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UK Finance response to FCA DP 18/8: Climate Change and Green Finance

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation. We welcome the opportunity to respond to the Financial Conduct Authority (FCA) discussion paper (DP) 'Climate Change and Green Finance' and have also responded to the Prudential Regulatory Authority (PRA) consultation paper (CP) 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change' (attached).

As can be seen from the response to the PRA consultation, we agree that climate change presents significant risks to the environment and society and that these risks have significant economic and financial implications. The Government and all sectors of the economy need to work together on this. The imperative for the financial sector is to understand better both the physical and transition-related impacts that could materialise as a result of climate change and assess how they could present financial risks to loan and investment portfolios.

DP 18/8 reflects the FCA's statutory responsibility as listing authority, prudential regulator for 18,000 firms, and its role in protecting consumers and market integrity. Specific FCA actions referenced in Chapter 5 comprise:

- Consultation planned for Q1 2019 on a package of changes relevant to Independent Governance Committees of workplace personal pension schemes.
- Its Innovate programme, including IGreenBank, and announcing the Innovate FinTech Challenge to industry calling for the market to develop innovative financial products and services to assist in the UK's transition to a low carbon economy – with details to be published on their website on 19 October.
- Its intention to consult on guidance to issuers about how the current regulatory regime might be interpreted to apply climate-change related risks.

Climate-related financial risks continue to be explored in a multitude of fora – most notably for banks and financial services through the UN Environment Finance Initiative (UNEP FI) and the central bank/regulator Network for Greening the Financial System (NGFS). This is in addition to the inter-governmental, regional and national discussions of more general application, with some banks working internally on their own accords. Looking ahead, we see a significant role for the UK Climate Financial Risk Forum being established jointly by the PRA and the FCA. It will be important to ensure that the dialogue within the forum is as open as possible and that there is wide market access to knowledge generated. UK Finance would be interested in exploring with the PRA and FCA how it might help with industry consideration of forum topics and the dissemination of ideas generated and that its expert membership is fully leveraged. UK Finance would be interested in exploring with the PRA and FCA how it might help with industry consideration of forum topics and the dissemination of ideas generated.

Disclosures in capital markets

We would respond as follows to the three questions in Chapter 5 concerning disclosures in capital markets:

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

As the DP observes, while some companies with securities provide disclosures on sustainability matters, there is not a consistent approach to disclosing climate-related risks. We see a case, in particular, for considering whether better disclosure could be required within prospectuses. Ideally this should be considered within the context of the

EU Prospectuses Directive and internationally coordination requirements around 'non-financial information'. It might also be better to think in terms of 'relevance' than 'materiality' with priority given to ensuring that instruments labelled as being 'green' or similar in substance meet claims made and are supported by data pools supporting investor analysis.

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?

The presumption should be consistency with the TCFD and related initiatives. We discuss disclosure (and scenario analyses) as it applies to banks and financial services firms in more detail in our response to the PRA consultation.

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?

'Comply or explain' would be an entirely appropriate way forward given the incomplete nature of the disclosure framework and the on-going work taking place in light of the TCFD's recommendations.

Public reporting requirements

We would respond as follows to the three questions in Chapter 5 concerning public reporting requirements:

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

Yes, subject to relevance and materiality. Thought, however, needs to be given to public reporting requirements more generally. Appreciating that there are other data sources, the longer term goal must be to place financial services firms in a position where they can assess risk more fully from publicly available information from the companies they do business with. Effective bank disclosure requires effective company disclosure. The more fundamental question therefore is the nature of any support that government or the regulatory authorities may be able to provide in this regard. We note the relevance of dialogue opened within the Financial Reporting Council's (FRC) Financial Reporting Lab.

Q2: Do you have any suggestions for what information could be included in a climate risks report?

Information identified as part of internationally co-ordinated initiatives building out from the TCFD recommendations.

Q3: Do you have any views on which regulated firms should be required to compile a climate risks report?

All subject to relevance, proportionality and materiality. Relevance, for instance, might determine that reports for some should be determined by business sector (or product line) and geography.

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?

We support proposals for transparency and labelling so long as they are grounded in substance. While much of the attention is currently around 'green' and 'environmental' benefit, we see merit in the framework being developed in principle with reference to 'sustainability' more broadly, including for social investment (and the 'social' element of 'green' financing given transition can involve countervailing social and community impacts that ought to be taken into account). Work being undertaken within an EU context is also important.

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

As market interest develops there will be an evident need for the FCA to ensure that environmental and social claims made have integrity.

Q3: In 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?

We see merit in common standards and metrics but cannot say the extent to which we would wish to see this tied to the outcome of the EU work on taxonomy until we have better sight of how this progresses. This needs significant further work and the goal should be the achievement of international consistency.

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

Given the intention as we understand is for the forum to have a core membership of a limited number of PRA/FCA regulated institutions, it will be important to ensure that the dialogue within the forum is as open as possible and that there is wide market access to knowledge generated. There will also be a need to ensure that a representative cross-section of firms (by size, business, focus etc.) are involved in the forum. We further understand that the intention may be for the forum's work programme to be advanced through the formation of technical working groups under the chair of a core member to advance specific workstreams and that additional firms may be invited to join these. UK Finance is supportive of this and would be interested in exploring with the PRA and FCA how it might help with industry consideration of forum topics and the dissemination of ideas generated.

In terms of the content for the immediate work programme, the forum may afford the opportunity to build on the recommendations of the Green Finance Task Force, given these effectively were the sector's recommendations to Government. This, of course, would be subject to coordination with the Green Finance Institute and others to ensure that there was no duplication of effort, let alone conflict. There may also be a role in terms of supporting industry needs on data collection.

It should be appreciated that breathing space needs to be given for market solutions to develop over time. This is particularly the case in developing the market for "green" mortgages where there are growing calls from policy makers across the UK for greater lender activity in this space.

In addition to showcasing innovation, the forum should also serve to raise the quality of the dialogue around climate-related issues, including the 'paradoxes' involved and the need to bear in mind social and community factors.

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

We would be concerned if a focus upon physical risk arising from climate change resulted in communities finding themselves excluded from financial services or products. Flood reinsurance provides an example where financial innovation can provide a better outcome than otherwise might be the case.

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

We are at the very early stages of market development. In the context of green mortgages, for instance, there are ongoing challenges about how to develop a consistently robust and credible approach to evidencing energy savings that could be factored into mortgage affordability calculations. Similar issues arise in relation to ascertaining the extent to which lower energy running costs translate into lower probability of mortgage default. And on property valuation, evidence is not unanimous on whether higher energy performance translates into higher property value. Issues such as these, taken together, illustrate barriers to growth of the green mortgage market. Similar considerations will apply to other products and services.

For further information about this submission please feel free to contact Paul Chisnall, Director, Finance & Operations Policy, UK Finance at paul.chisnall@ukfinance.org.uk