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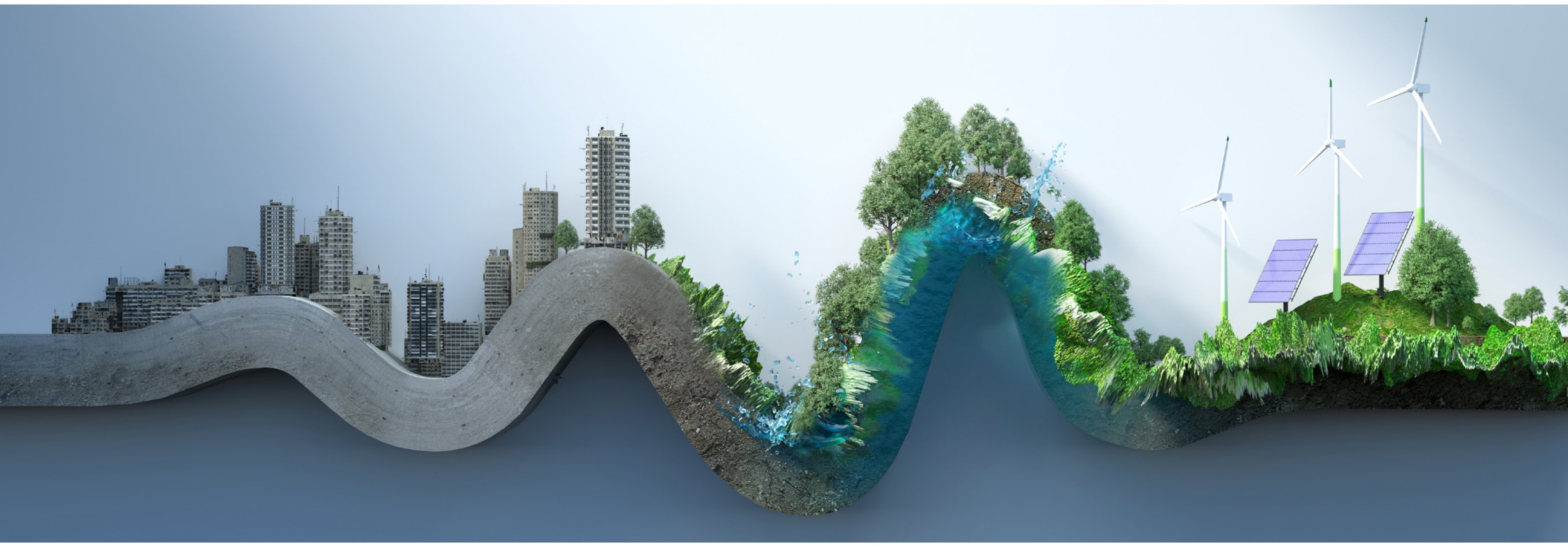

UK FCA PUBLISH DISCUSSION PAPER ON FINANCE FOR POSITIVE SUSTAINABLE CHANGE

On 10 February 2023, the UK's Financial Conduct Authority (FCA) published a Discussion Paper: 'Finance for positive sustainable change: governance, incentives and competence in regulated firms' (DP23/1). In DP23/1, the FCA states that it believes that good governance and a healthy culture is critical to financial services firms' being able to deliver value to clients and consumers, as well as supporting market integrity.

The FCA notes that the aim of DP23/1 is to encourage an industry-wide dialogue on firms' sustainability-related governance, incentives, and competencies.

In DP23/1, the FCA highlights that certain firms have already integrated material sustainability-related risks, opportunities and, in certain cases, impacts into their business, risk and capital allocation decisions.

Who will be interested in DP23/1?

The FCA notes that DP23/1 will be of interest to all regulated firms across the financial sector, particularly the following:

- Asset management firms
- Investment firms
- Insurers
- Banks
- Building societies

What is DP23/1 looking to achieve?

As noted above, in DP23/1, the FCA explains that the purpose of the paper is to encourage an industry-wide dialogue on firms' sustainability-related governance, incentives, and competencies.

The FCA states that it will use the feedback received in considering what firms would find most helpful and says that it will also take proportionality into account when proposing new rules or guidance as a result.

In parallel with DP23/1, the FCA states that it will, as part of its supervisory engagement with firms, also consider firms' arrangements in similar areas. Here the FCA references some examples such as governance of ESG and stewardship – including the role of product governance bodies in overseeing ESG and sustainability integration in investment processes. For further background the FCA provides a link to its recent letter to CEOs on its asset management supervision strategy.

DP23/1 also includes a series of ten academic articles, authored by external experts. The FCA encourages firms to reflect on the matters discussed and consider, as appropriate, incorporating them as they review and refine their current approaches to governance, remuneration, incentives and training.

Firms' governance, incentives and competence

In chapter two of DP23/1 the FCA points out that much of the regulatory focus to date has been on climate-related matters, with a 'disclosure first' approach, built around the Task Force on Climate-related Financial Disclosures (TCFD) Recommendations. The FCA also points out that this is evolving to a focus beyond climate, to matters such as human rights, diversity and inclusion, nature, and biodiversity.

