFF itself could be redesigned as a new Green Investment Bank (GIB). While this would mean that the impacts on Public Sector Net Debt (PSND) would not be eliminated going forward [and would increase the PSND level compared to the Office for Budget Responsibility's (OBR's) current forecast], effectively it would simply repurpose funds previously allocated for the pandemic emergency schemes towards supporting long-term recovery and net zero transition.

This approach would also align with the Prime Minister's promise for a "Rooseveltian boost" to infrastructure spending.⁷⁸ Under President Hoover, in 1932 the Reconstruction Finance Corporation (RFC) started as an emergency lending facility for the US banking sector that was funded by the creation of new money by the US central bank – the Fed. When Roosevelt subsequently came to power in 1933, the RFC was transformed from an emergency lending facility into a public investment bank to support new deal policies. Between 1933 and 1945, the RFC lent \$33bn (over \$1.2tn in today's dollars), making it the largest lending institution in the world at the time.⁷⁹

In fact, similar actions were taken by the Bank itself in the aftermath of World War II. The Bank established the Industrial and Commercial Finance Corporation and Finance Corporate for Industry to provide credit to SMEs and large businesses, respectively. The aim was to help support and re-organise industrial and manufacturing sectors in the wake of World War II, bearing an uncanny resemblance to today's context where support and re-organisation are desperately needed.^{80,81}

With the seed funding for the UKIB set currently at only £12bn over the next five years⁸² (with a further £10bn in government guarantees), the OBR has reported the UKIB would only be able to support £1.5bn a year in investment. This falls far short of £5bn a year on average the UK received from the European Investment Bank (EIB) ahead of the Brexit referendum,⁸³ and is even further off the current green investment gap in the UK,

estimated as at least £10bn annually with additional funding needs increasing to £50bn according to the Climate Change Committee (CCC).⁸⁴ Given the UKIB's modest initial funding, re-investing up to £4.5bn from the CCFF and possibly £27.5bn of the TFS loans (once repaid) would be a major boost. With more of its own capital, the UKIB would be able to finance more and bigger projects and crowd-in more private finance, as well as provide core funding to harder-to-market yet essential net zero and levelling-up investments.

Recommendation 3. Decarbonise corporate QE

The Bank, in response to its new remit from the Chancellor, has committed to “adjusting the Corporate Bond Purchase Scheme (CBPS) to account for the climate impact of the issuers of the bonds we hold”⁸⁵ following on from Governor Andrew Bailey's previous pronouncements that it is a “perfectly sensible thing to do”.⁸⁶

In May 2021, the Bank launched a discussion paper on policy options to green the CBPS and opened a public consultation, inviting feedback from both industry stakeholders and civil society.⁸⁷ Echoing the arguments previously made by the New Economics Foundation (NEF) and partners,⁸⁸ the Bank proposed a four-pronged approach to decarbonising the CBPS: setting targets, in particular for the emission path of the scheme; linking eligibility for the scheme with climate-related criteria; tilting its bond purchases towards issues with stronger climate performance; and using an escalation approach for tightening the standards with time and penalising non-compliant bond issuers. These tools are to follow three principles: incentivise companies to achieve net zero; lead by example, learning from others; and ratchet up requirements over time.⁸⁹

Promisingly, the Bank suggested that the bonds issued by the most carbon-intensive sectors from the scheme could be excluded and more bonds that could be conducive to a greener economy could be added. With the groundwork laid out, the Bank now needs to turn these principles into an ambitious climate-aligned policy. As the recent International Energy Agency (IEA) report stressed, “there is no need for investment in new fossil fuel supply in our net zero pathway.”⁹⁰ This provides clear guidance that such investments and related assets need to be excluded from support and curbed overall as a matter of priority.

