CFA Society United Kingdom

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Submitted by e-mail to: dp23-1@fca.org.uk

CFA UK response to the FCA's Discussion Paper 23/1 – 'Finance for positive sustainable change: governance, incentives and competence in regulated firms'

Dear ESG Team,

The CFA Society of the UK (CFA UK) welcomes the opportunity to respond to the FCA's discussion paper on the topic of promoting positive sustainable change, especially the issues relating to Training & Competence which is central to our own mission and purpose[1].

In line with our Society's purpose, we aim to highlight relevant issues to help the investment community to serve its stakeholders well and to build a more sustainable future. We provide our detailed responses to the specific questions in the discussion paper in Appendix II. However, we would like to emphasise the following points:

The FCA's role in promoting 'positive sustainable change':

Our overall assessment is that there are relatively few rules that the FCA can at this stage modernise effectively to promote 'positive sustainable change' and that most of the existing rulebook should be interpreted to be complimentary to its 'positive sustainable change' agenda.

Whilst we identify in our answers in Appendix II a number of rules that can now be amended to promote sustainable change, at this stage we believe the FCA's main role will be to promote best practice, provide firms with additional guidance and encourage the sharing of sustainable practices amongst investment firms.

At this stage, whilst the investment profession knows that it wishes to promote sustainability in the interests of both its clients and broader society, CFA UK believes that our current collective knowledge and understanding of what that means is insufficiently precise and certain such that it could be counter-productive for the FCA to be overly prescriptive. Promoting education and innovation in sustainability, linking pay to sustainability; this will all help create the right conditions to orient investment professionals' behaviour towards more sustainable practices. More prescriptive rules must then follow as

[1] A summary of relevant information about CFA UK and our umbrella organisation, CFA Institute, is provided in Appendix I.

soon as practicable, and likely in progressive increments, as objective / science-based, data-supported evidence emerges, not only in climate-related matters, but across the wider base of sustainability issues.

In the meantime, we believe that market forces alongside a supportive regulatory environment can drive positive change that will protect consumers and the integrity of the financial system and should also contribute to the growth of the UK economy.

Proportionality:

The transition of an investment firm towards sustainability is not a straight-forward task. It is multi-faceted; lacks clear definition; is subject to significant ongoing and external change into the medium-term; requires all staff to acquire new knowledge and skills; is beset by all manner of information challenges and has many qualitative as well as quantitative goals. The investment profession will overcome these hurdles, but it will take time. Whilst it is just as important in the long-run that small firms achieve this transition as well as large firms, regulation must be proportionate, consider the relative resources and in-house infrastructure available at firms of different sizes. It should not distract firms from serving their clients well and should promote, not stifle, innovation by not being overly prescriptive.

For this reason, we believe the FCA, and other regulators, should ask large firms to lead the exploratory process of transition allowing small firms to innovate and follow their example once best practice has emerged. As part of this, we believe it is now time for large firms – asset managers, asset owners and service providers – to be required to apply for signatory status under the Stewardship Code and that this mandatory requirement be extended to medium-sized firms in the foreseeable future. We think the FCA should look to build on the overall success of the 2020 Stewardship Code and not look to replace it or risk the confusion of inventing a co-existing model. At the same time, we have received feedback that some signatories have found the process of achieving signatory status under the 2020 Stewardship Code to have been an unrewarding use of valuable firm resources. We can only encourage therefore an ongoing constructive dialogue between firms and the FRC to overcome what are hopefully teething issues of implementing this relatively new version of the code.

Competence in Sustainability:

CFA UK is at the heart of the drive to educate the UK's investment sector on sustainable investment. To date we have pioneered the development of level 4 qualifications in ESG Investing[2] (currently averaging 1,200 registrations globally per month and with the highest number of registrations in the UK), Climate Investing[3] (very recently launched in the UK) and Impact Investing[4]. We are aware these qualifications need to keep up with a fast-moving

[2] CFA Institute's ESG Investing Certificate: https://www.cfainstitute.org/en/programs/esg-investing
[3] CFA UK's Climate Investing certificate: https://www.cfauk.org/study/certificate-in-climate-and-investing
[4] CFA UK's Impact Investing certificate is under development and expected to be launched within the next 12 months

world and that they are most suitable for only a section of the investment sector's workforce. We identify in our responses to your questions other gaps in sustainable knowledge which need addressing. Perhaps the two most pressing are at board level and at among operational middle- and back-office staff.

