FCA consultation - Climate Change and Green Finance

Discussion Paper DP 18/8

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Introduction

SRI Services is delighted to welcome this paper and to congratulate the FCA on its work.

Our work is entirely focused on raising awareness of and helping people (mainly intermediaries) to understand retail sustainable, responsible and ethical investment (SRI) options and we see climate risk as the most important single issue in this field.

SRI Services was started in 2009 (following my departure from Friends Provident where I was SRI Marketing Manager, for 12 years). The first version of the Fund EcoMarket tool went live in 2011 (self funded) . The free to use, whole of SRI market, fund tool has been continually expanding ever since, as fund managers have increasingly come on board as 'sponsors'. Founder / owner (Julia Dreblow) is also a director of UKSIF, on the Transparency Task Force advisory board and involved with the BSI work in this area (as well as being involved with advisers, distributors, fund managers and the financial services industry media.)

Having attended presentations by the FCA on this consultation paper we understand that this is a 'first step' and somewhat 'work in progress'. As such, we hope for this response will be read as it is intended as we wish to help advance this welcome and important initiative.

The main feedback I would offer on the paper is that it does not convey the level of urgency that science indicates is required if we are to guard against catastrophic climate change – the impact of which will far exceed any legitimate concern for financial markets.

However, SRI Services agrees wholeheartedly with a core premise of this paper – which is that it makes sound financial sense to focus on climate risk (and in particular how the financial community can help lessen those risks). Many other ESG and ethical areas are of course also important – but they are not equally 'urgent' given the rate at which our climate is shifting.

To explain further:

Tone

- The FCA should be careful to **avoid ambiguity** around its support for acting on climate change. Seeking to passify deeply conservative elements of our industry will not serve them or their clients well. The FCA should make it clear that the UK government (and therefore the FCA) is committed to working to hold down global temperature increases in line with the Paris Climate Agreement - and recognises this will require changes in the behaviour of the financial services community.
    - References such as:
        - 'climate change is likely to have a significant impact on the UK's economy'
        - 'climate change can have an impact on our role'
        - 'may be effected by climate change'

  are **too weak**. They imply a level of doubt which is out of line with our obligations, scientific opinion and the needs of those whose lives are impacted by the decision of the financial services community. They are also **potentially misleading** and somewhat back to front. Climate change will have an impact on people and business and will markets. Addressing climate change rapidly via the financial markets should be viewed as an integral to the role of finance and investment. Implying otherwise risks costly delays.

We know that climate change is starting to have significant effects - and that we need to 'manage down' future risks by **encouraging companies to transition** to more climate aware business strategies. We also know that this shift is unlikely to happen without the support of investors - and that as with any risk there will be winners and losers.

As such, the FCA should be unambiguous in communicating that **the investment community has a key role to play in addressing climate change -** and that it must play its part by placing greater emphasis on this risk so that the necessary changes are encouraged. This will benefit both investors and others.

Scope

The paper's enthusiasm for green finance is welcome and timely, however the FCA should recognise that **climate risk is relevant to all areas of investment**. No level of enthusiasm for, or investment in, green finance will reduce green house gas emissions (eg from coal, oil, gas, fracking, food supply chains, manufacturing, infrastructure.) This can only come from also focusing on areas that are emitting greenhouse gases.

This means we need climate aware strategies to be adopted by all investors; not only in 'green finance'. This should involve considering funds and strategies broadly described as SRI (Sustainable and Responsible Investment) or 'ESG' – as well as funds and other asset managers (and owners) that may not previously have considered environmental issues.

A clearer recognition of the benefits of both broad 'climate risk/opportunity aware' stock selection strategies and more 'responsible' and engaged asset ownership strategies (stewardship / engagement) and activity would both be welcome.

Both have a very significant role to play in magnifying the benefits of the increasing interest in Green Finance as well as facilitating the transition towards significantly more ‘climate aware’, ‘greener’ investment markets across the board.

Timescales & magnitude of the challenge

- The **2018 IPCC** report referred to the need to significantly reduce greenhouse gas emissions within 11 years **(by 2030).** This means climate risk is no longer a ‘long term issue’, or primarily relevant to pensions.
- Recent weather patterns and commentary from some scientists indicate that even this ‘12 year’ prediction is optimistic - commenting that we are **‘sliding’ towards climate chaos** (gradually, year by year) rather than heading towards a cliff edge in 2030. In either scenario this is relevant to almost all of today’s investors.
- This consultation paper refers to **transition risk**. Clearly this exists but given the diversity of opinions of those reading FCA materials it should be made clear that the bigger risk is ‘not transitioning’ or ‘not transitioning in time’. (Short term focused opportunistic investors risk sabotaging otherwise sound work if this is not made clear.)
- The biggest risk of all is however of **‘doing too little too late’** . This is in part because it is unclear how long any form of financial system will continue if global temperature increases exceed +2C degrees (temperatures are already +1C over pre industrial levels) - but also because it should rightly be seen as incumbent on our generation(s) to guard against ‘catastrophic climate risk’ for everyone’s sake. As such:
    - The FCA should make it clear that the financial system can only continue to thrive if rapid action is taken to protect the planet against further significant global temperature increases.
    - The FCA should also remind the financial services industry that it exists to serve society and not the other way around. And design regulation accordingly.

Where can the FCA find help?

- The FCA should look to collaborate or work in line with well respected organisations, and frameworks that also aim to address climate risk wherever possible.
    - Key international organisations and initiatives include TCFD, IPCC, Paris Climate agreement, SDGs etc, others will no doubt be mentioned in other responses.
- The FCA should be aware that there is a significant community of fund managers and industry professionals who have worked to bring climate change mitigation into investment strategies for 2-3 decades. Their products may use different language from newer ‘products’ (eg funds that pre date currently popular labels such as ‘ESG’ and ‘Impact’).
    - These organisations and individuals should be regarded as valuable allies and information sources as they are experienced in analysing and communicating issues, as well as responding to the objections thrown up by those who will always prefer to maintain the status quo.
- This expert ‘cohort’ (who use labels such as SRI, responsible ownership, ethical and sustainable, environmental and social investment) understand the reality of bringing environmental issues into otherwise often quite ‘mainstream’ investment strategies (ie not specifically ‘green finance’). Collectively they have a sound grasp of the nuances, the way

different strategies meet different client needs, and the need for balanced judgements and compromise. Many also have a sound grasp of how to communicate often complex (interconnected) themes to individual investors, scheme members and other clients.