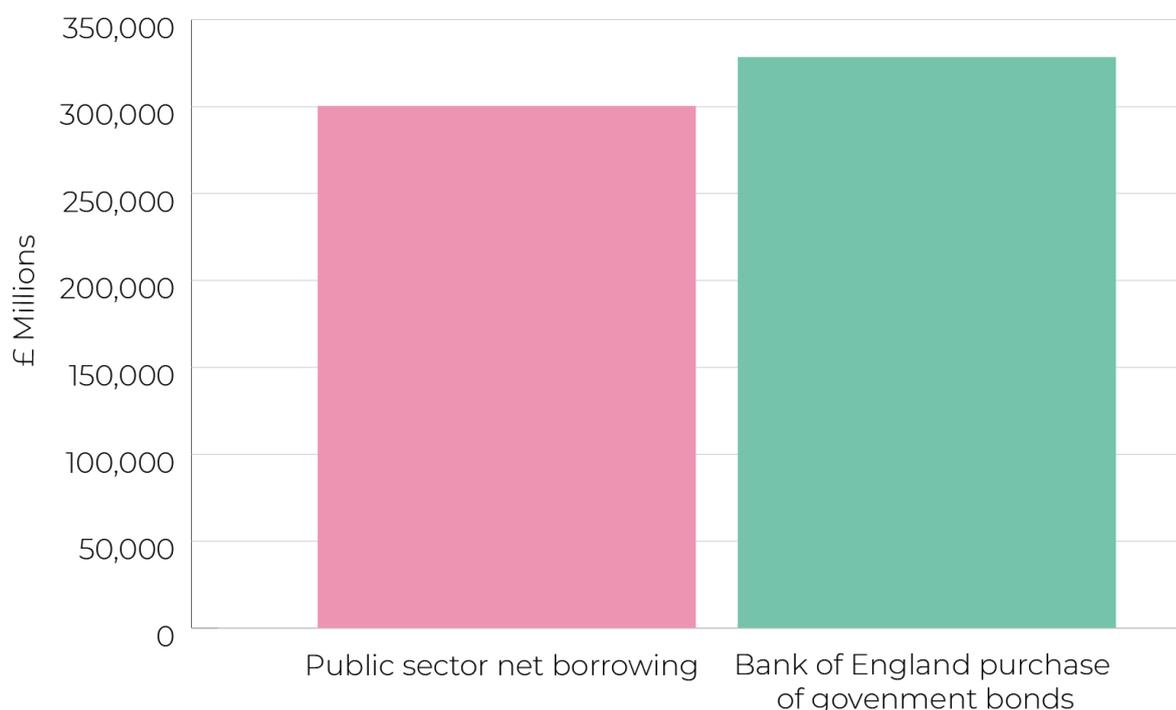
Lastly, as in Recommendation 2, besides decarbonising the CBPS, the Bank could use funds maturing from the CBPS for reinvestment into the UKIB once the Monetary Policy Committee (MPC) decides to begin reducing the corporate bond holdings. This more strategic form of quantitative easing (QE), could provide an additional £20bn of capital to the UKIB.⁹¹

Recommendation 4. Coordinate monetary-fiscal for build back better

The Covid crisis has revealed deep-seated and long-standing flaws in how mainstream policymakers understand public finances. Since the outbreak of the pandemic, there has been substantial monetary and fiscal coordination, making it clear that under certain macroeconomic conditions, the UK government's financing needs can be supported by the Bank with ease. Indeed, the Bank's QE programme, which creates new central bank money, has perfectly tracked the government's borrowing needs, and helped the government to borrow at cheaper rates⁹². It is hardly surprising that in a survey of the most prominent investors, the *Financial Times* found the overwhelming majority to believe the Bank was financing the government's new borrowing.⁹³ Indeed, the Bank created more money from March 2020 to March 2021 than the government borrowed as illustrated in Figure 4.^{94,95,96}

Figure 4: The Bank of England's asset purchases exceeded government borrowing in 2020-21 financial year

Public sector net borrowing excluding public sector banks, and Bank of England net gilt purchases in financial year ending March 2021.



Source: Author's own calculations based on ONS and Bank of England.

Naturally, there are limits and constraints, such as inflation, as to how much the Bank can support the financing needs of the government, and these deserve debate and discussion. What is clear from the most recent crisis, however, is that the Bank can offer

the Treasury significant fiscal room for manoeuvre. If we could use these tools for the Covid emergency, surely they can be re-deployed to help tackle environmental breakdown. Since public spending will also play a key role in our ability to respond to the climate crisis with a fair and green transition, the Bank and the Treasury should collaborate and use their powers to support public investment in well-paid (secure) green jobs and the infrastructure necessary to meet environmental targets.

