UKSIF
UK Sustainable Investment and Finance Association

<u>UKSIF Budget Submission 2017</u>

Policy: The FCA should be explicitly mandated to properly integrate and mitigate climate-related financial risks as part of its operational objective- specifically to protect and enhance the integrity of the UK financial system.

Rationale: Climate change, and the risks associated with climate change, poses a major risk to the global financial system and its impacts will be felt across all sectors. Ignoring externalities like climate-risk – as the regulator currently does – represents a market failure which must be addressed. According to Carbon Tracker, up to $13.8tn global assets are at risk in the event of a worst-case climate scenario. Even the most optimistic assessment (where existing targets to combat climate change are met globally) estimates at-risk assets to be in the region of $2tn. In comparison to the unprecedented threat presented to financial stability in the UK, however, climate risk remains critically ill-considered by the national financial regulator. The FCA should encourage climate-related financial disclosures, publish policy statements and guidance to firms on climate-related risks and conduct detailed research into climate-related liability, transition and physical risks and their impacts on the UK economy as the PRA has done for the Bank of England.

Various policy developments have taken place over recent months which have increased the need for the FCA to consider climate-related risks in the way it regulates the financial services sector in the UK and to publish guidance for firms on how to consider such risks. Three key developments are as follows:

> The Government endorsement of the Task Force on Climate-related Financial Disclosures: Following the introduction in the UK of the world's first mandatory carbon reporting rule for FTSE 100 firms, the Government has now backed the TCFD voluntary recommendations of climate reporting. The recommendations aim to integrate the risks and opportunities posed by climate change into mainstream financial disclosures. These disclosures are specifically aimed at investors, but many are still unsure how – or even whether they are able – to consider climate-risks during the investment process.
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> A recommendation to do so by the Law Commission: In a 2017 report the Law Commission recommended that the FCA should recognise the materiality of environmental, social and governance (ESG) factors and issue guidance for pension schemes on how to integrate financially material and non-financial factors. This follows similar guidance from The Pensions Regulator on what factors schemes may consider in the investment process which explicitly highlights climate-related risks as financially material to investments.
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> The High Level Expert Group on Sustainable Finance (HLEG): The HLEG has recent published its interim report which is backed by European Commission Vice-Presidents Dombrovskis and Katainen. We expect implementation of its recommendations to begin by the end of 2017. One key recommendation is for the European Supervisory Agencies (ESAs) to properly consider systemic risks from ESG factors – in particular climate changes – which it argues are not yet fully integrated into financial risk assessment processes. Assuming post-Brexit Britain's financial services sector is to export into the EU, firms will have to match the standards set out by the ESAs, including where these relate to climate disclosures. The UK is the biggest financial hub in the EU so the FCA has an opportunity to engage with ESAs on

this and seek both to influence and match these rules to ensure UK firms are not disproportionately impacted by new regulations.

Value for money: We do not consider there to be any cost to HMT. Any additional cost implications for the FCA will be minimal and directly relate to its core operational objective of market stability. Any expenditure will therefore meet the National Audit Office efficiency and effectiveness criteria on value for money assessment. A mandate to consider climate-related risks is in the interests of investors. Climate-risk is not just a long-term consideration: these risks are already impacting portfolios. Anyone who was invested in Peabody for example has already lost money as a result of climate change.

Revenue implications: Over the short term such a change is likely to be revenue-neutral. Over the medium to long-term investors will increasingly be able to exploit the opportunities available to as we transition to a low-carbon economy, boosting revenue – potentially substantially.

Wider macroeconomic implications: Proper consideration of climate-related risks by the financial regulator aligns with the overall objective of maintaining a stable macroeconomic framework. It has the potential to increase economic productivity by consolidating the UK's position as a leading player in industries such as offshore wind, electric vehicles and other green infrastructure projects by attracting increased levels of private investment. Over the long-term these industries will form a significant proportion of GDP and provide thousands of jobs. In fact, we recommend the FCA be given observer status on the recently announced Green Finance Task Force to better understand how some leading firms are already beginning to integrate climate-risk into investment decisions. We also have commitments to meet due to COP21 and our own Climate Change Act. Such a change would make this transition to a low-carbon economy much smoother. Any sudden repricing of carbon-related assets due to a lack of proper consideration of risk by the industry has the potential to be extremely damaging to the wider UK economy.

Sectoral impacts: Such a change, by encouraging private investment through increased issuance and investment into green bonds for example, would provide clear boosts to industries such as wind and solar power generation, fuel cells and energy efficiency. Currently green bonds listed on the London Stock Exchange have raised almost £10bn, we would expect this to increase dramatically if such a change were introduced due to increased demand. Conversely, over the medium-term it would be detrimental to fossil fuel energy generation and carbon-exposed industries which will have to be phased out if we are to meet our climate change commitments under COP21 and the Climate Change Act.

Legislative requirements: Such a change would require amendments to the COBS handbook and therefore no legislative action will be necessary.

Environmental impact: Encouraging investors to properly consider climate-related risks will have a substantial and positive impact on the environment, especially over the medium to long-term.

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