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Rt Hon Mel Stride MP
House of Commons
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Our Ref: SA200204A

Dear Mel,

Thank you for your letter of 3 February concerning comments made by Mark Carney and your questions about the work of the FCA on climate risk and green finance.

We agree with Mark that the financial services industry must adapt if the UK is to meet the Government's legally binding commitment to achieve net-zero carbon emissions by 2050. We recognise our regulatory approach will need to continue to evolve to ensure that consumers have access to readily available, reliable and consistent disclosures about climate change.

As set out in our Feedback Statement on Climate Change and Green Finance (FS19/6), we want to ensure our regulatory approach creates an environment where market participants can adequately manage the risks from moving to a low carbon economy and are able to capture opportunities to benefit consumers.

Disclosures and consumer choice

You ask whether consumers currently have clarity about whether their savings, pensions and investments are aligned to achieving net-zero carbon emissions by 2050, and if not, how this might be improved.

Accurate and timely information is vital to ensure markets work well and enables consumers to make effective investment decisions. Firms' disclosures on the climate-related characteristics of their financial products are still developing. As a result, UK consumers do not yet have clarity on the climate-related exposures of their investments, and whether their savings, pensions and investments are aligned to achieving net-zero carbon emissions by 2050.

We see considerable benefit in firms' improving their disclosures of how the funds they manage on behalf of consumers are exposed to climate-related risks and opportunities, enabling them to better understand the products and services they are offered and hold firms to account.

Currently firms' ability to provide these product-level disclosures is limited. For example, listed issuers' climate-related financial disclosures, which form the basis for the product-level information about the environmental characteristics of a product, are often inconsistent and insufficient. The disclosures often do not provide a forward-looking view of how a company or a portfolio is positioned relative to a transition path to net-zero by 2050. Clear, more informative product-level disclosures will require both richer data inputs from issuers, and more sophisticated modelling.

We are currently engaged in four initiatives to improve climate-related disclosures across both the financial and non-financial sectors. These initiatives will either directly enhance firms' disclosures to consumers, or help to provide firms with the information and capabilities they need to make these disclosures.

Adoption of Taskforce on Climate-related Financial Disclosures (TCFD) -aligned disclosures

Climate-related disclosures were a key area of focus in our Feedback Statement on Climate Change and Green Finance (FS 19/6), published in October 2019. We committed to consulting on new climate-related financial disclosure rules for certain issuers aligned with the recommendations of the TCFD, and will shortly be publishing our Consultation Paper on this. We will also clarify existing disclosure obligations in our rules and EU legislation. Improving the quality and consistency of the climate-related information from the real economy will both help financial services firms and other market participants manage climate-related risks and opportunities, and inform their own disclosures to consumers on the climate change exposures of their investment products and portfolios.

But improving climate-related disclosures by issuers is just the first step. As we said in FS 19/6, we are currently considering how best to enhance climate-related disclosures by regulated firms, such as asset managers and life insurers, in a manner consistent with the TCFD's recommendations.

We are carrying out this work in coordination with Government and other regulators, via a taskforce established following the publication of the Government's Green Finance Strategy. We are also considering interactions with relevant EU disclosure initiatives.

EU disclosure initiatives under the Sustainable Finance Action Plan

The EU's Sustainable Finance Disclosure Regulation recently entered the Official Journal and new rules will come into effect in the EU in March 2021. These will require asset managers, financial advisors, insurance companies and pension funds to disclose how they integrate environmental, social and governance (ESG) factors in their investment decision-making and advisory processes. These disclosures could inform product-level information provided to consumers, including on matters such as carbon footprinting. EU authorities are expected shortly to consult on Regulatory Technical Standards (RTS) to support implementation of the Regulation.

The Government committed in the Green Finance Strategy to at least 'match the ambition' of the objectives of the EU's Plan, as they relate to green finance. We will continue to consider, with the Government and other regulators what actions are necessary to achieve this.

Climate Financial Risk Forum (CFRF)

In March 2019, we established the Climate Financial Risk Forum (CFRF), jointly with the Prudential Regulation Authority (PRA). The CFRF brings together senior representatives from across the financial sector to share best practice and develop practical 'by industry, for industry' guides to support firms in addressing climate-related financial risks. These guides will cover disclosures, innovation, risk management and scenario analysis. The guides will be published in the Spring of this year.

The guide on disclosures will consider both firm-level and product-level disclosures, and will propose some key climate-related exposure metrics. The CFRF is due to meet next in late March to finalise its initial outputs and agree next steps.

Consumer access to sustainable retail investment products

Finally, we are currently undertaking policy analysis on the way that firms design specialist sustainable retail investment products and disclose information about these to consumers. We want to ensure that consumers have access to genuinely sustainable finance products and services and receive appropriate information and advice to help inform their investment decisions. This work will include considering whether additional actions, guidance or rules are necessary to achieve this and to promote good governance of the design and delivery of sustainable products and services. We expect to set out our initial findings and next steps over the Summer.

A visual rating system for carbon footprinting

As explained in our Handbook guidance in February 2019 ([PS 19/14](PS 19/14)), disclosures need to be 'simple, comparable and consumer friendly' if they are to be accessible to consumers and enable them to hold firms to account.