4. REGULATING PRIVATE FINANCE FOR A THRIVING PLANET

As the supervisor and a regulator of the UK financial industry, the Bank of England has responsibility for monitoring markets and ensuring that activities of private financial institutions do not lead to a build-up of systemic risk that threatens the UK's financial stability and economic resilience.

The Bank is home to the two key decision-making bodies responsible for regulating the UK financial system: the Financial Policy Committee (FPC) and the Prudential Regulation Committee (PRC). The FPC “identifies, monitors and takes action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system”⁹⁷ whereas the PRC makes the most important decisions for the Prudential Regulation Authority (PRA), which supervises around 1,500 UK financial institutions, promoting the safety and soundness of firms to maintain financial stability in the UK.^{98,99}

In failing to take action to curb environmentally destructive lending, the regulators are currently undermining the government's environmental objectives and allowing a build-up of systemic risk that threatens the stability of the financial system. Just as the Bank developed policies to mitigate housing market risk following the 2007–08 financial crisis, it should also adopt a precautionary approach and take action to protect against lending that is exposing financial institutions and society as a whole to major climate- and nature-related risks.¹⁰⁰ Most importantly, we need a regulatory system that doesn't just protect banking and finance from climate risks, but one that protects the climate and environment from banking and finance.

Recommendation 5. Require all UK financial institutions to outline credible Paris-aligned targets and plans to reach them

Financial institutions are already making voluntary net zero commitments, but they are still too sparse and insufficient. The Bank, alongside the Treasury and the Financial Conduct Authority (FCA), should require all financial institutions to outline credible net zero plans to achieve targets aligned with the UK's net zero target.¹⁰¹ The Climate Change Committee's (CCC's) advisory group on finance recommends that these targets and plans are “delivered through five-yearly interim net-zero goals, matching the UK carbon budgets, with annual reporting of progress”.¹⁰²

Over time, and once both green and dirty taxonomies are developed, UK financial institutions should similarly be required to disclose the greenness and dirtiness of their assets. As noted by Dafermos and colleagues (2021):

TCFD disclosures cannot replace disclosures about the greenness and dirtiness of their assets. The TCFD recommendations refer to information about the governance and strategies around climate-related risks and opportunities, as well as to risk management processes, metrics and targets. Disclosing information on these issues is useful, but does not ensure the availability of clear information on how green and dirty the activities and financial assets of corporations are.¹⁰³

Ultimately, the TCFD framework is still inconsistently applied and it is still extremely difficult to make useful comparisons across companies, which can impede critical climate-based decisions. Taxonomy-aligned disclosures should play a key role in aligning banks' balance sheets with a zero-carbon future.

Recommendation 6: Reflect climate risks in capital requirements

After it became clear that banks were severely under-capitalised and over-leveraged in the run-up to the last global financial crisis (GFC), new banking regulations materialised in the form of additional capital requirements. Capital adequacy requirements compel banks to back a proportion of their lending with shareholders' equity, ensuring those investing in the banks have more skin in the game when banks grant loans. In this sense, capital requirements are intended to act as a cushion to absorb losses when loans default, so that the bank can continue functioning after taking a financial hit without taxpayers having to come to the rescue.

Capital requirements are designed to prevent a repeat of the 2008 GFC and are conventionally considered a useful measure to protect taxpayers against potential bank bailouts. By ensuring banks have more skin in the game, higher capital requirements may also reduce their risk-taking practices. Higher capital requirements tend to make loans more expensive for banks, ie they must acquire more capital from shareholders to grant a loan. If raised, other things being equal, capital requirements will thus decrease the volume of loans granted by the banking sector to households and firms.