We greatly appreciate the opportunity to respond to this consultation and would welcome continuing our ongoing dialogue and collaboration to assist the FCA with the much-needed development of sustainability knowledge and skills in the UK's investment sector.

Yours sincerely,

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and the oversight of the Professionalism Steering Committee.

APPENDIX I: About CFA UK and CFA Institute

CFA UK serves nearly twelve thousand leading members of the UK investment profession. Many of our members work either managing investment portfolios, advising on investments, or in roles responsible for investment operations or oversight.

The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests.

Founded in 1955, CFA UK is one of the largest member societies of CFA Institute and provides continuing education, advocacy, information and career support on behalf of its members.

Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA UK has pioneered ESG-related examination-based courses in recent years, most notably the Certificate in ESG Investing, the Certificate in Climate Investing and the Certificate in Impact Investing.

For more information, visit www.cfauk.org or follow us on Twitter @cfauk and on LinkedIn.com/company/cfa-uk/.

CFA Institute is the global association for investment professionals that sets the standard for professional excellence and credentials.

The organisation is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow.

It awards the Chartered Financial Analyst® (CFA) and Certificate in Investment Performance Measurement® (CIPM) designations worldwide, publishes research, conducts professional development programs, and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. It also now manages the Certificate in ESG Investing, having taken over responsibility for that from CFA UK in 2021.

CFA Institute has members in 162 markets, of which more than 170,000 hold the Chartered Financial Analyst® (CFA) designation. CFA Institute has nine offices worldwide and there are 158 local member societies.

For more information, visit www.cfainstitute.org.

APPENDIX II: Responses to questions

ESG Governance

***Q1:* Should all financial services firms be expected to embed sustainability-related considerations in their business objectives and strategies? If so, what should be the scope of such expectations? Please explain your views.**

We believe that all firms should be expected to embed sustainability-related considerations into their business objectives and strategies to varying degrees. It is important that all investment firms in the UK embrace the sustainability revolution and share the cultural experience of being on this journey of learning. The challenge to become more sustainable and to adapt to a transitioning world affects everyone and so we see no reason why any firm should be excluded.

We take the viewpoint that all firms will benefit from embedding sustainability-related considerations into their business objectives and strategies in some way; it should make them better investment firms and improve their products and customer appeal. We also believe that firms' staff will benefit, acquire important skills for their futures and enhance their career paths and options.

At the same time, we acknowledge that not all firms are the same and that they have very different journeys in improving their sustainability. This means that any regulation needs to have an element of proportionality. Some small firms are very well-advanced in terms of embedding sustainable practices, but as a whole small firms' sustainability practices are understandably relatively under-developed. Large firms have the resources and the infrastructure to grapple with this complex project. Therefore, we do believe it needs to be the large asset owners and asset managers which lead the way forward, develop and share best practice.

Where applicable, we address the issue of proportionality in our answers below to other questions.

***Q2:* Beyond the FCA's ongoing work on diversity and inclusion, and introduction of the Consumer Duty, should we consider setting regulatory expectations or guidance on how firms' culture and behaviours can support positive sustainable change? Please explain your views.**

The FCA can help firms improve their organisation's culture to facilitate positive sustainable change, through both new rules and guidance, with the balance of these initiatives coming in guidance rather than new rules.

