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Mary Creagh MP
Chair, Environmental Audit Committee
House of Commons
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Dear Chair

FCA response to the Environmental Audit Committee's report on 'Greening Finance: embedding sustainability in financial decision making'

I have read the Committee's report on 'Greening Finance: embedding sustainability in financial decision making' with great interest. It included several recommendations for the FCA and I respond to these in turn below. I thought it would also be useful to set out the broader work the FCA is doing and our approach to climate change more generally. Finally, I have set out our thoughts on two wider initiatives that I think are important in this context.

Climate Change, Green Finance and the FCA's role

The FCA takes all risks that impact the markets and institutions we regulate seriously; including risks posed by climate change. We understand that international commitments on climate change and the response of corporations, capital markets, and investor demand, will all result in significant changes for the financial services sector.

Over the past few months we have been working alongside the Department for the Environment, Food and Rural Affairs (DEFRA) and other regulators to develop a more joined-up approach to climate change related issues. This has included a workshop we held on climate change and green finance in early May 2018. Attendees included members of the Green Finance Taskforce, the London School of Economics, the Bank of England, the Pensions Regulator, DEFRA and HM Treasury.

The workshop discussed the problems that could arise within the financial services sector as a result of climate change and generated ideas for how we, and other organisations, might respond. Within the FCA we have a Climate Change and Green Finance Working Group to coordinate our work internally and to develop the FCA's approach.

We plan to publish a document setting out the FCA's approach later this year. In line with our statutory objectives to ensure financial markets work well and consumers are appropriately protected, our approach to climate change and green finance will focus on:

1. Influencing activities that directly impact on the performance and integrity of financial services markets.
2. Promoting trust and confidence, helping consumers access green finance products they would like to invest in, and ensure that relevant advice and investment management meets appropriate standards.
3. Setting, supervising and enforcing clear standards to promote trust and confidence, where it is merited and appropriate.

The Environmental Audit Committee recommendations

1. **The FCA should rectify the disparity in the guidance between trust-based pension schemes and contract-based schemes to clarify the duties of the latter in relation to environmental, social and governance factors.**

On 18 June 2018, we published our response to the Law Commission's recommendations as part of the Government's final response to the Law Commission's Report[1]. We welcome the Law Commission's report, which we see as consistent with a number of other pieces of work that we are undertaking and we announced in our response that we intend to consult on rule changes in the first quarter of 2019 requiring Independent Governance Committees (IGCs) to report on their firm's policies on:

1. Evaluating environmental, social and governance (ESG) considerations, including climate change.
2. Taking account of members' ethical and other concerns.
3. Stewardship

At the same time, we will also consult on introducing related guidance for providers of workplace personal pension schemes on considering financial factors (such as ESG risks and climate change) and non-financial factors (such as responding to members' ethical concerns) when making investment decisions.

As we are undertaking other work on retirement outcomes which may also result in changes to the remit of IGCs, we intend to consult on a single package of changes in the first quarter of 2019.

2. **The FCA needs to improve its approach to climate change risks as it has not carried out an assessment of, or issued guidance on the management of, the impact of climate change to firms and markets.**

The FCA conducts wholesale reviews of risk as part of its business as usual activities, including medium to long term analysis to understand emerging risks across the financial markets we regulate. We are conscious of the range of ways in which climate change risks may impact the markets and sectors we regulate and are working to understand how we can effectively respond within the scope of our regulatory remit. The FCA is also a part of the 'UK Regulators Climate Forum' along with the Bank of England, the Financial Reporting Council, and the Pensions Regulator, to ensure a harmonised approach across the UK regulatory landscape.

3. **The FCA's listing rules should be amended to require climate-related financial disclosures on a comply or explain basis AND**

   The FCA will also need to update its guidance and listing rules regulating how information is made available to market participants when companies offer stock on the London Stock Exchange through Initial Public Offerings (IPO).

In light of your recommendations regarding changes to the FCA's Listing Rules, we would highlight that listed companies are subject to a number of obligations, both at the point of IPO and on an ongoing basis. These are derived from both domestic and European legislation.

