ShareAction»

63/66 Hatton Garden
Fifth Floor, Suite 23
London
EC1N 8LE
+44 (0) 20 7403 7800

Rt Hon Mel Stride MP
Chair, Treasury Select Committee
House of Commons
London
SW1A 0AA

Sent via online form

19th February 2021

Dear Mr Stride,

<u>Future of Financial Services inquiry response</u>

I am writing to respond on behalf of ShareAction, a registered charity established to promote responsible investment by institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters.

This response covers Questions 1-2, 6-9 and 12-13 in the call for evidence.

1) **How can the UK financial services sector take advantage of the UK's new trading environment with the rest of the world?**

We would like to see the opportunities afforded by Brexit to strengthen the UK's reputation as a global centre for sustainable finance. The Government has expressed its desire to develop its own, distinct standards outside of the EU, and to establish the UK as a thought leader on international finance standards. In the area of sustainable finance, we would argue the EU is a significant thought-leader on sustainable finance; their new SFDR legislation is the most recent product of this. As the UK redraws its own regulatory regime, it must maintain the commitment in the Green Finance Strategy to match (and exceed) the ambition of the EU's sustainable finance action plan. This is important to retain access to EU financial markets, as well as to attract investors beyond Europe to the UK looking for sustainable investment. There was a package of measures announced by the Treasury in November 2020, including green gilts and the development of a UK sustainable finance taxonomy; this was encouraging for outside investors to see, and continued policy output in this area would be welcome.

2) **What changes should be made to the UK's financial services regulations and regulatory framework once the UK is independent of the European Union?**

We have drafted a model piece of legislation, the Responsible Investment Bill ("the RI Bill")[1] that would adapt the UK's regulatory framework to facilitate transition to a sustainable economy. This would also establish the UK's position as a centre for sustainable finance in the global marketplace.

[1] The RI Bill can be read in full here: https://shareaction.org/wp-content/uploads/2020/10/Responsible-Investment-Bill-briefing.pdf

The main aim of the RI Bill is to establish a legal duty for financial institutions to act in the 'best interest' of their beneficiaries. 'Best interest' is defined to reflect the fact that a truly effective finance industry helps build a flourishing and sustainable society, factoring in a wide range of externalities that companies and investors often fail to consider. ESG issues should be considered by financial institutions in terms of double materiality, i.e. through both a financial lens and an impact lens. A person's best interests are not only financial, but also depend upon the opportunity to live in a healthy, stable, secure society and environment. The RI Bill legally binds financial institutions to pursue this for the beneficiaries; in its present form the Bill applies this to a number of institutions regulated by the Financial Services and Markets Act 2000 (e.g. asset managers, contract-based pension schemes) and the Pension Schemes Act 1995 (e.g. trust-based pension schemes), with the Government granted powers to extend the 'best interest' duty to others.

The RI Bill then goes on to establish a number of other legal duties, designed to ensure financial institutions are effectively pursuing the 'best interests' of their beneficiaries. These include a duty to strategically align with the Paris Agreement on Climate Change, and a duty to provide effective stewardship of investments in line with the 'best interest' definition.

The RI Bill also establishes a UK Council for Investor Due Diligence. Based on existing counterparts in Sweden and Norway, the CIDD would have the power to deliberate on and sanction institutional investors for serious breaches of environmental and human rights law. Many investors already seek to understand ESG risks within companies but are hampered by lack of research; the CIDD would therefore help investors avoid the financial and reputational risk of bad practice within investee companies and encourage engagement with them.

Beyond the provisions proposed of the RI Bill, we would like to see additional changes made to our financial services regulation. In particular:

- Climate change guidance for bond holders - Bond holders can and should engage on a collaborative basis to change issuers' approaches to consideration of climate change and other sustainability issues, but often cite legal risks as a key obstacle. The FCA should publish clear guidance for fixed-income investors on how they can act as good stewards of capital and help tackle climate change.