In terms of new rules:

- we highlight the success of the SM&CR regime in improving the culture of accountability within firms with its progressive roll-out across banks, insurers and investment firms from 2016 onwards. The Statements of Responsibilities ("SoR"s) of Senior Manager Functions ("SMF"s), and the Proscribed Responsibilities ("PR"s) within them, have provided discipline, rigour and focus to this. We recommend that the FCA now review the SoRs and look to embed and integrate relevant sustainability responsibilities across each of the existing SMFs;

- part of the challenge of embedding positive sustainable change lies in establishing definitions. This is fundamental because, unless there is a universal understanding of what a given sustainability term exactly means, any regulatory rule or guidance using that term may be left open to interpretation. We therefore believe that the FCA should, perhaps as part of the new SDR regulation expected in Q3, 2023, seek to establish a glossary or taxonomy of sustainability terms and definitions to assist the cultural change targeted[5];
- in this discussion paper, the FCA rightly identifies training and competence as another critical element to achieving positive sustainable change. To underscore its importance we believe that the FCA's rules regarding the training and competence of all staff and directors at firms need to be advanced to include specific mention of sustainability. Positive and effective sustainable cultural change will not be achieved if a firm's staff have insufficient or out-dated knowledge of sustainability, in all its many forms, as well as its relevance to their firm, their clients and their products.

In terms of new guidance, the FCA can be effective in promoting a positive sustainable culture by promoting examples of best practice where it sees it and by requiring firms to share best practice with peers and through industry networks. To achieve real cultural change in an organisation, it needs to touch all employees and not just leadership layers, so management tools which have been successful in driving positive cultural change generally will be useful also in driving sustainable change: 360-degree performance reviews, the publication of parent and maternity leave policies, annual staff surveys, highly visible and accessible senior leaders and an effective whistleblowing process are all examples of key ingredients which we would wish to highlight.

***Q3:* a) What steps can firms take to ensure that they have the right skills and knowledge relating to material climate- and sustainability-related risks, opportunities and impacts on their boards?**

We strongly agree that having strong sustainability skills and knowledge across firms at board level is essential to drive positive sustainable change in firms.

Climate and sustainability related skills at board level can be significantly improved and, even where specific training is being provided, is often lacking depth. We believe a push for greater diversity in recruitment will help fund boards acquire more sustainability knowledge which can be shared and benefited on by the whole organisation over time.

Another key step to this is the setting of effective sustainability objectives, reviewing board member performance against these and holding board executives accountable. A critical focus of these objectives should be in addressing any sustainability knowledge gap on the board, both individually and collectively.

b) Should we consider setting any regulatory expectations or guidance in this area?

Yes.

c) If so, what should be the scope of such expectations?

[5] In this context, CFA UK notes that publication of the EU Social taxonomy has been delayed and that the UK's Green Taxonomy is also as yet unpublished and it is unclear whether that will cover Social as well as Environmental factors.

We believe the competence requirements of senior leaders should be updated to encompass relevant sustainability knowledge and skills for the role and that this should be written into SMF SoRs.

Additionally, we note that the requirement in Principle K of the UK Corporate Governance Code should be understood as already covering this area, when it states: "The board and its committees should have a combination of skills, experience, and knowledge". As we write later in our response to the Stewardship questions below, we believe the time has now come to make the Stewardship Code mandatory for the largest firms - asset managers, asset owners and asset service providers.

We think that guidance from the FCA, to set regulatory expectations without overt prescription of what relevant board-level competence in sustainability is, would be appropriate to help firms align Board expertise with sustainability priorities, in two aspects:

(1) encouraging all board members to acquire better knowledge of climate and sustainability related risks and opportunities in the form of workshops, trainings and qualifications; and
(2) hiring Board members with more direct credentials and experience, over time, noting these profiles are still in short supply across the industry and hence not available especially for smaller firms, in the short-term.

***Q4:* a) What are likely to be the most effective strategies in embedding climate- and sustainability-related considerations across a firm's operations?**

To effectively embed climate and sustainability related considerations across a firm's operations, this requires their importance being championed by senior management, the board and the broader leadership team. The most effective strategies would be market, client and shareholder driven, with economic and sustainability objectives pulling in the same direction, rather than driven by regulation.

Making sustainability one of the firm's core values is one of the most obvious and easiest reforms to instil a firmwide commitment to sustainability and help embed a sustainability-related consciousness among its employees. However, for this to then come to life, it then needs to be translated into context throughout the organisation.