- The FCA should note experienced investors of this kind are not always well represented in major industry organisations or international bodies as some are relatively small (sometimes as a result of the events of 2007/8). (Many are however connected to more specialist organisations such as UKSIF, SRI Services and TTF.)
- Without the level pragmatism and experience that these investors /investment professionals can offer, the FCA (and others), risk making recommendations that are not workable in practice.
- Alongside these groups it is of course important to recognise that other (particularly newer groups) will also be able to bring valuable insight. In order to address climate risk we need to engage all investors and recognise that there remains much necessary innovation that is probably yet to happen!

What next?

- One of the core principles of the FCA is that it is responsible for the sustainability of financial system. The FCA must integrate climate risk into its core principles in order to ensure it does as much as it can to guard against the failure of the system due to catastrophic climate risk.
- The FCA should make it clear that it intends to ensure the financial system is **fit for purpose** and able to enhance rather than detract from the wellbeing of society - today and in future.
- Linked to these, the FCA should make it clear that :
  - It understands that weather patterns indicate that the climate has already started to change
  - We need to align financial regulation to societal needs by putting in place requirements that will help reduce the risk of catastrophic climate change
  - it intends to 'direct financial markets to help reduce climate risk' as soon as possible.
  - It intends to facilitate the orderly transition to lower carbon economies through its policies
  - It understands that in order to be effective rules need to be enforced – and that climate risk is a priority
  - Averting unsustainable climatic change will require international collaboration and the FCA (alongside other government departments) intends to be play its part as the regulator of one of the world's largest financial centres

- The specific FCA actions (p11 of the consultation) are welcome - although a greater focus on appropriateness of language for individual investors (how to convey these messages to individuals) would also be valuable.

Purpose of financial markets

- The FCA should make it clear that the **financial markets exist to serve those who rely on them** and that because financial services companies **own and lend to most organisations** their **ability to influence business behaviour is unparalleled**. As such it is incumbent on the financial community, indeed its responsibility, to make sure that investee organisations operate in ways that ensure the planet remains habitable – recognising that this is essential for both the financial services community and those we serve.
- In brief, the FCA must convey that if investors do not act fast climate change will lead to the failure (and irrelevance) of financial markets - and wider catastrophe.

Responses to comments made in the first section of the consultation document:

3.1 The paper states: "The FCA's overarching strategic objective is to ensure that the **relevant markets function well**. Under our **strategic objectives**, we have three operational objectives: **protecting consumers, improving market integrity and advancing competition** in the interest of consumers. When we carry out our general functions, we must, as much as possible, act in a way which is in line with our strategic objective and advances one or more of our operational objectives."

Response:

Examples of where climate risk is relevant to the FCAs strategic objectives include the following:

Protecting consumers – the market's focus on the short term and regulated companies' failure to deal with climate risk is putting consumers at risk…

- Individual investors' assets are not currently adequately protected as few understand the need to transition to **lower carbon assets** or guard against **stranded assets**.
- Individual investors are currently **unlikely to benefit from** the shift towards cleaner, greener business strategies as this is not commonly discussed by financial advisers. (Advisers often comment that clients 'do not ask' for such options, however in reality few ask for any specific 'product'. It is the role of the adviser to identify client aims and advise accordingly.)
- The FCA should take action to reflect what Governor Mark Carney refers to as 'The Tragedy of the Horizons' – short term oriented investment objectives (eg quarterly / six monthly objectives, benchmarking etc) leading to detrimental longer term impacts.

Improving market integrity – as end clients generally have low financial awareness they are not often in a position to ask questions about climate risk and its impact investment values.

- '**Market integrity**' should be widened to include having due regard for **the way investment decisions collectively impact corporate behaviour and therefore shape wider society** and the world people live in /will retire into.
- Investment professionals often say climate and other ESG risks 'must already be priced in' but the evidence suggests otherwise. (Trust in market integrity is commendable but markets do not always function perfectly – particularly without appropriate regulatory direction.)

Advancing competition – the lack of regulatory interest in climate risk has contributed to general market indifference, although this appears to be improving post Paris Climate Agreement and SDGs.

- Competition should be encouraged, through climate aware regulatory measures, to encourage a 'race to the top' not a 'race to the bottom'. Measures should include increasing company disclosure and information flow throughout the investment chain so that investment managers recognise the benefits of greener businesses (and the risks of 'dirtier' ones). For this to work best financial regulations would have to be in line with other government policies (eg tax).

3.3 States "It is widely recognised that the risk from climate change – both physical and those resulting from the transition to a low carbon economy – will affect the risk to, and therefore value of, some kinds of investments."

Response - Although subsequent text is welcome this paragraph is open to sceptics arguing it is be best not to transition. Similarly point 3.5 implies transition may be problematic. In my experience there remain people in our industry who could cite this as an excuse to do as little as possible (although their marketing materials may imply otherwise).

3.4 States "As the regulator of UK financial markets we need to ensure we are adequately prepared for the risks that climate change poses to meeting our objectives."

Response – this is a key point and very welcome. The FCA must make it clear that the only way to reduce both physical and transitional risk is to cut emissions as early as possible. There are clearly areas the FCA can not directly influence (eg energy pricing) but financial markets have far reaching influence in most industries. As such it should be incumbent on the FCA to seek to align regulated businesses to government policy and international obligations as far as possible. Various avenues are possible (eg lighter touch regulation for greener companies, naming and shaming etc) but the core focus should be on how to achieve greenhouse gas emissions and sensibly enhance the attractiveness of cleaner/greener companies without risking creating bubbles.

Section 5 'Specific FCA Actions' contains much welcome information.

SRI Services particularly welcomes the following:

5.1 … ' we intend to explore whether greater encouragement is needed to ensure issuers give investors appropriate information and whether issuers require further clarity over what is expected of them.

5.2 '… we are seeking views on introducing a new requirement for financial services firms to report publicly on how they managed climate risks to their customers and operations'

5.3 '… we want to ensure that those making investment decisions take account of all financially material risks, including climate change'.

5.4 'This is particularly important for workplace personal pensions… Over 90% of these schemes' members have their pension savings in the default strategies and rely on the investment decisions made for them'. We agree with this view and would encourage greater recognition of climate risk by default funds.