DP23/1 mentions the ongoing work of the International Sustainability Standards Board (ISSB). The FCA notes that the ISSB is developing a global baseline of corporate reporting standards on sustainability-related matters, building on the TCFD's recommendations.

The FCA also highlights that the ISSB has confirmed that it will issue an agenda consultation on its future direction, in which it will seek feedback to inform potential research projects on:

Biodiversity

Equity and inclusion

Human rights (including labour rights and communities' rights in the value chain)

The FCA also points out in DP23/1 that it supports the ISSB's recognition of the work of the Taskforce on Nature-related Financial Disclosures (TNFD) as it develops standards in this area.

The FCA notes that only with a trusted market and a flow of decision-useful, comparable and reliable information along the value chain can it expect the financial services sector to realise its potential in allocating capital to support a market-led transition to achieve greater levels of sustainability.

In this regard, the FCA refers to transition planning initiatives such as the UK Transition Plan Taskforce (TPT) Disclosure Framework and the Glasgow Financial Alliance for Net Zero (GFANZ) guidance.

By way of discussion with industry, the FCA is seeking views on how it can move most effectively beyond disclosure-based initiatives to help and encourage firms as they develop their arrangements for governance, incentives and competence in the area of sustainability.

Sustainability-related governance, remuneration and incentives in regulated firms

In chapter three of DP23/1, the FCA looks at how firms embed sustainability-related considerations into their objectives and purpose, also considering how these could be included in a firms' culture, business strategy, governance and incentives.

In this chapter, the FCA looks at the following areas in greater detail:

- A firms' objectives, purpose, business and strategy;
- Culture as an enabler;
- Governance, responsibility and accountability;
- The role of the board and senior management;
- Accountability;
- Governance of products and services; and
- Integration, remuneration and incentives.

The FCA says that, in their view, robust board governance, clearly defined responsibilities and accountability are essential to managing a firm's approach to climate change and sustainability.

The FCA also explores whether and how remuneration can help to drive the effective delivery of firms' sustainability approaches over the short, medium and long-term.

Chapter three of DP23/1 also considers the governance and organisation of investor stewardship and the role that asset managers and asset owners can play in influencing positive sustainability outcomes.

FCA consideration of investor stewardship to influence positive change

In DP23/1, the FCA states that it is interested in gathering further feedback on how asset managers and asset owners organise and govern their stewardship activities to support firm-wide sustainability objectives.

In the final part of Chapter three, the FCA considers the topic of stewardship from the perspective of asset managers and asset owners in more detail.

The FCA points the reader to pre-existing considerations such as those contained in the UK Stewardship Code, FCA PS19/13, implementing the revised Shareholder Rights Directive (see COBS 2.2.B), and joint FCA DP19/1, which identified some key attributes of effective stewardship, concluding in the in the FCA's FS19/7:

- A clear purpose;
- Constructive oversight;
- Engagement and challenge;
- Culture and institutional structures that support stewardship; and
- Disclosure and transparency of stewardship activities and outcomes.

In DP23/1, the FCA seeks to ask firms if it should consider additional regulatory measures to encourage effective stewardship, particularly in relation to firms' governance and resourcing of stewardship and associated incentive mechanisms and conflict of interest policies.

Training and competence on sustainability in regulated firms

In chapter four of CP23/1, the FCA says that firms are increasingly incorporating consideration of sustainability matters into their operations, products and services.

The FCA recognises the need for genuine capability-building across the financial sector, including staff training on climate change and net zero, and sustainability more broadly.

The chapter explores good industry practice, where there could be knowledge gaps, and whether further regulatory measures are necessary.

Here the FCA refers to its Training and Competency Framework (TC2.1 specifically), SYSC 5.1.1, the Monetary Authority of Singapore's twelve technical skills and competencies needed for professionals to perform various roles in sustainable finance and the recent launch of the Principles for Responsible Banking Academy with the aim of supporting banks' alignment with the objectives of the UN Sustainable Development Goals and the Paris Agreement.[1]

The FCA also notes that certain firms are considering how to expand their sustainability-related capabilities, many of whom already provide relevant staff training. The FCA notes that professional qualification and training providers have also been responding to this growing demand – with an increase in ESG/sustainability related qualifications and training.

Next steps

DP23/1 will close for comments on 10 May 2023.

Following the benefit of feedback to DP23/1, as well as ongoing analysis and supervisory engagement with firms, the FCA says it will consider how it can better support the industry and consider if there is a case for further regulatory measures in the area of firm governance, incentives and competencies to support the role of finance in contributing to positive change.

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1. UN Environment Programme Finance Initiative (UNEP FI), the Chartered Banker Institute, and the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) have announced the launch of the Principles for Responsible Banking Academy to train all bankers about the climate emergency and sustainability. The new Academy has been designed in partnership with banks to help signatories to the Principles for Responsible Banking implement the sustainability framework across all their business activities.

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