Grantham Research Institute on Climate Change and the Environment

October 2019

The London School of Economics and Political Science

University of Leeds

Policy brief
Financing inclusive climate action for a just transition in the UK

In collaboration with

PRI Principles for Responsible Investment

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Headline issues

- The UK must strive for a 'just transition' as it works to deliver net-zero greenhouse gas emissions by 2050.
- For institutional investors, contributing to a just transition is both the right and the smart option, making portfolios more robust.
- The just transition represents a strategic opportunity to connect the environmental, social and economic dimensions of climate action.

Summary

For institutional investors, contributing to a just transition that engages workers, communities and consumers offers a way of reducing systemic risks, realising fiduciary duties, identifying material value drivers and generating positive social impacts. It also responds to the growing demand from end investors to connect their savings with societal benefits as well as financial returns.

The just transition has become a recognised priority in the UK but there is little experience of what it means in operational terms. Our analysis of the Yorkshire and Humber region show that a shared approach is needed to evaluate business performance on the just transition; that there is a crucial role for local 'anchor institutions' with scale and community links; and that system-wide innovations, such as new regulations or markets, are needed.

We have developed a roadmap of priority actions that identifies where investors can make a real difference, highlighting five priority areas: *1) investment strategy*, placing the just transition into the heart of strategies and signalling its importance along the investment chain; *2) corporate engagement*, with a focus on power generation, construction and real estate; *3) capital allocation*, highlighting the role of sustainable bonds and impact investing; *4) policy advocacy and partnership*, calling for government to introduce a strategic framework for the just transition; and *5) learning and review*, delivering experimentation at scale with monitoring, evaluation and sharing of outcomes.

Policy briefs provide analysis on topical issues, presenting specific recommendations to inform ongoing policy debates. Drawing on the Grantham Research Institute's expertise, they summarise either our research findings or the state of knowledge about a particular issue.

This policy brief has been written by **Nick Robins, Andy Gouldson, William Irwin, Andrew Sudmant,** and **James Rydge**.

The brief summarises a longer report, *Financing Inclusive Action in the UK: An investor roadmap for the just transition* (October 2019) and builds on an earlier report, *Investing in a Just Transition in the UK: How investors can integrate social impact and place-based financing into climate strategies* (February 2019).

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The global imperative for a just transition

Climate change is arguably one of the greatest injustices in history, given the projected extent and duration of its negative impacts on current and future generations, rooted in past greenhouse gas emissions, the vast majority from developed countries. The transition to net-zero greenhouse gas emissions needs to be an inclusive process, delivering social justice for workers, communities and consumers.

The imperative of the just transition is embedded in the 2015 Paris Agreement on climate change, with a focus on managing the process of change for the world's three billion workers. The just transition rests on a well-established body of international law and policy, notably around human rights (including labour rights) and sustainable development. Importantly, the imperative of net-zero is one of many disruptive transitions that are underway – others include digitisation – all of which need to be managed together.

Delivering a just transition in the UK

In the UK, the scope of the just transition has expanded beyond the world of work to the implications for citizens overall, including communities and consumers. The Scottish Government, for example, has launched a Just Transition Commission with a mission to set out how to develop "a carbon-neutral economy that is fair for all" (Scottish Government, 2018). In May 2019 the Committee on Climate Change in its report on achieving net-zero in the UK also concluded that the transition will need to "be fair and perceived to be fair" (CCC, 2019). The transition needs to include a responsible approach to decarbonisation, an inclusive process of clean growth, and resilience to the physical shocks of climate change that also incorporates a strong social focus (see Figure 1). The place-based dimension of the just transition will be crucial, particularly given the extent of regional imbalances across the UK.

We have identified five central elements of delivering a just transition in the UK:

1. **Maximising the benefits** for society in terms of the quantity and quality of work that is generated, achieving reductions in poverty and inequality, and building stronger and resilient communities across the regions and nations of the UK.