5.5 Regarding IGCs - we concur with the view that IGCs should pay greater attention to climate risk and support the work of the DWP in this area. We agree with points 1-3 that all areas – ESG, scheme members' ethical views and stewardship are all important – but are comfortable with the view that the initial focus should be on climate change because of the significance of the risks it presents.

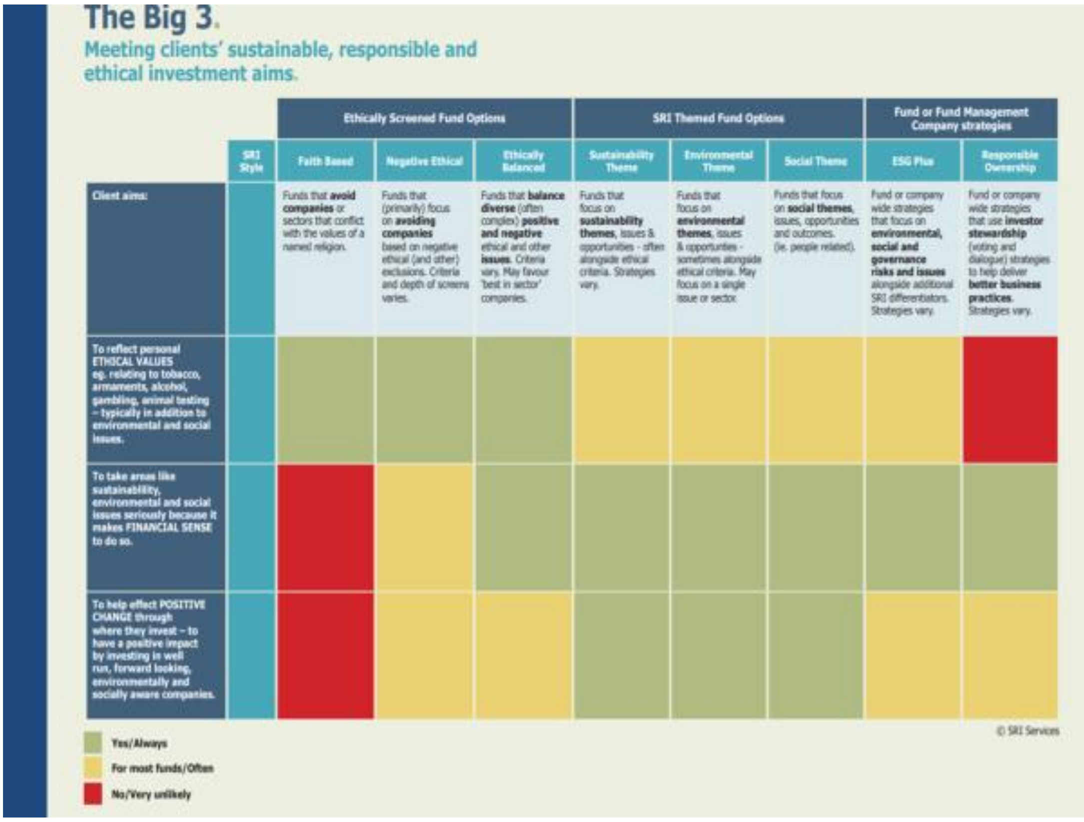
5.8 We agree '…Financial services play a key role in supporting the development of greener products and services, improving customer choice and transparency about relative greenness of' market participants and in depth solutions that may help match consumers' preferences for green products with opportunities.' The implied focus on green finance is however a concern as the FCA should recognise the breadth of appropriate investment strategies and solutions that can (and will be required to) support the transition to greener lifestyles.

With regard to meeting client preferences - the image below shows how we explain retail fund options to financial advisers and others on our www.FundEcoMarket.co.uk fund tool. The tool aims to help intermediaries research this area and understand the many different individual fund strategies and options.

This table cross references our 7 'SRI fund styles' (and one 'style' that represents fund management company strategies) against the three most common client aims; Personal values/opinions led, Financially led, led by a desire to 'Make a difference' (positive impact) .

The purpose of highlighting these is to explain that there are diverse fund strategies, all of which will have regard for climate risk, but that they meet different client aims, objectives and motivations because of their different 'SRI/ESG/ethical' (etc) strategies. (Noting that few individual investors wish to focus on a single issue – see below)

(Download original from https://www.fundecomarket.co.uk/help/wp-content/uploads/ECO_FLYER_SEPT2018_Single-pages.pdf)



Questions:

Q1 (p 15) **What, if any, difficulties do issuers face in determining materiality? We are also interested in exploring how investors consider materiality in this context.**

Materiality is complex and calculations are often regarded as imperfect not least because assessing materiality is multifaceted and businesses are complex. We agree with the issues raised in the paper.

Measuring materiality is however an important component of making well informed investment decisions and better information in this area would be welcomed by most.

Because of the challenges involved methodologies are still evolving, different data providers may provide contradictory information (on which materiality is assessed) and some areas require in effect 'best guesses'. Despite this many managers make reasonable, well informed assumptions – which is considered far preferable to not doing so.

TCFD is the leading reference point in this area – (although assessing climate related materiality has been worked on by some investors for a number of years).

UK regulators should use and support the TCFD's work. Supporting this initiative will also aid the evolution of a common language and better information flow and be particularly useful to larger investors who operate internationally.

(Generic) Fund examples:

> Investors, such as those offering Sustainability Themed investment funds, have focused on climate risks and opportunities as have Environmentally themed funds and many Ethical funds. Such funds do not necessarily seek to quantify materiality. Most focus on 'what business do and how they do them' in order to form an opinion of whether or not climate risk presents a risk or an opportunity to their business and therefore shareholder returns.
>
> These are typically actively managed funds where the manager has a sound knowledge of individual companies and stock selection decisions are made by ESG aware analysts and managers.
>
> Most of these funds buy in research and climate related data. Some such funds, particularly those that do not employ in house experts, rely heavily on third party data providers (although different providers are regarded as having strengths in different areas.) Fund management companies that employ in house experts tend to buy in research from multiple sources and often comment that information from different providers can be contradictory.
>
> The situation for passive funds and index trackers is different and potentially worrying as they are more data oriented and have less close relationships with investee companies than active managers. Although data driven investments that focus on climate risk are welcome (as a perhaps imperfect climate risk analysis will almost certainly be better than a lack of analysis) the way these funds are communicated to clients is important.
>
> For many individual investors factor such as passive options not taking into account nuances around why emissions can not be cut or why certain practices may occasionally be acceptable may not be relevant, but for others it will be.
>
> These point to the need for the FCA to recognise that 'Passive' and 'Active' funds will most probably remain different. There may be broad alignment between them, but to guard against mis-selling transparency and effective communication (including having a proper understanding of client aims and fund operations) is essential.

