TITLE:
Markets do not correct and regulate spontaneously: A call to financial advice firms to raise Sustainable Finance market participation

CONTENT:
Let's start with this: we believe in good outcomes for people, good outcomes for the market and good outcomes for our planet.

It is now widely known that climate risk is investment risk and that it is systemic.
TCFD is becoming mandatory and ESG metrics will deliver the required reporting. Do not forget we also now have Taskforce on Nature related Financial Disclosure - TNFD.

In its final communique the G7 finance ministers said; "We support moving towards mandatory climate-related financial disclosures that provide consistent and decision-useful information for market participants."

The FCA has given us its Sustainable Finance Strategy themes - these are trust, transparency and tools. The Financial Services Bill was recently amended to include the wording for climate considerations for financial services. The Sunak remit letters mean every financial decision should include climate considerations, regulators must consider the climate.

In a recent keynote speech Mark Manning (Sustainable Finance and Stewardship at FCA) was asked - what can advisers do now to prepare? His answer was; "…looking at what is happening in the EU is a really good place to start".

So here we are.

In April 2021 the European Commission adopted the Sustainable Finance Package. Within the Delegated Acts, in the section on investment and insurance advice: when financial advisers assess a client's suitability for an investment, they now need to discuss the client's sustainability preferences.

OK, ESG factors are metrics, what is Sustainable Finance?

Sustainable Finance encompasses banking, credit, insurance, mortgages, pensions and investments - all finance.

Clients hold Sustainable Finance investment values and preferences. These span across a spectrum - ranging; no interest, broad level ESG, ESG plus common-sense screening applied, Responsible and Sustainable, Impact and SDGs up to full Ethical views.

Clients also hold Sustainable Finance mortgage values. Lenders and Advisers interact with clients at key decision points, so advisers need to ensure a client ends up with a product and lender to match their values.

We understand that the policy makers will give us the taxonomy and disclosure regulations and that the interests of clients and the infusing of ESG & Sustainable Finance values will come from conduct principles.

Delivering Sustainable Finance requires a compliance process for all clients, it is consumer care/KYC requiring a neutral and educational approach to ensure good client outcomes.

MiFID II - now - means assessing client knowledge and experience, financial situation and investment objectives. Firms must take reasonable steps to ensure that information collected from clients is reliable.

As part of a firms overall client advice process, Sustainability preferences are secondary and additional to general investment objectives. To engage with clients fully the fund objectives can be communicated - the client can know they are making a difference, or not doing 'harm'.

Let's apply some common sense. Many clients fall into the broad 'making a difference, or not doing harm' categories, it will not be necessary for the adviser to ask overly detailed questions research to filter out fund after fund - doing so holds risks of:

1/ ending up with nothing suitable left to invest in for the clients risk profile
2/ a ridiculously complicated and expensive advice process, cost passing on to the client
3/ the risk of client changing their mind at next review for another favoured on-trend 'preference', cue churning

For these clients we believe preferences can be met via the fund managers mandates and processes. Remember TCFD, Net-Zero commitments and fiduciary duty.

We are at the start of huge transition - risks and opportunities. The investable universe is evolving, ESG listed funds and bonds are increasing rapidly.

A disorderly transition to a low carbon economy could have a destabilising effect on the financial system. The FCA is bang on with the Sustainable Finance themes - trust, transparency and tools. Advisers are included here as market participants with a duty of care.

Embed a robust Sustainable Finance compliance process. This enhances market participation. Place responsibility of investment decisions in asset managers for broad interest clients, from this there is some protection for consumers from a snap reactionary shift of preferences. Good for long term client outcomes and for stability and trust in the markets - and an orderly transition.

What about conduct?

We all know that MiFID II aims to better protect investors by regulating each stage of a product's life cycle - this requires participation from design/manufacturers (fund groups) and distributors (advisory firms).

This level of participation is linked to the culture of a company/firm, by how (and if) the firm articulates its purpose and values through its systems, controls, and arrangements. Good research and due diligence starts by bringing attention to the KYC and PROD requirements. The outcome from a firm's KYC and PROD procedures drives the MiFID II participation/dialogue/due diligence with fund groups.

This participation can be assisted via a robust Triage & Values Questionnaire framework. This will bring robust and granular client profiles for PROD. This in turn feeds back into the development of products to help ensure investors' sustainability preferences are genuinely met.

We believe increased market participation is now more important than ever as we are in a fast evolving area. This in turn reduces conduct risk which includes the impact of product design (ESG products piling into market) and the impact of this on consumer outcomes.

And, lest we forget, getting ready now for incoming Sustainable Finance regulatory changes - ignoring the compliance process changes needed now increases conduct risk and reputation risk for firms.

Likewise at what point will omitting discussion of financially material climate and ESG risks be viewed the same as not including discussion of shortfall risk with a client entering FAD?

Financial services are pivotal for climate action, can be pivotal in helping realise SDGs and biodiversity, can deliver positive impact across many sectors and industries. To be in this industry now is a once in a lifetime chance to be part of global good driving positive change.

And so, yes, we may be waiting for HM Treasury MiFID II tweaks for Sustainable Finance … but in the meantime we absolutely have duty of care for best practice and enhanced market participation and this means adopting a robust and granular compliance process for Sustainable Finance preferences now.

Should you have any questions on issues raised here or on other areas of ESG or Sustainability, please contact us: admin@esgaccord.co.uk