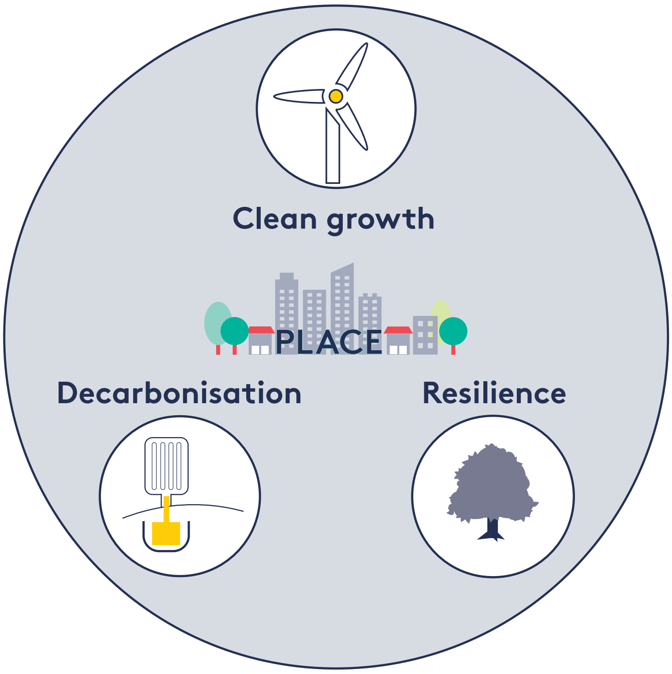
2. **Mitigating the social risks** from the transition, particularly for workers and regions dependent on high-carbon sectors, as well as vulnerable and low-income consumers in all parts of the UK.

3. **Empowering those affected by change** so that they are actively involved in decision-making, whether in the workplace, in communities or in key policy processes, making sure that this is open to all in terms of gender, ethnic group, age or income.

4. **Anticipating the changes,** through careful assessment of what is needed to achieve the UK's climate goals, and of key trends – not least in technology – so that social implications can be addressed ahead of time and plans adapted as circumstances change.

5. **Mobilising investments** from the public sector, business and finance, and citizens across the UK to build the human, social and technological capacities that will be needed to deliver a successful and inclusive transition and so that our places and communities are resilient to the impacts of climate change.

Figure 1. Key components of the just transition



> "Supporting a just transition is not only the right thing for investors to do but is also the *smart* thing to do, helping to secure broad public backing for ambitious climate action."

The central role for finance and investment

Finance will be critical for a just transition, not just in terms of the increased quantity of capital required, but also to fulfil the need for an improved *quality* of capital that incorporates environmental, social and governance (ESG) standards.

Internationally, a set of compelling reasons have been identified for why investors should support a just transition, touching on systemic risk, fiduciary duty, material value drivers and opportunities to generate a positive impact through investment (Robins et al., 2018).

In the UK, our key finding is that supporting a just transition is not only the right thing for investors to do but is also the *smart* thing to do, helping to secure broad public backing for ambitious climate action and making investors' own portfolios more robust in a fast-changing economic and environmental landscape.

The Government's Green Finance Strategy published in July 2019 also highlights the importance of delivering a just transition (HM Government, 2019). Brexit has made it pressing to develop fresh thinking and action on the relationship between public and private finance to deliver a just transition, not least with the likely withdrawal of funding from the European Investment Bank.

A growing number of institutional investors in the UK are making commitments to support the just transition, alongside collaborative efforts of investor alliances (for example, local authority pension funds, and faith and charity investors). A number of investors are already providing important insights and perspectives on the just transition; Box 1 (p4) outlines the varied priorities and focuses of 11 UK-based investors.

"The zero-carbon transition will not take place evenly across the UK and the different spatial and sectoral impacts need to be understood by policy- and decision-makers."