Treating asset managers fairly

Some investors and asset managers have put a great deal of resource (often over many years) into understanding the overlap between issues like climate risk, business and investment returns (materiality). In doing so they have helped encourage progress and shape important debates. The FCA may like to consider that others have not done so (and may have gained price advantages as a result) - but have benefitted from this activity (particularly stewardship related). Indicators of activity that has helped deliver positive social or environmental benefits include membership of industry groups (eg UKSIF) and coalitions (eg ClimateAction 100+ (previously 'Aiming for A'), ClimateWise, IICGCC).

Still evolving

I would also encourage the FCA to recognise that this area will continue to evolve for some years.

> The FCA should make it clear that 'perfection should not be the enemy of the good' and that making 'informed decisions' perhaps based on diverse (perhaps only indicative) data is acceptable.

The core message to convey is that starting to measure material climate risks (direct, indirect, physical and transitional) is important even if methodologies may continue to evolve.

Unlikely to 'crack' climate risk materiality without a push from regulators

By encouraging a greater focus on materiality regulators such as the FCA, PRA and FRC can encourage investors to work towards and/or support initiatives that are working on measuring materiality.

Without regulatory interest history indicates that many fund managers will do as little as possible in this area.

By stimulating demand for data through regulatory mechanisms it is likely that measurement methods and tools will improve – possibly from multiple sources.

Retail investors

For investors (particularly retail) the knowledge that investment companies use the best available tools to measure climate risk would be welcome. This could help build trust and confidence as many individuals are aware of the importance of climate change and would readily recognise how it might impact their investments if prompted.

> **Note** - The FCA should be aware of the complexities in this area. For example 'carbon footprint' and 'materiality' are not always aligned. For example, a manufacturer of parts for wind turbines may have a high carbon footprint but this is not to be viewed as a material risk as their overall benefit is positive.
>
> The FCA should be careful not to be too 'binary' in this area as this could have a detrimental effect on 'green finance' and other investments that aim to help reduce (by steering steer investors away from often carbon intensive manufacturers of 'solutions companies' such as those who make parts for wind farms.)
>
> The FCA should therefore recognise the relevance of fund manages focusing on 'purpose' or 'intentionality' – and consider what a company does, how and why. Information of this kind is not necessarily easy to present in data, but is welcomed by individual investors.
>
> The FCA should consider that the relatively low level of individual investor awareness of climate risk is a problem as they may suffer 'material' losses as a result of being left behind as better informed investors shift towards higher ESG standards and more climate aware strategies.
>
> Few retail investors are well placed to make properly informed decisions about this area because of low financial literacy, awareness and advice.
>
> The risk of effectively 'selecting against' retail investors is significant (and likely to be hidden by adviser comments such as 'the client did not ask for it' which is inappropriate as it is an

adviser's role to 'advise'). This should be recognised by the FCA as clients risk suffering material loss. Part of the solution to this is to improve the advice process (currently under review as part of MIFID II).

Advisers should identify interested clients, probe their aims and be able to discuss the likely relevance of climate risk to a given portfolio. This requires tools, support and training (much of which we offer through SRI Services but is rare to see from other service providers).

Q2. **We are interested in understanding whether greater comparability of disclosures would help investors in their decision making more generally. If so, what framework would be most useful?**

Greater comparability of disclosures would be helpful and indeed in many cases necessary if we are to shift capital sufficiently rapidly in order to protect markets from substantial climate related risks.

The TCFD is the leading initiative in this area and we understand that further guidance on its use will soon be published.

In order to be effective however any proposed rules must be able to be enforced.

Further along the investment chain however it may be useful to consider how this information reaches end investors (individual, retail clients and their advisers) who need information to be displayed in a more digestible way.

The FCA may like to look at our fund tool www.FundEcoMarket.co.uk that offers fund information primarily for investment intermediaries. Information is presented in a straight forward fashion without implying the area is binary (good/ bad etc). Its purpose is to enable users (mainly intermediaries) to find fund options that meet different client SRI/ESG aims, opinions and preferences.

Funds are segmented into 7 SRI Styles for funds and an additional 'style' that highlights fund management company level activity. The Styles are; Faith Based, Negative Ethical (avoidance led), Balanced Ethical (best in sector led), Sustainability Themed, Environment Themed, Social Themed, ESG Plus (uses ESG integration but also has other points of differentiation) and Responsible Ownership (for fund company strategies. All such funds will consider climate risk to a greater or lesser extent.

Experience dictates that if we are to make retail funds easily more attractive people need to be able to recognise their similarities and differences. Our relatively simple classification system (with additional detail and links) aims to facilitate this.

Other options could include a colour coded system along the lines of food labelling (ie high/medium/low carbon intensity) although it must be recognised that simplification has both advantages and disadvantages and in reality most funds consider many factors and issues.

Any rating would also have to be clear whether it was backward looking (historic data), a snapshot in time or reflective of stated company aims (policies).

Q3. **Would exploring a 'comply or explain' approach, or other avenues to encourage more consistent disclosures, be an effective way of facilitating more effective markets?**

I am broadly supportive of the concept of 'comply or explain' as there can be good reasons why an organisation can not comply. However, the urgency of this situation and current market failure is such that this may now be insufficient. A better method may be to require compliance to a set of principles - perhaps with explicit exemptions (eg for new businesses.)

If the 'comply' route is to be adopted companies must be given clear guidance with regard to what 'compliance' means and how (and when) it will be reviewed.

Both scientific research and the weather patterns we have observed (both at home and in the news) in recent years indicate that climate change is more rapid than many predicted. This highlights the relevance and urgency of reducing climate risk. Understanding companies' exposure to climate risk (physical and linked to their operations) should be regarded as essential and (almost) all investors should be required to consider it in order for market mechanisms to operate properly.

The purpose of this should however be to reduce climate risk globally, so international collaboration should be sought.

