global witness

BRIEFING September 2022

AN OPPORTUNITY TO END THE MONEY PIPELINE TO GLOBAL DEFORESTATION AND ACHIEVE THE UK'S CLIMATE AND NATURE TARGETS

Financial Services and Markets (FSM) Bill 2022
Global Witness's Second Reading Briefing

The Financial Services and Markets Bill has been described as a 'once-in-a-generation' opportunity to redesign the rules underlying all UK financial regulation. It establishes the UK's future regulatory framework, which includes a new 'international competitiveness' objective for the Financial Conduct Authority and Prudential Regulation Authority, who will also receive greater powers to write, amend and enforce new regulations through the Bill.

A 'once in a generation' Bill must be fit for the future economy and the planet we want to leave for the next generation. However the current draft is weak in this respect. With all major economies signed up to legally binding Paris Agreement targets, the transition to a green economy is gathering pace and this is a chance for the UK to place itself at the head of the pack.

In its current form, the Bill does not deliver the leading competitive net zero financial centre and nature-positive economy the British public have been promised. Nor does it deliver on UK-led global commitments to align financial flows to end and reverse tropical deforestation.

We are therefore calling for the following amendments:

1. New forest-risk commodity due diligence requirements for financial actors, so that financiers take responsibility for the deforestation they're funding and associated human rights abuses and stop such funding, as recommended by the Government's own Global Resource Initiative taskforce in May 2022. Such requirements would match those required of large companies under Section 17 of the Environment Act, bringing companies operating in the UK and their UK funders into line.

2. A new statutory objective for regulators on nature and net zero

Currently, the Bill forces regulators to prioritise competitiveness and growth over the UK's legally-binding nature and climate targets. Although the Bill includes a 'regulatory principle' (which has a lower status than a statutory objective) on net zero alongside principles like "recognising differences in businesses" regulators must only take this '*into account when pursuing their statutory objectives*'. It replaces a similar existing principle on sustainable growth, which has not proved effective for nature either[1].

A climate and nature-specific statutory objective – as is backed by Aviva, WWF, ShareAction and E3G – would prevent a race to the bottom and position the UK as the financial centre at the forefront of the global green economic transition. It would ensure regulators have the powers necessary to deliver the UK's legally binding targets, including reaching net zero by 2050 and the Glasgow Leaders' Declaration on Forests and Land Use.

FURTHER DETAIL

Nature and net zero: Ending the UK's role in global deforestation

Net zero targets can only be met if the UK financial sector stops financing global deforestation. The agriculture, forestry and land use sector produces almost a quarter of all global greenhouse gas emissions. Around 11% of all CO_2 emissions come from deforestation and forest degradation. Urgent action to end deforestation by 2025 at the latest is required to keep the Intergovernmental Panel on Climate Change's 1.5°C no/low-overshoot scenario pathway alive.

The UK government has already acknowledged deforestation is key to achieving net zero. Deforestation is a 'top priority area' in the UK's Net Zero Strategy and the UK legislated to limit the deforestation impact of its consumption of goods, through the Environment Act. It has not however legislated to address the deforestation impact of its financial sector.

The Glasgow Leaders' Declaration on Forests and Land Use was a major outcome of the UK's presidency of COP26, with at least 144 countries committed to halt and reverse deforestation and land degradation by 2030 – including by re-aligning financial flows. This Bill provides an important opportunity to solidify the UK's COP26 global legacy, making good on this commitment.

The Dasgupta Review called for the wholesale reorganisation of the UK economy, leading HM Treasury to commit to a 'nature-positive' economy in 2021. As a result, the Environmental Audit Committee has called on the government to place nature and net zero at the centre of UK financial regulation.

The UK is a major financier of global deforestation. UK banks and asset managers provided an estimated $16.6 billion between 2015-2020 to just 20 agri-businesses implicated in deforestation, making an estimated $192 million (£147 million) in profit. Over £300 billion of UK pension money is invested in companies and financial institutions with high deforestation risk and the UK financial sector faces up to £200 billion in risk exposure in Brazilian beef and soy supply chains and Indonesian palm oil supply chains alone.

