Front of mind
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FCA addresses climate change

The FCA Climate Change Adaptation Report is set within the context of the FCA's strategic approach to climate change, including the transition to net zero by 2050.

The report outlines the FCA's

- climate change and environmental, social and governance (ESG) strategy and how it is evolving.
- a timeline of their major ESG publications between now and next summer.
- the climate-related risks that financial services firms are exposed to, including insurance underwriting risk, credit risk, financial market risk and operational risk.
- how firms are addressing and adapting to these climate-related risks and opportunities.
- how firms and listed companies are planning to transition to net zero.
- the role of capital mobilisation in financing both climate change adaptation and climate change mitigation.

Why the change?

The increased awareness of climate change and the transition to a net zero economy has grown and been strengthened by the remit letter sent to the FCA from the Chancellor in March this year.

The remit letter states that the FCA should 'have regard' to climate change considerations in advancing their objectives. In particular, the FCA should 'have regard to the government's commitment to achieve a net-zero economy by 2050… when considering how to advance [the FCA's] objectives and discharge [their] functions.' This has been reflected in the FCA's Business Plan for 2021/22, which includes Environmental, Social and Governance ("ESG") as a priority across the markets they regulate.

Such is the prominence of their ESG agenda, the FCA has now appointed a new Director of ESG, Sacha Sadan and has increased its resource to embed ESG throughout its function.

In terms of consumer protection, the FCA wants consumers to have access to Green products, however it wants Firms to avoid "greenwashing" whereby products are made to appear greener than they actually are.

Market integrity

Transparency is an important mechanism supporting market integrity. Climate related disclosures will enable all investors to make decisions that take climate risks and opportunities into account, including reflecting the impacts in asset prices.

The FCA clarifies:

"*We want to promote globally consistent standards. So we have introduced, or are introducing, disclosure requirements for key listed companies and regulated firms that are aligned with the Task Force on Climate-Related Financial Disclosures' ("TCFD") recommendations. We discuss in our chapter on capital mobilisation (Chapter 6) how we are implementing these requirements to support the Government's commitment to mandatory TCFD-aligned disclosures.*"

Effective competition in the interest of consumers

Setting domestic and international standards on climate disclosures: the FCA is working closely with other regulators to deliver consistent standards in the UK and globally as well as the Competition and Markets Authority to ensure the right framework is in place to facilitate firms competing effectively in the climate space.

Promote positive innovation in green finance. The FCA is supporting firms seeking new ways to mitigate climate risk and enable consumers to take advantage of the opportunities that the transition to net zero offers. This will in turn support effective competition by bringing new products to the market that better meet consumers' evolving needs and preferences.

Sustainable finance strategy – The FCA'S 3 themes

1. Transparency – Promoting good and consistent disclosures along the investment chain.
2. Trust – Ensuring that the market delivers sustainable finance instruments and products that genuinely meet investors' sustainability preferences – and are seen to do so.
3. Tools – Government, regulators and industry working collaboratively to share experience, develop consistent guidance and tools and provide mutual support as they confront the challenges of climate change.

Retail investments

Due to the increased demand for green products and to avoid "Greenwashing" especially in the fund management sector, the FCA has introduced guiding principles for the design, delivery and disclosure of retail ESG/sustainable funds. These principles aim to assist consumers to make more informed choices. Their emphasised is mainly on the importance of clear and accurate ongoing disclosures to consumers where funds make ESG-related claims.

The FCA'S guiding principles for the design, delivery and disclosure of retail ESG/ sustainable funds

References to ESG (or related terms) in a fund's name, financial promotions or fund documentation should fairly reflect the materiality of ESG/sustainability considerations to the objectives and/ or investment policy and strategy of the fund.

The resources (including skills, experience, technology, research, data and analytical tools) that a firm applies in pursuit of a fund's stated ESG objectives should be appropriate. The way that a fund's ESG investment strategy is implemented, and the profile of its holdings, should be consistent with its disclosed objectives on an ongoing basis.