Q1 p 16 **Do you think that a requirement for firms to report on climate risks would be a valuable measure?**

Yes. The FCA (and the PRA, FRC) have an essential role to play in addressing climate risk and should encourage all organisations (investors and investees) to report on their climate risks.

A failure to disclose climate risk should be regarded as a failure to disclose market relevant information to investors (and clients) and treated as such by regulators.

Responses to climate risk should be flagged publicly available (ie online) so that investors can make better informed decisions (or request further information in order to do so).

Financial firms to report on what really matters

If reporting climate risk and progress against such risk is to be useful it must focus on key risks and opportunities to help reduce those risks.

For example it should be made clear that the most effective way **financial services organisations can help reduce the risk of catastrophic climate change is through better investment decisions and stewardship activity** (dialogue and voting) - not through improving the way they manage their own offices (eg changing lightbulbs).

> The built environment is of course important (indeed often underestimated) – but for financial services firms stranded assets represent a bigger risk than (eg) higher electricity bills.
>
> The regulatory focus must therefore be on investment 'selection, retention and realisation' processes and activity (ie where money is invested, not invested and actions taken to encourage higher corporate standards (stewardship)).

5.24 p16 "In the context of the TCFD framework, we welcome views on introducing **new requirements for financial services firms to report publicly on how they manage climate risks** to their customers and operations. This report would reflect the risks in the financial sector a firm operate within. For example, a report prepared by an asset manager would set out how it is managing the risk to longer-term investments such as pensions assets, created by climate change".

Background

- The TCFD framework is highly regarded and should be adopted as the framework for the FCAs response to climate risk.
- The financial services community should report publicly on how they manage climate risk
- See comments above regarding material risks to financial services firms (and their key opportunity to help address risks being through investment decision making.)

In order to effect change across the industry the FCA should make the following clear:

- urgent action is needed in order to **meet the UK's obligations** under the Paris Climate Agreement and reduce climate risk and
- communicate that addressing climate risk is a priority and that 'voluntary' responses have **not effected sufficient changes in behaviour up to now** - hence the need for new rules and setting out what needs to be measured.
- climate change presents both **risks and opportunities** and over time climate friendly business practices will be 'business as usual'
- The financial system needs to understand and support both climate risk **mitigation and adaptation**
- The FCA recognises that in order for this are to be managed effectively **additional measurement and reporting** will be necessary (eg metrics/ targets as set out in TCFD)
- The FCA recognises that **shareholders and other investors have exacerbated climate risk** through their drive to maximise profits at any cost
- The FCA recognises that shareholders (and other investors) are **uniquely well placed** to address climate change through their dialogue with companies (stewardship) and their buy/sell decisions .
- The FCA should make it clear that the **climate is already changing** (global temperature increases >1C already, with more erratic and extreme weather) and **should not be viewed as only a 'long term issue'.**
  - Investors should therefore be able to demonstrate how they are managing this across all assets
- It may be acceptable for reports to be incomplete (particularly when first introduced) however overstating activity, or the usefulness of incomplete or debatable data is not acceptable ('**greenwash**').
- The **FCA will review** all areas of climate related financial disclosures

Q2 p 16 **Do you have any suggestions for what information could be included in a [financial services] climate risk report?**

Focusing on **retail** (our area) – a suggestion:

- All financial services companies should have a brief consumer facing document - c250 words, in plain English, summarising their climate change policy.
- This document should summarise where a manager invests (eg worldwide, equities etc) and what their 'investment selection' and 'stewardship' activity is – and how it helps mitigate climate risk and maximise opportunities for their clients.
- This document should be available to all eg via websites.

- The document should be flagged in marketing literature/online, RFPs and fund fact sheets.
- The document should be supported by (url linked to) comprehensive, strategy and risk management information and verifiable data where available
- The document should be owned and signed by the CEO
- The document should include contact details of a named individual (or a well informed team) that clients can contact for further information
- These should be produce by all firms in order to raise standards and ensure there is a level playing field (noting that the production of this information will incur costs – and that these costs should not only be borne by less engaged/responsible asset owners and fund managers as this would be counter productive.)
- Intermediaries (advisers, DFMs, platforms etc) should be directed to make use of and compare these reports as part of their due diligence.
- Climate Risk Reports should form part of their advice process and made available to clients (noting that levels of interest will vary).

Q3 p16 **Do you have any views on which regulated firms should be required to compile a climate risks report.**

All regulated firms should be required to compile a climate risk report although asset managers and larger firms should be required to submit more information that (for example) financial advisers.

Platforms, Wraps DFMs and other distributors should be required to display/supply information produced by asset managers (funds and across their business). This should be presented as part of their core information to users. Transparency is essential.

This would both raise awareness of the risks across the sector and avoid pockets of low awareness distorting markets (eg by not incurring the costs associated with assimilating this information).

This should be enforced throughout the industry in order to protect against retail clients (and other 'individual investors' eg in pension schemes) continuing to be unaware of climate risk and suffering potential losses as a result of being less well informed than other investors.

> Noting that intermediaries generally ignore this area at present, so this risk is likely.
>
> Those advising or interfacing with individual investors (including pensions schemes) should be supported in understanding how this area relates to offering 'appropriate' solutions with information on theories such as the 'carbon bubble' and the 'Tragedy of the Horizons'. Fund tools such as Fund EcoMarket should be flagged as (free) resources.

6.3 Climate Financial Risk Forum - starting early 2019

My understanding of this is that it is worthwhile however a broader 'forum' involving a wider range of industry stakeholders and experts would also be useful. Groups such as UKSIF might be able to help co-ordinate. (SRI Services could help in the retail market).

6.5 "ESMA and EIOPA to provide technical advice on how existing legislation can be amended to require that sustainability risks are included in investment decision making or advisory processes".