The post-GFC reforms to strengthen banks' capital adequacy requirements took shape under Basel III regulations, which are intended to ensure that banks remain solvent in times of distress when there are unexpected losses.¹⁰⁴ These new rules initially failed to account for climate-related financial risks, but the Basel Committee on Banking Supervision (BCBS) is now seeking to correct this glaring oversight. In a recent speech, the chairman of the BCBS revealed that the Committee will "conduct a 'gap analysis' to identify areas in the current Basel Framework where climate-related financial risks may not be adequately addressed or are not captured. This gap analysis will be comprehensive in nature, and will cover regulatory, supervisory and disclosure elements."¹⁰⁵

While determining its post-Brexit financial services regulatory framework, the UK is in a perfect position to stay ahead of the curve and implement "climate-calibrated capital

adequacy rules”.¹⁰⁶ Basel prudential requirements already state that regulators should “apply a 150% or higher risk weight reflecting the higher risks associated with some other assets”.¹⁰⁷ As argued by Finance Watch, existing fossil fuel exposures should be considered as high risk and therefore be subject to a 150% risk weight, while exposures related to the production of new fossil fuel resources should be assigned a high-enough risk weight to make them entirely equity funded to discourage such investments.^{108,109} A recent report by the Climate Safe Lending Network found that sustainable finance experts across academia, civil society, and finance rated this as a highly impactful and feasible proposal.¹¹⁰

These higher-risk weights for fossil fuels and other environmentally destructive exposures, otherwise known as ‘dirty penalising factors’, should be the regulatory priority to protect financial stability and steer financial flows away from these activities. Conversely, lower capital requirements for green loans are currently not advised, as they are unlikely to lead to a noticeable increase in the level of sustainable investment. Instead, they would risk weakening an already fragile banking system and undermining the efficacy of the still-developing field of sustainable finance.¹¹¹

Recommendation 7. Implement climate systemic risk buffers

An alternative to raising capital requirements on carbon-intensive loans would be to implement a **climate systemic risk buffer** (Climate SyRB) as proposed by Pierre Monnin from the Council of Economic Policies, similarly requiring banks to hold increasing amounts of capital corresponding to increased exposures to climate risks.¹¹² A capital buffer is obligatory capital that a financial institution is compelled to hold in addition to capital requirements. The capital buffer was introduced as one of several macroprudential tools after the financial crisis to account for the macro-financial environment that banks operate in and to protect the financial sector from periods of excessive credit growth.¹¹³ A Climate SyRB could help guard against the potential build-up of endogenous systemic risks (those risks created from within the financial system itself), act as a financial backstop in the face of shocks, and limit the spread of potential financial contagion.

While capital buffers are generally applied on a broad basis, there are examples of capital buffers that target specific segments of the credit market. For example, in February 2013, following a proposal from the Swiss National Bank (SNB), the Swiss Federal Council activated a sectoral countercyclical buffer targeting mortgage loans for residential real estate in Switzerland. The measure reflected the SNB’s concerns that imbalances in the residential mortgage and real estate markets had reached a level that posed a systemic risk to the stability of the banking sector. The measures remain in place and require banks to hold additional capital of 2% of the relevant risk-weighted positions. Such

sectoral capital buffers may also lend themselves to address the financial risks of coal-exposed assets.^{114,115}

Recommendation 8. Encourage adoption of climate-related regulation at the international level

Adjusting climate-related financial regulation domestically is important, but it is not enough. As well as positioning itself a step ahead of international prudential standards, the Bank must also encourage reform of international standards to protect against evasion of domestic climate-related financial regulation¹¹⁶. The Bank should use its membership in the international standard-setting bodies – the BCBS and the Financial Stability Board (FSB) – to accelerate the adoption of new climate-related requirements globally, including a dirty penalising factor for global systemically important banks (G-SIBs), requiring them to hold additional capital depending on the dirtiness of the assets in which they invest.¹¹⁷

At the same time, it is worth noting that the majority of UK banks' fossil fuel lending is done internationally and measures to curb such lending are desperately needed. Indeed, it is inconsistent for the UK to phase out unabated coal-fired power stations by 2025 while allowing UK banks to profit from lending and underwriting the expansion of coal energy projects elsewhere in the world. The government should explore putting specific ceilings on UK bank lending for international fossil fuel generation with the eventual target of phasing out all lending for new fossil fuel energy expansions.

