THE INVESTMENT ASSOCIATION

INVESTMENT MATTERS

POSITION ON UK GREEN GILTS

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. The UK investment management industry is the largest in Europe and the second largest globally.

The IA and its members have long been advocates of the importance of integrating environmental, social and governance factors (ESG) into all investment decision making. A more holistic approach to investment drives positive change whilst also producing sustainable long-term returns for investors and savers. The issuance of a Green Gilt comes at an opportune time: not only is the UK Government striving to achieve its net zero target but is also seeking to meet its social and economic needs in order to achieve a post-Brexit, post-COVID recovery and in line with its 'levelling up' goals.

Following the Government's announcement of its plans to issue a Green Gilt, as well as publication of the Green+ Gilts proposal[1] in October 2020, the IA established a Green Gilts working group to provide a forum for members to discuss the Government's proposals, engage with key stakeholders and reach a consensus position on the ideal features for such a gilt.

Below, the IA sets out its position on the features its members consider desirable for these instruments to be viable for investment managers while also allowing the Government to finance the environmental and social needs of the UK.

STRICT USE OF PROCEEDS

In order to ensure that financing is used only for projects aiming to achieve an environmental and social benefit, the legal documentation for the Green Gilt should explicitly note how proceeds are being used. This would bring the Green Gilt in line with ICMA's Green Bond Principles[2]. Investments should be carried out on the basis of their compliance with the EU and UK Taxonomies for Sustainable Activities[3]. A separate account should be set up to monitor and track the net proceeds which have not been allocated.

Members note that strict segregation of accounts is currently prohibited under UK legislation and an amendment would be required to achieve this in the UK – nonetheless the IA considers that this is the best method for providing certainty to investors while ensuring funding needs for key environmental projects with social co-benefits are met.

[1] 'The Green+ Gilt: How the UK could issue sovereign bonds that deliver climate action and social renewal', The LSE Grantham Research Institute on Climate Change & the Environment, the Green Finance Institute & the Impact Investing Institute, Oct 2020

[2] ICMA Green Bond Principles

[3] European Union Taxonomy For Sustainable Activities, which is currently incorporated into UK legislation.

The Investment Association (IA) supports UK investment management, serving savers, investors and businesses in the UK and around the world. Our 250 members manage £8.5 trillion in the UK, providing the UK with an important economic contribution in the form of export earnings, tax paid, and jobs created.

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FORWARD LOOKING

An optimal Green Gilt would be forward looking, providing a long-term financing path for future projects. This would align the Green Gilt issuance with the forward looking nature of the UK's Nationally Determined Contributions (NDCs), and present an opportunity for the UK Treasury to challenge market practice of using look-backs, in order to leave a lasting enhancement to the green bond market.

MEDIUM TO LONG DATED

The project timelines in which bondholders are investing would ideally be linked to debt with similar maturity lengths. In the case of medium to long-term infrastructure financing, investors would therefore expect these projects to be funded through the issuance of medium to long-dated Green Gilts. This would also allow investment managers, such as those managing pension funds, to meet their long-term liabilities. This will in turn ensure that Green Gilts can finance vital environmental and social projects, while also helping the UK's citizens meet their long-term investment needs.

USE OF AN AUDIT COMMITTEE

In line with the ICMA Green Bond Principles, the Government should set out their sustainability objectives, the process for determining eligible projects, the eligibility criteria covering any exclusions and the process for environmental and social risk due diligence. Scrutiny of this process should be carried out by an Audit Committee consisting of market representatives as well as representatives from within Government.

SOCIAL IMPACT ELEMENT

Members support the integration of a social investment element into the Green Gilt, with proceeds being used to fund environmental projects with social co-benefits. The integration of social impact investing would demonstrate the UK to be a world leader on social and environmental financing. Investment managers would welcome clear guidance from Government as to exactly how this social element is to be incorporated.

MANDATORY VERIFICATION

The IA expects verification of Green Gilts to be mandatory, in line with the requirements of market standards such as the Climate Bond Standard and proposed EU Green Bond Standard.

REPORTING

The Government should report annually and seek Certification of the bonds. Reporting should demonstrate allocation details as well as the impact of the investment of Green Gilt proceeds, including performance against both qualitative and quantitative KPIs, following examples such as those set out in the ICMA Harmonised Framework on Reporting.[4] Bond documentation should clearly specify when reporting will conclude. Ideally this would occur once there is full allocation of bond proceeds or on maturity of the security.

[4] ICMA Harmonised Framework on Reporting

CONTINUOUS ENGAGEMENT

In addition to ongoing reporting and industry representation on a Green Gilt Audit Committee, the IA calls for continuous engagement between investment managers and Government to discuss project progress over the life of the Green Gilt.

USE OF EXISTING FRAMEWORKS

Along with ICMA's widely used Green and Social Bond Principles[5], the IA considers that there is an opportunity for the Green Gilt to incorporate other widely understood existing frameworks to maximise investor take-up by ensuring broad international harmonisation as well as providing greater clarity as to the objectives of the Green Gilt.

The Government may wish to consider:

- the UN Sustainable Development Goals[6];
- the Impact Management Project's Impact Management Norms[7];
- Nationally Determined Contributions (NDCs), determined as part of the UN Paris Agreement on climate change;
- The EU Taxonomy for Sustainable Activities principle of 'Do No Significant Harm'.

EQUIVALENT FEATURES WITH CONVENTIONAL GILTS

Green Gilts should otherwise have equivalent features to conventional gilts. For example:

- Green Gilts should be issued in both inflation-linked and fixed income formats;
- Green Gilts must be eligible for inclusion within the range of UK Government bond benchmark indices, particularly the FTSE indices. This is vital to ensure maximum investor take-up;
- Green Gilts should be eligible for use as collateral for derivatives;
- Green Gilts should be eligible as a deliverable bond on long gilt futures.

The IA welcomes further engagement on this topic and would like to invite any interested parties for discussion of our position.

[5] ICMA Social Bond Principles
[6] UN Sustainable Development Goals
[7] Impact Management Project's Impact Management Norms

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