> http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-act-2018_en.pdf
>
> This is essential (see comments made in this response regarding retail markets and advisers).
>
> This has been a major focus of my/our work for many years. I would be happy to help the FCA to respond to this and help draft appropriate responses.
>
> The key factor here is that advisers must be able to understand diverse client aims and match them to fund options. To do this they need training, appropriate processes and support.
>
> We (SRI Services) offer a free to use SRI Styles online fact find tool as well as more detailed fact find support on www.FundEcoMarket.co.uk . The site includes extensive information on individual funds and we regularly help advisers by phone.
>
> **https://www.fundecomarket.co.uk/help/financial-adviser-support/fact-finding-support**
>
> **https://stylefinder-tool.fundecomarket.co.uk/**

Secton 8 - Additional Questions

Q1 **How can authorities, including the FCA, most effectively work with industry to meet investor demand for green investment opportunities and encourage those raising capital and investing in it to pursue sustainable outcomes?**

Collaborate and consult directly with existing organisations with proven commitments to this area:

> **Who** – eg UKSIF, ShareAction, SRI Services (Fund EcoMarket), Climate Wise, IIGCC – understanding that each has areas of specialist expertise and capabilities
>
> **Why** – to accelerate the development of information/support and appropriate rules/best practice guidance

Provide clear and unambiguous messaging from financial regulators

- **The FCA** and other regulatory authorities must **make it clear that they understand climate risk** and are updating rules to help meet the **UKs commitment to the Paris Climate Agreement**. Indicating that the FCA recognises that the 'light touch' approach has failed and as such regulatory action is required.
- Climate risk needs to be **led from the top** of the FCA.
    - Communications from Andrew Bailey and other senior executives must consistently demonstrate an understanding of the seriousness and immediacy of climate risk, the intention to address market failures - by putting in place the necessary mechanisms to help reduce climate risk - and to protect the financial system and those who rely on it.
    - Andrew Bailey to issue letters to CEOs to convey this message.
- Regulators must make it clear that the current financial system is heading towards being **no longer fit for purpose** (potentially within 10-20 years) and that they understand that:
    - if global temperatures continue to increase on their current trajectory the financial system, like other systems, will fail to function in any conventional sense.

- governments can not solve climate change on their own
- many companies are unlikely to focus on climate risk without encouragement from investors and/ or regulators.

Stimulating demand for cleaner / climate friendly company assets

- Climate related factors should form part all investment processes - and the regulation governing them.
- There should be a 'climate sense check' section in all regulatory communications to remind people to consider whether or not there are relevant climate risks or opportunities to help address climate challenges through stock selection, stewardship activity or other actions. in order to ensure climate risk is properly managed.
- Intermediaries should be directed to discuss this area with clients – or if appropriate (eg for robo - to highlight leading climate related options - or the lack of an option to do so.)

Understanding individual investor (retail) demand for green finance and related fund options:

Most clients will not request green finance, SRI, ESG or other forms of 'climate aware' investments as they do not understand financial options sufficiently well.

Investment options for individual investors can be split into **two broad and sometimes overlapping areas** (both of which can be further subdivided):

- **Impact investments** – the 'purest' form of which is unlisted, higher risk, potentially illiquid, generally smaller (but highly positive) assets that explicitly aim to help solve specific challenges. These are mostly appropriate for wealthier clients.
- **Collective investment funds – eg SRI, ESG, Ethical, Sustainable, Environmental, Social themed**. These include a wide range of fund options that can help address climate change. The first retail option was the Friends Provident Stewardship (ethical) fund launched in 1984. In line with diverse investor opinions and risk profiles there are now around 100 UK regulated, onshore primary (mainly OEIC) fund options – with hundreds of sub funds. These invest mostly in liquid assets, listed companies (equities and bonds) – many of which may be complex and display some positive attributes and some negative attributes.
    - These funds can have different strategy combinations which are generally versions of **avoidance, positive stock selection and engagement/stewardship** activity – all of which may help deliver benefits through 'climate & sustainability aware strategies' - actual returns are the result of a combination of different factors).
    - Experience teaches us that most individual investors are not 'single issue' focused, so these funds make sense (eg if someone is concerned about the environment they generally will not want to invest in tobacco).
    - These strategies (depending on what they do) can be labelled SRI, ESG, sustainability and/or ethical options. **Most if not all of these funds can help direct capital towards 'better companies' and as such help deliver 'positive impacts'** to a greater or lesser extent.
    - In many cases their impacts/benefits are not quantified although clearly directing investment towards better companies should be viewed as

    - useful and sensible (there is a shift towards greater impact measurement but opinions vary.)
    - These funds may or may not focus on 'green finance' but all will help to make finance greener.

- Regulators should aim to understand this area better as experience gained here could point to what should become the new baseline for all investment funds (which is why I believe separate 'ethical sectors' do not make sense).
- Embed the requirement to consider **environmental factors into fact finding** (see above re MIFIDII) and other relevant areas of COBS as part of the concept of **'true, fair and not misleading', 'fair, comprehensive, unbiased and unrestricted', 'know your customer'** etc. IT should be made clear that climate risk should be understood by all retail intermediaries and applied as part of the advice process. The core process changes would be:
    - Direct intermediaries to have an ethical/ESG fact find question in their main fact find
    - Direct intermediaries to have supplementary ethical/ESG fact find
    - Direct intermediaries to have processes in place to support clients who have an interest in this area (fund research on relevant strategies, available fund options on panels, support materials etc).
- Investigate advisory firms where there appears to be no or very few clients interested in environmental issues. This is liable to be an indicator or inadequate fact finding and/or poor processes.
- All financial services professionals to be trained/supported to understand key climate risk issue, their relevance to our lifestyles also to investment performance. Areas such as the 'Tragedy of the Horizons', the work of the IPCC work, the Paris Climate Agreement etc, the existence of the TCFD should be central to adviser competence.
- Advisers should be helped to find sensible investment responses (eg our Fund EcoMarket – the purpose of which is to address the issue of low awareness of appropriate investment options. The fund tool helps intermediaries match clients personal opinions to fund options.)
- Advisers should be directed to recognise that client aims and opinions will vary and as such having a single 'ethical/environmental' fund option on a panel (or similar) is not appropriate.