Box 1. Investor insights and perspectives on the just transition

- **Aviva:** Committing to supporting a just transition
- **Impax:** Making the transition efficient, effective and equitable
- **Aberdeen Standard:** Connecting human rights and the just transition
- **Legal & General:** Inclusive capitalism and the just transition
- **Hermes Real Estate:** Responsible property investment and the just transition
- **Abundance:** Crowdfunding municipal bonds for the transition
- **Bridges:** Exploring the role of social impact bonds in the just transition
- **Northern Local Government Pension Scheme:** Incorporating the just transition into investment policy
- **Vigeo Eiris:** Measuring just transition preparedness in UK energy utilities
- **Friends Provident Foundation:** Engaging with UK utilities on the just transition
- **Church of England Pensions Board:** Learning lessons from South Africa's Courageous Conversations

Understanding the practical implications: Yorkshire and the Humber case study

The just transition remains a relatively new agenda for both policymakers and investors. Turning this aspirational goal into lived reality raises a range of profound challenges, such as how those affected by the transition will be involved in decision-making and how the transition will affect individuals, communities and regions differently. The zero-carbon transition will not take place evenly across the UK and the different spatial and sectoral impacts need to be understood by policy- and decision-makers so that opportunities can be maximised and any risks can be anticipated. Investors need to understand how these place-based impacts are linked to their portfolios.

To ground our analysis, we have focused on Yorkshire and the Humber, in the North of England, as a case study region. We profile seven companies from the region, covering different asset classes: listed equities, bonds and fixed income as well as real estate. Some are global corporations, others national and regional champions, along with innovative start-ups and community enterprises. Importantly, these examples do not necessarily offer ready-made solutions for the just transition, and none explicitly uses the framing of a just transition to describe its work. But they point to the actions that investors can take, through corporate engagement, capital allocation and policy dialogue.

Lessons from the case study

Table 1 summarises the lessons from the example companies in our case study region. From this analysis we have drawn out the following three overarching lessons:

1. Shared approach: There is an urgent need for a shared approach to evaluate business performance in the just transition, bringing together different ingredients such as the Sustainable Development Goals, human rights and impact investing frameworks.

Table 1. Lessons for investors from the Yorkshire and Humber company examples

1. Decarbonisation	**Drax Power Station,** Selby *Listed equities*	Drax has the potential to be an anchor institution in a net-zero industrial cluster on the Humber estuary, based on the deployment of bio-energy with carbon capture and storage (BECCS). Drax's current use of biomass and plans for gas expansion are controversial, however, and the development of BECCS would require new policy incentives. **Lessons for investors:** Investors can engage with Drax to ensure its plans are aligned with the Paris Agreement and wider sustainable development objectives.
	Advanced Manufacturing Research Centre (AMRC), Sheffield *Listed equities*	Built on the site of a former colliery after redevelopment by the Harworth Group, and with the support of local, national and European funding, the Advanced Manufacturing Research Centre (AMRC) has generated additional well-paid jobs in high productivity sectors with expertise in light-weighting and composite materials. **Lessons for investors:** AMRC demonstrates how smart redevelopment in former high-carbon areas can create a platform for capital inflows and regional revitalisation.
2. Clean growth	**Siemens Gamesa and Green Port,** Hull *Listed equities*	The Green Port development in Hull, a joint venture between Siemens Gamesa and Associated British Ports (ABP), has created direct benefits for the workforce and the wider economy through the expansion of offshore wind. **Lessons for investors:** This example shows how policies at the corporate level for people and society – such as Siemens' framework agreement with unions – along with policy incentives and investment in skills can be implemented in a particular place.
	Wellington Place, Leeds *Real estate*	Wellington Place is the leading development project for commercial office space in Leeds. It has been designed and implemented with a conscious focus on place-making and generating wider benefits for the region. **Lessons for investors:** Asset owners can play a strategic role in providing long-term patient capital for urban regeneration that produces market-leading environmental, workplace and community benefits as part of an active place-making strategy.
	Citu, Leeds *Real estate*	Citu is building a 'Climate Innovation District' in Leeds, turning a central brownfield site into a mixed-use neighbourhood with strong green credentials. **Lessons for investors:** With the right design, new residential buildings can be 70 to 80 per cent more energy-efficient than existing UK homes, with strong community benefits, including reduced fuel poverty. The example also shows the need for public finance from local and national government to support breakthrough innovations.
	Energise Barnsley, Barnsley *Fixed income*	Energise Barnsley is a community benefit society that developed solar PV on council-owned buildings, cutting bills for low-income households, financed by a bond open to local and national investors. **Lessons for investors:** Community ownership and crowdfunding have potential as tools to build a more decentralised energy system.
3. Resilience	**Yorkshire Water** (region-wide) *Fixed income*	Yorkshire Water has introduced a comprehensive framework for sustainable finance that combines both social and environmental aspects, issuing its first sustainability bond in April 2019. Over time, resilience and decarbonisation requirements will lead to new challenges as well as potential job opportunities. **Lessons for investors:** The sustainable finance framework offers an approach that could enable fixed income investors to back the just transition.