A 'visual rating system' on the lines you suggest could be considered, and more work will be needed over time to make this a reasonable, effective and viable approach to disclosing the carbon footprint of firms' products. A comprehensive approach would currently be challenging given data and methodological limitations (e.g. difficulty in sourcing appropriate data inputs; insufficient and inconsistent issuer-level disclosure; lack of an agreed set of standards, metrics and criteria for defining sustainable activities), though capabilities will improve over time.

Therefore, as noted above, we feel that any preliminary visual rating system would need to be transparent about the limitations, and more work will be necessary to overcome data and methodological limitations.

Given the backward-looking nature of carbon footprinting data, we would need to consider what other 'key performance indicators', such as forward-looking information on the transition path, might need to be disclosed at the product-level to provide a more complete and relevant picture for consumers. However, we are mindful that our approach needs to be proportionate and measured so that it is feasible for firms, not unduly burdensome and does not encourage an over-reliance on one or few metrics.

We note that a number of industry and regulatory initiatives are considering how to develop classifications and 'labels' to clearly signal products' sustainability characteristics to consumers. We are closely monitoring these initiatives and are keen to support the development of appropriate common approaches, which could support consumers in making investment decisions, as this space evolves and limitations are overcome. Examples of these initiatives include:

- *EU-level initiatives:* The EU is developing an 'eco label' which will reference the Taxonomy for sustainable activities that it has developed. This sets different thresholds of investment in defined sustainable activities for specialist sustainable funds to meet in order to be given a 'green' label.
- *UK initiatives:* The Investment Association (IA) and the British Standards Institution (BSI) each plan to consider product labels in the coming months. The Investing and Saving Alliance (TISA) also has a programme of work looking specifically at how firms can engage consumers on the ESG objectives and characteristics of their products.

In our view, the FCA has powers available which could allow us to introduce rules on regulated financial services firms to disclose a 'simple, comparable and consumer-friendly' environmental carbon footprint visual rating system, if appropriate. As measures and proposals evolve, we would need to undertake further diagnostic work to consider whether there would be any barriers to specific approaches. If our existing statutory remit and/or powers prevented us from taking action, then we would raise this directly with relevant governmental departments and the Committee, and through our annual perimeter report.

However, as noted above, we feel that more work is necessary to overcome data and methodological limitations before a common visual rating system could be considered.

Risks to consumer protection and market integrity and firm supervision

We agree that if firms and markets fail to appropriately consider climate-related financial risks, this could result in a 'carbon bubble' and could seriously impact consumer protection and market integrity.

To protect and enhance market integrity, it is important that the UK's financial markets can both respond to climate-related financial risks and support the transition in a stable and orderly way. Doing so will include ensuring that material climate-related financial risks and opportunities are disclosed effectively, which will support the market in appropriately pricing assets and making informed business, risk and investment decisions. If inconsistent, unreliable or insufficient disclosures are made to consumers and the market, there is a risk that assets are mispriced because the market is unable to determine their true value. This could result in capital being misallocated, eroding trust in the market and, more broadly, harming market integrity.

Consumer protection could also be undermined if consumers do not have transparent information about how their providers are managing their assets' exposures to the 'carbon bubble'. If consumers are unable to assess the risks inherent in the products or services they purchase, this could result in their being unable to make informed choices and purchasing unsuitable products and services.

Several existing FCA initiatives also aim to promote a longer-term perspective in institutional investment decisions and product design, where appropriate, including to take account of climate change and other ESG risks. This includes further work on investor stewardship, as set out in our Feedback Statement (FS 19/7), building on new rules on shareholder engagement for asset managers introduced in June 2019 (PS 19/13). We aim to ensure that asset managers are delivering good outcomes for their customers, and supporting long-term decision-making.

Linked to this, we have extended the remit of Independent Governance Committees (IGCs) to report on contract-based pension providers' ESG and stewardship policies, and how the firms take members' concerns into account in their investment decisions. These new rules and guidance (PS 19/30) will come into effect on 6 April 2020. We believe that IGC oversight of providers' policies on climate change and other ESG issues, and of what the providers do in practice, can provide greater protection for consumers by acting as an additional check on the firm's approach.

It also important to emphasise that the Bank of England's Biennial Exploratory Scenarios will be helpful in ensuring firms prepare for the transition to a greener economy. The scenario being tested in 2021 will build on progress already made by firms and regulators in adapting to the transition by testing the resilience of the core of our financial services system to the possible effects of climate change.

As noted in FS 19/6, we will further consider the role of firms' culture, governance and leadership in ensuring that they appropriately take action to manage the risks of climate change and support the transition more widely. We are keen to ensure our regulatory framework and supervisory work appropriately promotes transparency and accountability around climate-related issues. Any steps we take in this area could be informed by the Supervisory Statement issued by the PRA in April 2019 with the aim of enhancing banks' and insurers' approaches to managing the financial risks from climate change. This statement sets expectations in the areas of governance, risk management, scenario analysis and disclosure.

We actively consider stewardship as part of our supervisors' assessment of firms in the asset management sector. In 2019, the FCA pro-actively engaged with a number of firms on stewardship to understand their aims and approach. We used this to establish best practices in effective stewardship for firms, as outlined in our Stewardship Feedback Statement (FS 19/7). For many firms, the exercise of stewardship and ESG-related factors will be integral to the effective delivery of their services.

I hope you find this information helpful.

Andrew Bailey

Andrew Bailey
Chief Executive