Q2. **Do you agree with the extent of the FCA's proposed interventions on climate change related financial disclosures? Is there a specific need for us to intervene further in the interests of market integrity or consumer interests?**

- Yes, the recommendations are welcome
- Yes, the FCA should intervene further
- See earlier comments, particularly regarding:
    - **urgency** - we need to use financial markets to address climate risk rapidly
    - **scope** - we need to review all aspects of the investment chain across both 'cleaner' and 'dirtier' investments. Even a stellar expansion of 'green finance' will not deliver benefits if polluters continue to pollute (ie we need to reduce greenhouse gas emissions through every means possible). Investors should be aware that there are multiple investment solutions and that both stock selection and responsible ownership / stewardship have roles to play

    - ‘**Consumer interest’** – the definition of ‘consumer interest’ should be reviewed to incorporate consideration of the way investment shape the world we live in - and retire into. The needs of future generations should also be represented.
    - Noting that most ‘end investors’ – ie scheme members, individual fund investors - would find it odd that climate risk is not integrate into investment decision making given the longer term nature of most policies).
    - Recognise that sentiments such as ‘**the business of business is business’** or ‘the only social responsibility of business is to make a profit’ (Friedman, Drucker etc) now look very dated. As such it should be incumbent on asset managers (shareholders) to reflect the views of society and not focus entirely on a single aim (financial performance).
    - As a result of investors largely ignoring climate change (eg by failing discourage greenhouse gas emissions) we are currently on track for substantially lower standards of living in future. Few individual end investors would think this makes sense.
    - The **1987 Bruntland report** defines sustainable development as ‘development that meets the needs of the present without compromising the ability of future generations to meet their own needs’. The FCA should build this into their core principles and purpose. Investors should be directed to ‘invest in ways that meet the needs of todays investors without compromising our future wellbeing or that of future generations.’
- **The FCA should intervene to require financial advisers to ask their clients whether or not they would like environmental issues to be taken into account as part of their investment planning** - also previously referred to as an ‘ethical/ESG/SRI fact find question’ – see MIFID II proposals.
    - This will only work if it is supported by training and advice/research processes that facilitate a change in the advice process (ie ‘what to do when a client says ‘yes’’).
    - It is well known that many (probably the majority of) advisers consider that they have a problem **if a client ‘says yes’** – ie when a client indicates an interest in SRI, ESG and ethics. As such it is common practice for advisers to steer clients to change their mind and indicate that they are not interested in such matters. Advisers continue to cite reasons such as poor performance or price - that have no basis in reality. A truer reason is often a lack of knowledge and poor advice processes.
    - This is a **failure to meet clients’ needs** appropriately and likely to leave some clients demonstrably worse off as ‘greener’ and ‘more sustainable’ companies outperform their ‘dirtier’ peers.
    - This is a mis-selling scandal waiting to hit the media. It has been regularly discussed by the SRI/ESG/ethical investment community for many years. **The evidence for this is the ‘mismatch’** between retail SRI fund inflows (averaging around 1% pa for many years) and potential interest as indicated by both investor research (which has typically been c50-70% - see UKSIF research) and buying patterns across other products.
  - Addressing this will require training and support. The FCA should be aware that the quality of training and information in this area is currently mixed (at best).
- The FCA should announce that they will be concerned if they find **intermediaries with no/ very few clients interested**. In the post ‘Blue Planet 2’ world this should be viewed as an indicator of a failure to meet clients needs appropriately.

- The FCA must be prepared to enforce new rules in order for them to be effective.

Q3 **In the light of the EU work on taxonomy, what are your views on the form common standards and metrics for measuring and reporting against green financial services products should take.**

- The green taxonomies work is on-going. My impression is that although it is welcome in theory and has generated lots of good-will, opinions about its efficacy (so far) appear to be mixed.
    - The issues appear to be around the fact that companies are complex and dynamic and that technological change/progress is continually.
- With regard to common standards for measuring and reporting these would be welcome if they can work well - but given the associated complexities a principles based approach is probably most likely to succeed.
    - Although it would be helpful if common standards could emerge the FCA should have regard for the fact that market solutions that meet different client needs are likely to continue to be important.
- The work of the BSI should help progress this further
- The AODP (now part of ShareAction) work should be looked at / learned from also.
- **Individual retail investors** should always be directed to consider what funds actually set out to do rather than simply looking at ratings (noting this is not necessarily the same as setting impact aims or targets). 'Intentionality', 'investment policies' and 'ESG/SRI/ environmental (etc) strategies' should be viewed as essential guides to what a fund does. This is more important than looking at fund names or descriptions such as 'impact investment' (as impacts can vary - some focus on 'social' issues others focus on 'environmental' issues, some combine both). Any such fund should be open and transparent about they do (policies, processes etc).
    - Information on this area is available, for free (it is supported by 12 fund managers) on our website www.FundEcoMarket.co.uk . The SRI Services 'SRI Styles' classifications have been running since 2011 and were developed based on 20 years experience. (The styles appear to be similar to the IA proposals that are currently being consulted on).
    - The Fund EcoMarket SRI Styles have been altered two or three times since launch because of market changes – the need for such flexibility must be recognised in order to avoid mis-selling risks.

Q4. **How could regulators and industry best work together as part of the Climate Financial Risk Forum.**

- The FCA should be aware that extensive expertise already exists in this area, many of whom would be pleased to help develop improved regulations in this area.
    - Examples include UKSIF, EIA, SRI Services (Fund EcoMarket partners), Transparency Task Force (groups I am involved in). Others include Climate Action 100+ coalition, PRI
- Regulators should aim to build on the work of existing projects, products and solutions that also work to reduce climate risk (whilst being aware that experience varies).
    - Such groups can help regulators to understand the difference between nuanced approaches and greenwash.

  - These groups could help regulators recognise that all investments have impacts (not just impact investments!) – and that core business strategies, supply chain issues and product usage etc are all relevant.
  - Any forum should aim to be pragmatic and help 'shift the dial' across all areas of investment rather than being too focuses on a single asset type, industry or region.
- Professional bodies should be encouraged to be involved – but should also be encouraged to make use of people with relevant experience. The work of the Institute of Actuaries in this area is notably excellent.

Q5 **What are your biggest concerns and commercial priorities regarding climate change**?

Awareness of climate risk and its implications

- Our biggest concern is that we are on track to do **'too little too late'** – as there is insufficient pressure from investors, regulators or other key stakeholders to do otherwise.
- A lack of understanding that **the financial system will collapse** if the predicted climate scenarios (3-4 degree temperature increase) take place.
- A lack of understanding that addressing climate risk is **about far more than the future prosperity of financial services** or the growth of green finance. It is about the prosperity of society – that the financial services community is tasked with 'serving'.

Investor responses

- Messaging from the investment community that **confuses philanthropy and/ or PR with sound, forward looking investment decision making** however well-meant is a problem**.** Paying attention to climate risk when making investment decisions makes sense because there are **material risks and opportunities**. It also makes sense as it will benefit society. However combining the 'financial benefit' with the 'doing good' message needs to be handled with caution if we are not to confuse (or annoy) those with little experience – and sceptics.