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2. Anchor institutions: Institutions such as local authorities, leading businesses, trade unions and universities, as well as long-term investors, can play a central role in the creation of an ecosystem in which the just transition can flourish.

3. System-wide innovations: There is a vital need for system-wide innovations to drive market transformation for a just transition, whether in terms of new structures for dialogue, new regulations, or creating new financial markets and instruments that better respond to the social nature of the transition. Additional focus needs to be placed on bringing together the zero-carbon and resilience dimensions of the transition.

A roadmap for investor action in the UK

Looking ahead, investors can play a potentially significant role in supporting the just transition in the UK – as fiduciaries on behalf of millions of savers, as allocators of capital to the real economy, and as stewards of assets, ensuring that their voice is heard by both business and policymakers. Drawing on the lessons from our work in Yorkshire and the Humber and nationally across the UK, we have tailored our global framework for investor action on the just transition (Robins et al., 2018) to produce the following five-point roadmap for the UK.

Action Area 1 – Investment strategy: Investors need to incorporate the just transition into their investment strategy and signal the importance of the social dimension of the climate crisis along the investment chain. The just transition needs to be incorporated, for example, in the ways that investors deliver their obligations under the Stewardship Code. In addition, they need to build effective partnerships across the investment system and beyond so that they can understand the priorities for those affected by the transition and achieve critical mass. A priority for immediate action is to set clear investor expectations on the just transition, based on national and international standards for environmental and social performance. Providers of sustainability ratings and research can play a key role in evaluating corporate performance on the just transition.

Action Area 2 – Corporate engagement: Investors are ramping up their engagement with the businesses they own to ensure alignment with the Paris Agreement. This now needs to be extended to include the social dimension to support a just transition. In the UK, the power generation sector is a first priority for engagement, to facilitate the planned phase-out of coal-fired power generation and the expansion of renewable energy. This could focus on ensuring labour and community standards as well as maximising the benefits of decentralised energy models. A second priority could be construction and real estate to upgrade the UK’s building stock in a strategic and inclusive fashion. We estimate that 60 per cent of construction jobs could be affected by the transition, requiring considerable reskilling. This engagement could also extend to the banking sector to ensure that lending to real estate is aligned with the just transition.

Action Area 3 – Capital allocation: Investors can shift their allocation of capital to specific assets aligned with the just transition, particularly through place-based strategies. One priority is to build a thriving ‘sustainable bond’ market in the

UK, covering the environmental and social pillars of the just transition, including local issuance by leading companies, communities, public authorities (for example, via crowdfunding), and national-level issuance (for example, through a sovereign bond).

Another priority is to build on the growing interest in impact investment to develop new investment products, including infrastructure, enterprise and property as well as community-owned assets, that seek to support a just transition.