- Mandatory TNFD disclosure – The Taskforce on Nature-related Financial Disclosures has published a reporting framework for asset managers, companies and asset owners. It is designed to capture the financially material risks of biodiversity impacts in the corporate and financial sectors.[2] We recommend the Government introduce mandatory biodiversity-related disclosures in line with the TNFD recommendations. This would replicate the recent commitment from the UK government to make climate disclosures mandatory by companies and financial institutions using the framework developed by the Taskforce on Climate Related Financial Disclosure (TCFD).

6) How can Government policy and the UK regulators facilitate the emergence of FinTech and new competition; develop new areas of growth for the financial services sector; and promote the UK as the best place to incubate new financial technologies and firms?

We would encourage the adoption of the RI Bill provisions outlined in Question 2 as a means of developing new areas of growth for the financial services sector, in particular that of green finance. The RI Bill's provisions to align the sector overall with the Paris Climate Agreement would encourage investors to diversify their portfolios into green financial products, and further develop this area which is vital for the future of the sector.

[2] Endorsed by 34 financial institutions and cross-continent governments, the TNFD framework will be launched in 2021 and tested in 2022 before made available worldwide. The Treasury's ongoing review into the economic value of biodiversity will provide the formal underpinning of the framework.

7) **Through what legislative mechanism should new financial regulations be made?**

We support retaining and amending the Financial Services and Markets Act 2000 as the main legislative mechanism for financial regulations; as detailed in Question 2, we would like to see significant amendments to this to promote responsible investment.

8) **What role does Parliament have to play in influencing new financial services regulations?**

We would like to see greater Parliamentary scrutiny of how new financial services regulations promote sustainability. For example, the Treasury Select Committee's regular sessions on 'the work of the FCA' should regularly examine how the regulator's output is promoting a sustainable economy.

9) **How should new UK financial regulations be scrutinised?**

We would like to see more effective scrutiny of regulations against the existing statutory objectives of the UK regulators. The Financial Services and Markets Act 2000 outlines a number of objectives for the FCA and PRA to pursue in their regulation – these include market confidence (Part I, Section 3 of the Act) and financial stability (Part I, Section 3A of the Act). It would be helpful for regulators to outline to Parliament and Government how they perceive these statutory objectives. Developing a sustainable economy is central to establishing market confidence and financial stability. The regulators should outline the challenges they are facing in helping promote a sustainable economy, and be granted additional powers from the Government if they feel this would equip them to do so. For example, we understand the Treasury is considering granting the FCA power to regulate investment consultants – this would be a welcome move to ensure the advice they provide to many financial institutions adequately accounts for ESG risk.

12) **Should the mandate and statutory objectives of the financial services regulators change to include wider public policy issues?**

As detailed in Question 9, it would be helpful for regulators to formally articulate how they perceive their statutory objectives. We would also advocate amending the statutory objectives to include 'promotion of sustainable economy' and/or 'mitigation of ESG-related risk' as statutory objectives could be made. An explicit reference to sustainability/ESG would serve to counterbalance the relative neglect of these issues compared to other risk factors such as inflation, political risk etc.

13) **How important is the independence of regulators and how might this best be protected?**

We would encourage regulators to involve civil society organisations and individuals more in their work, to ensure a sufficient check on the influence of the finance industry. ShareAction has enjoyed a longstanding and constructive relationship with the FCA; however this type of regulator-civil society relationship is not commonplace. It has necessarily taken us time to develop our network of contacts with the FCA, and to ensure we are able to participate in various workstreams. There are many other organisations and individuals, with great expertise and insight, who do not have the resources to do this. While regulators necessarily engage with industry, they should bear in mind how well-resourced they are by comparison, and do more do more to involve their civil society counterparts in their work. Their voices must be heard alongside those of the industry itself if the regulators are to protect their independence.

Yours sincerely,

David O'Sullivan
UK Policy Officer, ShareAction