

MEMO# 35040

February 28, 2023

UK FCA Publishes Discussion Paper on Finance for Positive Sustainable Change

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TO: ICI Global Members

ESG Task Force

Global Regulated Funds Committee SUBJECTS: Compensation/Remuneration

ESG

Fund Governance

International/Global RE: UK FCA publishes discussion paper on Finance for Positive Sustainable Change

On 10 February, the Financial Conduct Authority (FCA) published a discussion paper on regulated firms' sustainability-related governance, incentives, and competence.^[1] The FCA's stated goals are to highlight good practices in this area and explore whether further regulation is needed. The FCA states that firms' governance, purpose, and culture are critical to how sustainability considerations are incorporated into business, risk, and capital allocation decisions. Responses to the discussion paper are due on 10 May 2023. ICI Global will be consulting with members to determine if we should provide a response.

1. What is the FCA Considering?

The FCA is looking to develop a plan for its future regulatory approach to sustainability-related governance, incentives, competence, and stewardship arrangements. To do this, they are seeking feedback on how firms are already embedding sustainability objectives in their operations. They note an intention to understand the importance of buy-in and tone from senior management when it comes to sustainability-related issues, as well as how remuneration is used to align corporate outcomes with long-term sustainability aims. Specifically, the FCA is looking for feedback on:

- Whether firms have environmental or social objectives and how these are reflected in their policies and strategies;
- How firms design their approaches to governance, remuneration, incentives, training and competence, to deliver effectively on these objectives;
- Practical challenges, and observed gaps and shortcomings; and,
- Whether existing rules and guidance in these areas are appropriate or need to be refined to adapt to the changing role of finance.

The FCA notes that it is using the TCFD's governance pillar as a framework for its thinking on these issues, as well as the ISSB's developing governance-related disclosure requirements.

2. What are the Next Steps?

The FCA does not specify timing or what form new regulatory measures in this area would take. However, it is clear they are considering several options including:

- Setting more strict expectations that firms embed sustainability-related considerations into their business objectives and strategies;
- Setting regulatory expectations or guidance on firm culture and behaviors with respect to promoting positive change;
- Setting regulatory expectations or guidance on board-level knowledge and skills relating to climate and sustainability risk;
- Setting regulatory expectations or guidance on decision-making processes, including systems and controls, audit trails and the flow of management information to key decision-makers with respect to climate- and sustainability-related developments;
- Setting regulatory expectations or guidance on senior management responsibilities for a firm's sustainability-related strategy, including the delivery of the firm's climate transition plan;
- Setting regulatory expectations or guidance on the governance and oversight of products with sustainability characteristics, or that make sustainability claims, such as more clarity on the roles and expectations of governing bodies like Fund Boards;
- Setting regulatory expectations or guidance on the link between sustainability-related objectives and remuneration and incentives plans;
- Setting regulatory measures to encourage effective stewardship, particularly in relation to firms' governance and resourcing of stewardship, and associated incentive mechanisms and conflict of interest policies; and,
- Setting regulatory guidance on sustainability-related training and competence expectations.

3. How does this Relate to Existing UK Sustainable Finance Measures?

- UK Strategy for Positive Change ([link](#)): in March 2021 the FCA published its ESG strategy including target outcomes and actions for the financial sector to drive positive change such as the net-zero transition. The strategy emphasized the role of the financial sector in the transition and the need for firms to adapt their objectives and business models, as well as their governance arrangements and incentives structures, which the FCA notes as an impetus for this discussion paper.
- UK Consumer Duty Rules ([link](#)): in July 2022 the FCA published its new final rules on Consumer Duty, setting out expectations for firm around consumer protection and disclosure, among others. The FCA notes that governance is already a key factor of the new Consumer Duty rules.
- Dear CEO Letter on Asset Management Supervision ([link](#)): on 3 February 2023, the FCA sent a Dear CEO letter outlining its intentions for supervising asset managers and emphasized product governance and ESG investing as top priorities. The FCA notes that this supervision strategy will work in parallel with future regulatory developments in the area.

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Notes

[1] FCA Discussion Paper 23/1, Finance for positive sustainable change: governance, incentives and competence in regulated firms, is available at https://www.fca.org.uk/publication/discussion/dp23-1_updated.pdf.

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