The FCA's CP21/17: Enhancing climate-related disclosures

This is a great step forward for the FCA and for all of us in the long term. The momentum is building towards a sustainable financial system, but this CP is only a small element of the change needed.

Whilst it is vital that product Providers (PPs) and Fund Managers (FMs) will be mandated to be more transparent in their descriptions of products and funds, this will be of limited benefit until:

1) The public are better informed about the sustainability aspects of their money
2) Financial advisers are required to ascertain client sustainability preferences

In itself, the Consultation Paper only partially address point (1) because until the public get past the "I don't know what I don't know" barrier, lots more info is just going to make financial products even less accessible than they currently are. Due to the relatively low level of financial education and understanding of financial products and how the financial system works, most people don't understand where their money is invested and, when faced with the truth there is general shock and surprise.

Far too many times I have heard "I can't believe they are allowed to do that with my money". Over three decades of advising retail investors, this response was frustratingly common, and rather worryingly a large proportion of these comments came from people who had been to a financial adviser. So much for 'know your client'!

So, whilst I am completely in agreement with the principle of transparency, it won't be of that much help to the majority of people who are both unsure of how the financial system works and unsure about all of the different areas that are covered by the term 'sustainable finance'.

Sticking with (1) for a little longer, I can see a very significant misselling cloud on the horizon. The language of government and regulators is a little mixed, ranging from 'sustainability' to 'climate-related'. The former has a much broader remit and will mean different things to different people (see my comments on (2) later). Climate-related is far narrower in focus and ignores sustainability aspects in so many other areas, as well as ignoring social and governance issues. And here I've identified the dark cloud on the horizon – ESG.

PPs and FMs have, to date, looked at the development of sustainability disclosure in Europe and the FCA instructions to date and decided that this means ESG. As far as I can see, there is a slightly better connection to 'sustainability objectives' than to 'climate-related' objectives with an ESG strategy, but in either case it can be a bit of a stretch.

Yes, the 'E' in ESG is directly linked to climate, so a tick in the box there. However, there is also a direct connection to climate with the S and the G as well (recent Shell case is just one example). If FCA's CP is the only one issued covering instructions to PPs and FMs, the providers will be completely free to decide whether or not to disclose on the 'S' and 'G' and if they do disclose, they can effectively say whatever they like. In a world of subjective interpretation, it could be a marketing free for all. Not sure how well consumers will be protected in such an environment.

One of the FCA's objectives is to "to secure an appropriate degree of protection for consumers". It is really difficult to see how the FCA can meet this objective by simply focussing on 'climate-related' disclosure and letting the market decide what to do on everything else. Individual investors will be bombarded by an unfiltered stream of (un)consciousness from PPs and FMs and the big misselling danger is that they will be forced to make assumptions about what it all means, what their investments will be supporting or avoiding and on whether broader social issues or even ethical issues are covered. After 30 years of advising retail investors, I can assure you that many assumptions will be made by investors about what all this means that that is a recipe for disaster/PPI 2.

Whilst CP21/17 is very focused on net zero and climate related disclose, it looks like other bodies have already committed to a broader framework. Both The Pensions Regulator and DWP are working on a broader focus, more akin to the EU's sustainability preferences rules. What the market doesn't need is for pension schemes to be operating and disclosing information to scheme members whilst the same scheme members are receiving a different set of disclosures from their personal investments. Which information is the best/most accurate and why isn't it all the same – just a few questions that might be asked!

Let's have a look at (2) now. Well, at the moment it is solely down to each financial advice firm to decide whether 'know your client' translates as know their sustainability preferences, ethical views or moral/religious convictions. One interpretation is that an adviser cannot know their client if they haven't asked suitable 'soft' questions. On the other hand, asking such questions and being forced to act on the answers, leads many firms to avoid the issue all together. With no specific guidance from the FCA that know your client DOES include the ESG/sustainable/ethical/moral issues, consumers sit in a vacuum with most only getting advice on these areas if they specifically ask their adviser.

Until the FCA issues guidance to the financial advice community, on a similar basis to CP21/17, it is difficult to see how the regulator is meeting its "to secure an appropriate degree of protection for consumers" objective. We are led to believe that the UK will be following the EU's lead in respect of ensuring that advisers ascertain a client's sustainability preferences.

There seems to be no shortage of commentary from advisers along the lines of "my clients don't ask about ethical, ESG etc so there is no interest in it". This is a very dangerous compliance position for advisers to adopt. That's because if clients are not asked the appropriate questions, it cannot be assumed that there is no interest. Clients are almost certainly not asking the questions because, here we go again…"they don't know what they don't know". Until the public are better informed about the workings and machinations of the financial industry, it is incumbent on advisers to be at the forefront of financial education to ensure better questions are asked by clients, leading to the ideal position of best outcomes for clients.

We believe that best practice must already cover asking about a client's values, but to ensure there is no ongoing doubt we wait for the FCA to take a lead on this. This lead needs to go beyond the narrow 'climate-related' disclosure of CP21/17, to broaden out to full 'sustainability preferences'.

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