Retail investor risks

- How to balance messages around opportunities and risks without coming across as opportunistic, optimistic or alarming.
- The need to balance 'plain English' with what is often complex information in ways that individual investors understand and can make effective use of.
- Greenwash and the risk of individual investors ignoring this area as a result of cynicism and/ or mistrust.

Regulatory pitfalls

- A **lack of joined up regulation** that sends mixed messages to investors and investee companies – leading to either a failure to take necessary action or boom/bust cycles (as we saw in solar.)
- Our fear is that addressing climate risk (through its integration into investment processes) **risks becoming tied down in data, detail and vested interests** (both for and against expanding this area). These could result in this paper being 'kicked into the long grass' –

rather than taking necessary action to start the process of using financial markets to address challenges that have been well understood for many years.

UK leadership

- The risk that **other financial markets leading** this area because low support / interest / regulation in the UK. (Climate risk has been deprioritised historically so much of the UK financial community is ill placed to act fast in the event of regulatory changes.)
- The UK's credentials in this field are excellent – particularly in terms of industry innovation and leadership. Regulatory support that could have facilitated 'up scaling' has not yet happened.
- The desire to lead should be coupled with a desire to collaborate internationally in order to effect global progress.

Q6 **What are the biggest barriers to the growth of green financial services in the UK**

The vicious cycle myth of 'low demand' in retail

- Low awareness amongst retail investors has led to low apparent demand – leading to low industry interest – this is a vicious cycle.
- Poor advice processes. See earlier comments regarding fact finding - but be aware that Fact Finding and the need appropriate processes, support, training and regulatory scrutiny.
- Greenwashing risks (eg we see funds being marketed as 'ethical' that only exclude tobacco. We see fund companies claiming have high ESG standards that rarely vote against company management. We see funds failing to effectively communicate that they have a 'balanced' approach to stock selection and therefore invest in 'best in sector' companies across all sectors rather than (eg) having significant exposure to wind and solar power. We see funds 'synthetic' funds promoted as 'sustainable'…)
- Low trust in the financial services community. (This has probably stimulated support for newer/ more niche D2C impact solutions – but will not help 'improve' the mass market.)

A failure to recognise opportunities and risk through incentives and regulatory regimes

- A failure to recognise opportunities and societal / international shifts (ie the view that considering climate risk and investing in solutions companies is somehow niche and, or not material).
- A failure to recognise that investors invest internationally so if green finance opportunities do not emerge in the UK money will flow to other more active countries (eg USA)
- A failure to understand that climate risk relates to all investments (not just coal and oil companies / equities).
- The FCA has not previously recognised that as their regulator it sets the standard for much activity that directly impacts responses to climate change. Low regulatory interest in this area has (inappropriately in many cases) pushed options such as sustainable investment into a niche. The FCA should now be supportive of a wide range of 'positive' strategies from green finance, to sustainable investment and improved investor stewardship activity - and encourage asset owners, managers and intermediaries to do likewise.

Expertise / people

- Too few experienced investment professionals who are able to help explain 'the big picture'.
    - To date investment professionals have needed to be highly committed to persevere in this area – sometimes adopting 'activist' approaches in order to be heard.
    - This has changed significantly recently, creating very different dynamics and resource challenges (many experienced industry experts do not respond to consultations such as this as they do not have time).
    - A balance now needs to be struck between learning from experience and building climate risk into 'business as usual' without dumbing it down or systematising it to the extent that it becomes meaningless, ineffective or 'tick box'.
- Vested interests – people/organisations that prefer to maintain the status quo. Comments such as climate being a 'political' issue are particularly worrying and hard to answer for those who understand the significance of climate risk.

Appendix – about the retail fund market

Evidence of growing individual investor awareness is indicated by the recent uptick in sustainability themed fund launches that lead with 'sustainability strategies' – which we refer to as 'Sustainability themed funds'.

- Our www.FundEcoMarket.co.uk SRI fund database tool currently shows 10 of the 26 new 'SRI funds' launched since 2016 have put 'sustainability' as their lead theme
- 36 of the 100 OEIC funds on our database are Sustainability themed. (We have 7 fund categories representing the different lead strategies available in this field).
- 12 of the total of 36 Sustainability themed (UK registered) OEIC funds have been launched since January 2016. (The first fund was launched in 1991).
- 50 of the 100 funds have climate change policies
- 45 of the 100 funds exclude coal, oil and gas majors
- 27 have a clean energy theme/strategy

About Fund EcoMarket:

- Fund EcoMarket was set up to stimulate interest in funds with strong environmental, social and ethical (& ESG, responsible investment etc) investment strategies. It is free to use and open to all - but focuses on helping financial advisers to find funds that match their clients' personal aims.
- The site is fund manager sponsored (sponsoring funds are listed first) however we aim to collect as much information as we can on all options in order for the tool to be as comprehensive and whole of market as possible.
- Our policy research is shown in primary fund entries (mainly OEICs) only. Most of these funds have mirror life and pension funds – and there are some additional Investment Trusts and SICAVs listed .
- We list all of the funds we are aware of that focus significantly on 'environmental, social and ethical' issues – referring to the cohort as '**sustainable** and responsible investment' options (SRI).
- Our research into fund specific SRI strategies comes directly from fund managers.
- Although we list all the funds we can find and some fund managers do not return our requests for information - so the number above may be an underestimate.
- 6-800 unique users currently visit the site each month
- The tool was designed by founder Julia Dreblow (who has specialised in this are for over 20 years) with input from intermediaries, fund managers and others. SRI Services (www.sriServices.co.uk) is not regulated. The site is 'for information only'.

Useful links:

- https://report.ipcc.ch/sr15/pdf/sr15_spm_final.pdf https://www.theguardian.com/environment/2018/oct/08/global-warming-must-not-exceed-15c-warns-landmark-un-report
- https://www.nationalgeographic.com/environment/2018/10/ipcc-report-climate-change-impacts-forests-emissions/
- See www.fundecomarket.co.uk for videos (including Lord Deben on 'Why climate change matters to investors') fund information, blogs, support information and links.
- https://www.fca.org.uk/publications/discussion-papers/dp18-8-climate-change-and-green-finance