[1]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/717375/pension-funds-and-social-investment-final-response-to-law-commission-report.pdf

The Listing Rules prescribe standards that listed companies have to meet at the point of listing and on an ongoing basis. The Prospectus Rules, which are based on European legislation, set out the disclosures companies have to make in a prospectus, including at the point of IPO. The Disclosure and Transparency Rules set out ongoing disclosure obligations, including requiring companies to file annual reports, the detailed content of which is derived from international accounting standards as well as European and domestic law. Companies also have to make ad hoc disclosures pursuant to the Market Abuse Regulation in certain circumstances, for example to announce price sensitive information.

The regulatory framework governing these disclosures is, as reflected in your report, complex. Its intention is to ensure that investors have the right information for an informed assessment of the securities they are investing in, at IPO and on an ongoing basis. In assessing the adequacy of that framework, we have regard to the needs of its users and investors.

Understanding how ESG related matters, including climate change risk, are managed by listed companies is relevant to an investor's understanding of the prospects of a particular company. It is, therefore relevant, to a fully informed understanding of the valuation of securities they are investing in. We are increasingly aware of a challenge that institutional investors are facing in discharging their fiduciary duties given the increasing demand by beneficiaries for investments to be sustainable.

We, therefore agree, that there is a need to work with other stakeholders and other public bodies on this issue. We also agree there is a need to consider further whether the framework can and should be strengthened, and if so how, while taking account of the international nature of capital markets.

Finally, the existing framework is far from inconsequential, and within that existing framework there are a number of proactive steps the FCA is already taking or will take in the future in relation to climate change-related disclosures, which we believe align with your recommendations:

- We have been contributing to regulatory initiatives to ensure better disclosures where required, and we would highlight in this context the Commission's initiatives in Green Bonds and more sophisticated credit ratings.
- We are continuing to work with the Financial Reporting Council to support better disclosures in annual reports.
- In light of your recommendations, we will highlight to issuers the need to make adequate disclosures regarding materially important information, including information that allows investors to understand how ESG matters affect the valuation of a listed company's securities and how these matters are managed by the company. We will do this through our regulatory publications and we will work with companies and investors to monitor progress in this area.

4. **There is a compelling case for other regulators to use the current round of adaptation reporting required by the Climate Change Act to integrate climate change risk management into their work.**

We are currently waiting for Government to lay its final strategy for Adaptation Reporting before Parliament. In the meantime, we will continue to build our approach for climate change and green finance which will include setting out how these areas impact on the objectives of the FCA.

Wider initiatives

European Commission Action Plan on Sustainable Finance

The Committee will be aware that the European Commission published an Action Plan on Sustainable Finance in March in response to the recommendations of its High-Level Expert Group on Sustainable Finance. Further to this Action Plan, the Commission has made a small number of legislative proposals:

- To establish a framework to facilitate sustainable investment, to set harmonised criteria for determining whether an economic activity is environmentally-sustainable and clarify for economic actors and investors which activities the Commission considers sustainable on the advice of a new Technical Expert Group on Sustainable Finance. This may form the basis for the future establishment of standards and labels for sustainable financial products.
- To require disclosures relating to sustainable investments and sustainability risks.
- To create a new category of benchmarks, comprising a low-carbon benchmark or "decarbonised" version of standard indices and positive-carbon impact benchmarks.

The FCA as part of its market integrity and consumer protection remit is considering these proposals actively and will engage with the European institutions during the legislative process. We are also working with a range of our counterpart authorities in other jurisdictions to share knowledge and best practice on green finance.

Innovate

In order to meet its commitments under the Paris agreement, the UK will need to make a significant transition towards green finance.

We have an objective to promote effective competition in the interests of consumers and are considering how this competition objective can relate to the transition to a more sustainable economy. In particular, if there are barriers preventing new entrants with business propositions in this area from gaining access to the market.

The FCA's Innovate can offer direct support to firms that present genuinely innovative ideas for green finance products that are in the interests of consumers. For example, the FCA's Sandbox allows businesses to test innovative products, services, business models and delivery mechanisms in the real market, with real consumers. It is already working with firms in this context.

If viable green finance proposals are put forward, which meet the criteria of the regulatory sandbox, we can work closely with these firms to ensure regulation does not act as a barrier to innovation.

The FCA will continue to develop the proposals above and continue to consult stakeholders, at both a domestic and international level, identifying areas where we can take joint action if necessary.

I hope that this is helpful.

Yours sincerely

David Geale
Director of Policy