Agri-business companies funded from the UK do not necessarily supply the UK with commodities directly and are therefore not held accountable under the Environment Act, despite the human rights, land grabbing and environmental harms they have been linked to. Many financial institutions are signed up to voluntary deforestation commitments but without legislative underpinning such commitments have consistently failed to deliver the progress needed.

Recommended amendment 1: The introduction of mandatory forest-risk commodity due diligence for financial actors. Such obligations for the financial sector were considered under the Environment Act and received support from many MPs and peers from across the political spectrum.[2]

This Bill focussed on financial regulation is a more appropriate place for the amendment and the reasons to support it have only grown in the interim. A YouGov poll in Dec 2021 found that 67% - over two thirds - of British voters supported the Government introducing a law to ban banks from lending money to or doing work for organisations who are involved in deforestation overseas.[3] In May 2022, the Government's own Global Resource Initiative taskforce recommended the introduction of mandatory due diligence to prevent, mitigate and remedy the financing of deforestation and linked human rights abuses.

An amendment on this would bring the financial sector into line with rules already in place on the use of goods from deforested land under the Environment Act 2021. Wording for the amendment is under development and we'd be happy to discuss the detail with parliamentarians.[4]

Recommended amendment 2: Introduce a statutory objective for regulators on climate and nature. Sadly, the current approach of including sustainable growth as a regulatory principle for UK finance has proved ineffective – as £billions of finance continue to flow into nature-destructive projects. There is nothing to suggest replacing it with a net-zero principle would be any more effective. What is needed is a new secondary statutory objective requiring the regulators to facilitate the alignment of the financial services sector with net zero including wider considerations of nature.

The UK Green Finance Strategy recognises that climate change and biodiversity loss are a threat to the growth and stability of the UK financial system. In May 2022, the Bank of England concluded climate change will cost UK banks more £340 billion by 2050 if climate action is severely delayed. The economic argument is compelling: the introduction of green investment taxonomies, mandatory net zero transition plans and new sustainability disclosure regimes in key jurisdictions including the UK, EU and US demonstrate the tide is turning.

The UK has an opportunity with this bill to steal a march in leading the funding of the green transition, generating huge export opportunities for the country in future and helping to tackle current issues like reducing household bills. Empowering financial regulators to actively advance climate and nature targets in their policies and supervision will enable the UK to become a front runner in the global green economic transition.

ENDNOTES

[1] For example it would be hard to claim that **£12.7 bn** in UK financing for known deforestation risk business (taken from our *Deforestation Dividends* report analysis) is compatible with the current principle of 'sustainable growth'.

[2] Amendment 27, tabled by Neil Parish, Ben Lake, Jonathan Edwards, Caroline Lucas, Lilian Greenwood, Sir Oliver Heald and supported by Olivia Blake, Sir Roger Gale, Stephen Farry, Janet Daby, Clive Efford, Kerry McCarthy, Debbie Abrahams, Barry Gardiner at report stage had a great number of further MPs speak in support including Maria Miller, Jim Shannon, Luke Pollard, Claire Hanna, Kenny MacAskill, Liz Twist, Rebecca Pow. The debate can be found here: Environment Bill - Hansard - UK Parliament.

[3] Private polling for GW by YouGov in Dec 2021 found that when asked "To what extent, if at all, would you support the Government introducing a law to ban banks from lending money to or doing work for organisations who are involved in deforestation overseas?" 67% supported the idea. Looking at the data from a party alignment perspective - 65% of those who voted Conservative in the 2019 General Election supported the idea.

[4] The finance amendment tabled in the Environment Bill debate reading can be found on page 6, amendment 27 here: environment_rm_rep_0429.fm (parliament.uk). A new amendment is likely to draw on elements of this.