Ultimately, a globally coordinated approach to regulation will be necessary to adequately tackle the “climate-finance doom loop” whereby the financial sector finances climate chaos, which in turn threatens financial stability.¹¹⁸

5. DEVELOPING A FIT-FOR-PURPOSE INSTITUTIONAL FRAMEWORK

To support the implementation of these recommendations, a new institutional ecosystem within the public sector will need to be developed – urgently. A significant issue facing financial supervisors and central banks across high-income western countries is that they were not designed to address market failures related to climate change and wider environmental breakdown. In this respect, there is a fundamental mismatch between what the Bank, and regulatory institutions like the Financial Conduct Authority (FCA), were originally designed for and what society and the planet really need. A consequence of this mismatch is that the appropriate institutional processes and tools, such as green and dirty taxonomies, have not been developed.

Recommendation 9. Establish a coordinated body to help govern finance for a build back better recovery

An implicit assumption of the UK's governance framework is that the profit-maximising behaviour of financial firms will drive them to allocate economic resources efficiently, maximising the welfare of society. Yet, in the UK, we have a relatively undiversified banking system, geared towards prioritising shareholder profits over the environment. Financial analysis is generally focused on short-term time-frames. While long-term investors (are supposed to) seek returns over a 15–30-year time horizon, financial analysts focus on the next 1–5 years. According to research by the 2 Degrees Lending Initiative, “non-cyclical, nonlinear risks that will only materialise after the forecast [analysis] period are likely to get missed by analysts and therefore mispriced by markets.”¹¹⁹

The assumption in our institutional design is largely that finance always works in society's interest, and thus public policy interventions are intended to ensure the continuity and stability of the financial system. Authorities believe they can only act on climate if it has an impact on financial and monetary stability. In this respect, these institutions were not designed to govern finance's impact on the planet and society.

At the same time, it is clear that the cost of inaction in the fight against climate change will only aggravate climate-related financial risks (as well as wider environmental risks). In this respect, the severity and nature of climate-related financial risks fundamentally depend on how well a green transition is managed by the government. For example, fiscal policies – carbon taxes, capital infrastructure investment, continued fossil fuel subsidies – all have implications for the financial system and climate-related financial risks. Thus, while the Bank and the FCA have an elevated responsibility to act on climate change, a coordinated approach to govern finance is required.

Accordingly, the Bank must coordinate closely with the Treasury, as well as other government authorities including the Department for Business, Energy, and Industrial Strategy (BEIS), and independent bodies such as the Climate Change Committee (CCC). The Bank should initiate a Green Finance Action Taskforce (GFAT) with representatives from these institutions to coordinate and oversee the greening of the financial system.¹²⁰ As proposed by Dafermos and colleagues. (2021) “GFAT will closely oversee progress in greening private finance, including the development of the Public Taxonomy, will monitor the green finance gap, will take actions to tackle transition risks and will respond to obstacles that stand in the way of reorienting private finance towards green activities.”¹²¹ Indeed, GFAT could among other things:

- Monitor the transition effects of green finance policies and design appropriate measures to mitigate transition risks.
- Review and coordinate policies that help fill the green finance gap by stimulating the investment required over the next decades to meet the goals set by the Paris Agreement.
- Dynamically update the set of measures tackling dirty assets to minimise the potential for greenwashing and regulatory arbitrage.
- Dynamically update the set of measures encouraging the emergence and rapid growth of green assets to minimise the potential for greenwashing and address potential imbalances between the demand for and supply of green assets.
- Analyse how climate policies are likely to affect the financial system and make suggestions for the coordination of green fiscal, industrial, and finance policies.
- Advise and adjust regulations regarding fiduciary duties to ensure that climate regulation does not lead to fiduciary breaches.

GFAT would be a key step in building the capacity and the institutional architecture necessary to adapt the financial system to the challenges of climate and ecological breakdown, ensuring it contributes to achieving the government’s net zero target. While establishing such a body would not be essential for the implementation of the policies recommended herein, it would accelerate progress.

GFAT should run frequent public consultations to ensure its policies are informed by a wide array of views from civil society and the private sector. GFAT officials could be responsible for reporting their progress to the Treasury Select Committee or a new parliamentary committee made up of a range of members from several existing committees.

Importantly, to maintain operational independence, the committee would not be able to provide any operational directives to the Bank. With input and recommendations from GFAT, the Bank would design its proposals for managing risks, goals, and targets, and how these relate to realising its current operational objectives of sound prudential and monetary policy management. It could outline how it wants to use the policy tools at its disposal. It may even come up with proposals for using new tools (subject to approval to

the Treasury). The Treasury and the BEIS (and other members of the committee) could then have open conversations about gaps in the Bank's approach and what supportive policies from other institutions are needed.