To further support collective buy-in, regular engaging firmwide ESG training for all employees would help educate staff. Online training can have a tendency to achieve limited engagement and so, depending on the firm's own situation, in-person training or a mix of in-person and online training might be most effective.

Four other practices, which could be identified as guidance or best practice, to embed sustainability might be (i) the updating of role descriptions and performance objectives of all roles, including senior-, middle- and junior roles to ensure they include a sustainability element; that (ii) new hires receive 'firm-context' sustainability training as part of their on-boarding process; that (iii) firms adopt a net zero or transition plan; and (iv) firms adopt sustainability specifically as one of their key pillars in their Value for Money reporting.

b) What is the potential benefit of initiatives such as the appointment of functional 'champions', or the creation of dedicated working groups or forums? And how can the value of such initiatives be enhanced?

We are generally in favour of the FCA's recommendation of firms appointing sustainability champions and working groups to create dedicated resources and focus to drive the desired cultural change.

That said, the working mechanism of these groups will be important and how they feed back into the dedicated sustainability team or senior management – they need proper empowerment. It would be desirable for the sustainability champions to come from different functions so as to create a multi-disciplined team, but they should be adequately trained and educated on sustainability topics both when onboarded and on an ongoing basis. In addition, mandatory annual or semi-annual sustainability forums for all employees could be a useful tool to reach all areas of the business. As such initiatives often exist already in large organisations, it would be helpful for the FCA to promote the public description of the best versions of these in guidance.

We also believe it is critical that sustainability related considerations are built into firm recruitment processes in order to ensure new hires understand the context of sustainability within their own organisation. When a firm incorporates sustainability into the hiring process as well as other key processes, such as remuneration and stewardship (see our responses to questions 8-11 below), it is likely to achieve the desired culture as an outcome.

Q5:* *a) What management information does senior management use to monitor and oversee climate- and sustainability-related developments, and to monitor progress against public commitments?

This depends enormously on the firm, in particular its size and strategic focus. While there is no one-size-fits-all approach, we advocate some elements which it may include are:

- Monitoring staff and board acquisition of sustainability knowledge and investment training;
- Sector focused information with an emphasis on forward-looking data and forecasts, rather than historic reporting;
- Aligned with relevant regulatory taxonomy definitions (noting the UK green taxonomy is still under development);
- Regular verification of reports by second-line, internal and (say annually) external audit;
- Systematic use of client feedback on sustainability issues;
- Use of multiple standard and principle-based external frameworks e.g. SFDR, ISSB, TCFD, UN SDGs in combination to minimise gaps;
- A combination of both in-house and external sustainability data sources and expert opinion;
- The monitoring of progress against a net-zero target or transition plan;
- The monitoring of progress against specific sustainability KPIs under a fund's Value for Money reporting objectives;
- Adequate investment and resourcing;
- Disclosure and communication via a universal intranet-based portal and dashboard widely used by senior management and at all levels of the firm;
- Integration of product or sales targets, for example the proportion of AuM that is aligned with the Paris Agreement or net zero goals and the regular monitoring of these KPIs;
- Partial linkage of remuneration to firm sustainability goals and monitored regularly;

- Key stewardship achievements, successes, goals and challenges

b) Should we set expectations or guidance for decision-making processes, including systems and controls, audit trails and the flow of management information to key decision-makers?

The wide range of firm types and strategies argues against the FCA providing too much prescription in this area at the current time.

c) If so, what should be the scope of such expectations?

The FCA could share examples of best practice.

Q6: a) Should we consider setting new 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?

As mentioned above and below, the sharing of best practice by the FCA will help raise standards across the investment sector.

Firms should seek feedback from stakeholders on their climate transition plans and the FCA is one of those stakeholders.

b) If so, which existing SMF(s) would be the most suitable to assume these responsibilities? Please explain your views.