Action Area 4 – Policy advocacy and partnership: Policy reforms are necessary to provide investors with the incentives that encourage sustained action. As a result, investors should call for government in the UK to introduce a strategic framework for the just transition that recognises the importance of decentralisation and devolved decision-making along with the need to engage all stakeholders in its design.

Such a framework could cover the key policy dimensions – including macroeconomic, industrial, regional, labour market and wider environmental policies – and public finance, notably with a dedicated financing mechanism for sustainable infrastructure, such as a National Infrastructure Bank. A forward-looking plan to strengthen the UK's skills for the net-zero transition is essential and a core interest for investors, given the importance of human capital for wealth generation.

Action Area 5 – Learning and review: As the just transition is still a relatively new dimension of the climate change agenda for investors, an important element of the proposed collaborative approach will be to develop experimentation at scale with effective monitoring, evaluation and sharing of outcomes. This means establishing effective ways of listening to, learning from and partnering with key stakeholders affected by the transition. Place-based engagement will also be important in the evaluation and learning phases, to ensure that investor action is not detached from stakeholders. Finally, universal investors should incorporate the just transition in their own reporting: this can be done by building on the framework developed by the Task Force for Climate-related Financial Disclosures (TCFD).

The UK within the world: global steps forward

UK investors have a global reach, and it is important for them to apply the just transition internationally, through engagement with global corporations and by allocating assets into investments in developing countries that would facilitate a just transition there. In the latter respect, investors could also collaborate with the Government on how to make the just transition an effective core component of the UK's International Climate Finance programme.

This is a critical moment for the country, with political uncertainty over Brexit coming at a time when urgent climate action is needed. Furthermore, 2020 will close with the UK hosting the UN's climate conference, COP26, in Glasgow. This will provide a major opportunity to show how financing a just transition in the UK can also connect with wider efforts to achieve ambitious steps forward in climate action at the global level.

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This policy brief summarises a longer report (56 pages), *Financing Inclusive Climate Action in the UK: An investor roadmap for the just transition,* available to download from: www.lse.ac.uk/GranthamInstitute/publications

The Investing in a Just Transition initiative

Launched in February 2018, Investing in a Just Transition is working to identify the role that institutional investors can play in connecting their action on climate change with inclusive development pathways. The initiative is led by the Grantham Research Institute on Climate Change and the Environment and the Initiative for Responsible Investment at the Harvard Kennedy School, in collaboration with the Principles for Responsible Investment (PRI) and the International Trade Union Confederation (ITUC). The initiative has produced a global guide for investor action, and 140 institutions with more than US$8 trillion have signed an investor statement on the just transition.

The Investing in a Just Transition UK project

In 2019 the Grantham Research Institute at LSE and the Sustainability Research Institute at the University of Leeds started a process of research and dialogue to identify the specific role that investors can play in the just transition in the UK. This part of the project is being delivered in collaboration with the PRI and the Trades Union Congress (TUC).

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Georgina Kyriacou at the Grantham Research Institute edited and produced this policy brief.

The authors' special thanks go to Sophia Tickell, strategic advisor to the project. The authors are grateful for the comments on the longer report on which this brief is based, particularly those from the project's advisory committee.

The Investing in a Just Transition UK project is funded by the Friends Provident Foundation, with support from the 30 Percy Foundation. Funding from the Grantham Foundation for the Protection of the Environment and the UK Economic and Social Research Council through the Centre for Climate Change Economics and Policy (CCCEP) is also gratefully acknowledged.

The authors declare no financial relationships with any organisations that might have an interest in the submitted work in the previous three years and no other relationships or activities that could appear to have influenced the submitted work.

This policy brief is intended to inform decision-makers in the public, private and third sectors. It has been reviewed internally and externally before publication. The views expressed in this brief represent those of the authors and do not necessarily represent those of the host institutions or funders.