Recommendation 10. Develop a comprehensive taxonomy, including dirty activities

Transitioning the financial system will require a taxonomy: a common understanding and application of the terms 'green' and 'dirty' or 'sustainable' and 'unsustainable'. How we define these terms will determine where finance flows in the coming years, and consequently whether we achieve our environmental targets. The Treasury has announced that a UK Green Technical Advisory Group will develop a green taxonomy based on the EU taxonomy.¹²²

However, the EU green taxonomy has been weakened by industry pressure and parts of it have become detached from scientific grounding, deviating in several areas from the recommendations by the European Commission's own Technical Expert Group (TEG).¹²³ Indeed, there are multiple lessons that the UK should learn from the EU. For this reason, GFAT should monitor and scrutinise the taxonomy developed by the UK Green Technical Advisory Group.

The UK's taxonomy must have a firm grounding in science, benefit from extensive public consultation, and classify both green *and* dirty activities.¹²⁴ At present, plans for the UK taxonomy only focus on the greenness of assets, with no classification system for non-green activities, including levels of harmfulness. Developing a comprehensive taxonomy, going from green to dirty (how environmentally harmful activities in question are) and including different shades of both is crucial for regulators to be able to penalise activities with detrimental climate impacts.

Recommendation 11. Develop metrics and targets on progress in shifting the UK financial sector to be Paris-aligned

As noted by the CCC, there currently is no metric that measures the extent that the UK government is delivering on the Article 2.i.c financial consistency test of the Paris Agreement. Indeed, the Bank does not publish or gather data on the level and sufficiency of capital flows needed to meet UK climate goals. Nor does it publish data surrounding the stocks and new financial flows going into environmentally damaging activities. This makes it impossible to understand or evaluate the extent our financial system is being decarbonised.

Accordingly, the Bank (alongside GFAT), in consultation with academic experts, civil society, and industry practitioners, should develop a metrics dashboard that helps us better understand where financial flows are going and for what purposes. Yearly targets

for financial flows could be developed and GFAT could be assessed against the progress in meeting these targets. Moreover, if certain targets were missed, either consistently or on a large scale, then bolder policy interventions could be designed.

As is current practice with fulfilling price and financial stability mandates for the Bank, accountability mechanisms could be established to ensure that GFAT is meeting its outlined goals. For example, the Bank is obliged to write a letter to the Chancellor of the Exchequer when it misses its inflation target by 1% or more. Similar processes could be established if GFAT misses targets for managing climate-related objectives.

6. CONCLUSION

Despite some important developments, at present the UK financial system is significantly misaligned with the goals of the green transition and a build back better recovery. A return to finance as usual is fundamentally at odds with the government's levelling-up agenda, the creation of new green jobs, and a socially just recovery, let alone our environmental goals. As host of the G7 and COP26 this year, the UK has a unique opportunity and a responsibility to lead the way in steering finance in a sustainable direction. This report has outlined a roadmap that can help us achieve this objective.

A key theme of this report is that we cannot simply protect the financial system from climate change and environmental breakdown; rather we need to protect the climate and environment from finance. This will require more than mere incremental adjustments to the financial sector that tinker around the edges. What is really needed are bold solutions that will reshape finance to credibly deliver a sustainable green transition.

At the same time, the set-up of the current financial system is not geared towards providing the vital, patient, strategic finance needed to support jobs, businesses, and local communities in line with a green recovery. It is becoming increasingly clear that we will not succeed in realising our climate goals if they are not linked to socio-economic goals. Green finance policies are primarily about ensuring the financial sector is resilient to climate-related risks; they are not about stimulating investment, creating new jobs, and supporting local communities. Much more consideration is required around how to steer the financial sector to support a build back better recovery.

Finally, the new mandate for the Bank should allow it to do more to address market failures related to climate and environmental risks. Nevertheless, it cannot be, nor should it be, solely responsible for greening the financial system. This requires a coordinated and collaborative governance approach, with various public sector bodies and the appropriate checks and balances.

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