ESG/sustainability-related information in a key investor information document should be easily available and clear, succinct and comprehensible, avoiding the use of jargon and technical terms when everyday words can be used instead. Funds should disclose information to enable consumers to make an informed judgement about the merits of investing in a fund. Periodic fund disclosures should include evaluation against stated ESG/sustainability characteristics, themes or outcomes, as well as evidence of actions taken in pursuit of the fund's stated aims.

These guiding principles are complementary to the measures the Government is developing. The FCA is providing technical advice on:

- Creating a Taxonomy. The Government has established a Green Technical Advisory Group ("GTAG") to oversee the Government's delivery of a 'Green Taxonomy' – a common framework setting the bar for investments that can be defined as environmentally sustainable. The GTAG is made up of financial and business stakeholders, taxonomy and data experts, and subject matter experts.
- Developing economy-wide Sustainability Disclosure Requirements for corporates, asset managers, asset owners and investment products to report on their sustainability risks, opportunities and impacts. This work will build on measures already taken or underway to implement the TCFD's recommendations.
- Creating sustainable investment labels, so that consumers can navigate the range of investment products based on their sustainability characteristics.

Impact of climate change on Retail lending

This primarily affects the mortgage sector as flooding and coastal erosion together with Increases in extreme weather events could intensify the likelihood of defaults due to borrowers' increased financial losses. For investors in real estate and infrastructure assets, these changes can lead to asset devaluation.

The FCA, other UK authorities, and the industry have all driven a programme of change to address the risks within the retail lending sector.

The CFRF's working groups have been focusing their attention on producing tangible outputs to help the industry in adapting to climate-related financial risks. In October 2021, the CFRF published guidance on a climate risk appetite statement ("RAS"), focusing on 4 sectors, including retail banking.

The Bank of England's 2021 Climate Biennial Exploratory Scenario ("CBES") will explore the financial risks of climate change for the largest UK banks, including retail lenders. This exercise aims to highlight where action may be necessary and improve firms' risk management and prompt a strategic view.

The future

The FCA has several projects planned, including:

- Net zero investor stewardship. The FCA are part of a Stewardship Regulators Group, which is chaired by the FRC and made up of the financial regulators and relevant Government departments. In summer 2021, the Group gathered views from a cross-section of stakeholders on the policy case for, and possible design of, 'Say on Climate' resolutions at annual general meetings. The Group will consider next steps in light of the feedback received from stakeholders.
- Research on capital mobilisation – assessing the need for efficient capital allocation, potential market failures and barriers to the flow of funds that may inhibit the financing of green initiatives.
- Innovate Digital Sandbox. Estimated to go live early 2022 and shall focus on sustainability and climate change.
- Net zero targets together with greener financing

The net zero alliances require signatories to set targets and some also produce target-setting protocols. These explicitly set out how members are expected to set targets, including guidance on the scope of emissions to be covered and recommended methodologies.

The FCA recognises firms will require a significant amount of financing to support their transition to net zero. While conventional equity and debt instruments may be used to finance this investment, industry has also looked at innovative solutions to support companies in their transitions. There are also green solutions such as ESG Bonds – green, social and sustainable bonds – and UK green gilts.

The FCA has confirmed it will monitor the impact of UK green gilts on the wider ESG debt market by UK issuers. It will also continue to engage with issuers, advisors and investors to better understand whether the current framework for ESG bonds supports the work led by the Treasury on funding the transition to net zero.

In brief

The FCA is aware of the need to evolve their approach to embed ESG and climate risk more holistically. It is fully committed to engaging and mitigating risks to support firms through the challenging times ahead. Firms themselves will have to adapt to the ever changing framework required to achieve this goal. The FCA is itself subject to change as they engaging in international working groups and maintaining dialogue with global counterparts to exchange best practice to protect both consumers whilst maintaining market integrity on their journey to Net Zero by 2050. This commitment should achieve a successful transition for all and target objectives being met without damaging financial and retail markets. ■

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