We are against the creation of a new Chief Sustainability Officer SMF role. Since sustainability needs to be integrated across the entire firm these changes will likely touch the descriptions of all the regulatory roles, since they are all relevant to the organisation's ongoing success and viability. Only this way will sustainability be factored into operational and strategic decision-making. Whilst we are not against firms creating the role of a Chief Sustainability Officer, we would argue against this becoming an SMF role within the SM&CR regime as this could 'silo' sustainability to an under-resourced support function of the business.

All senior managers need to grapple with the different risks and opportunities of the sustainability agenda. Our view is that all existing SoRs should be reviewed through the lens and updated to include a sustainability element and help drive the firm's positive sustainable change.

Q7: Should we consider introducing specific regulatory expectations and/or guidance on the governance and oversight of products with sustainability characteristics, or that make sustainability claims – for example to clarify the roles and expectations of governing bodies such as Fund Boards? If so, which matters in particular would benefit from clarification?

Yes.

We look forward to the FCA's publication of its Position Statement on SDR in Q3 and the implementation of the (new) Consumer Duty later this year.

Governing bodies will have an increased responsibility under both of these two FCA initiatives to clamp down on any over-promotion of sustainability claims relating to their firm or their products. This will require them to have the appropriate systems in place as well as the right skills, resources and knowledge.

We recommend that the FCA provide guidance to encourage fund boards to make reasonable efforts and have sufficient resources to assure themselves that any sustainability claims made by their fund can be substantiated and are neither exaggerated or omitted.

As mentioned above, the publication of a sustainable taxonomy within the SDR regulation would be helpful to minimise any doubt or ambiguity about what these new rules mean. It would be an unhelpful and unwelcome development if this taxonomy differed to any material extent from sustainability definitions used in other leading global markets.

As mentioned below, we support the suggestion that a proportion of staff and board remuneration should be linked to sustainability and this could be overseen by the firm's existing pay governance arrangements.

ESG Incentives

***Q8:* What matters should firms take into consideration when designing remuneration and incentive plans linked to their sustainability-related objectives? In particular, we welcome views on the following: a. the case for linking pay to sustainability-related objectives b. whether firms should break down their sustainability-related commitments into different factors, allocating specific weightings to each c. whether short-term or long-term measures are more appropriate, or a combination of both d. whether sustainability-related incentives should be considered for senior management only, or a wider cohort of employees e. how firms could consider remuneration and incentive plans in the design and delivery of their transition plans f. remuneration adjustments where sustainability-related targets (at either the firm level or individual level) have not been met. Please explain your views.**

a. the case for linking pay to sustainability-related objectives;

In our view, there is a strong case for linking pay to sustainability-related objectives to ensure alignment and to motivate behaviours to drive positive change. Linking pay to stretching (and not easy-to-meet/beat) sustainability-related objectives can help reinforce the firm's commitment, engagement, and aligned interests.

b. whether firms should break down their sustainability-related commitments into different factors, allocating specific weightings to each;

Breaking down firms' sustainability-related commitment and allocating weighting should not be mandated at this time. The FCA should let each firm determine and tailor the appropriate key metrics that are material for them because of differences between firms' size, asset class, and investment strategy. Such factors and weights can be adjusted over time based on the firms' experiences. While case studies or guidance from the FCA would be helpful, we do not believe that such requirements should be prescriptive at this time.

c. whether short-term or long-term measures are more appropriate, or a combination of both;

The FCA should let each firm determine whether short-term or long-term, or a combination of measures would be most appropriate. Having such measures will permit firms to do trending analysis, with effectiveness reinforced by appropriate oversight. While we recognize a good balance of short, medium, and long-term targets towards net-zero transition would be best practice, it may not be practical for all firms to comply. Effective implementation and what's most appropriate for each firm will vary, depending on the company size, resources available, business model, strategy, and operating environment.

d. whether sustainability-related incentives should be considered for senior management only, or a wider cohort of employees;

Sustainability-related incentives should be required for senior management as a minimum. For staff outside the management team, it should be focused on employees who have a direct and material influence on sustainability-related operations within the firm, but companies should be encouraged to broaden sustainability-related incentives to all employees to further drive a culture shift to positive change based on their experience.

e. how firms could consider remuneration and incentive plans in the design and delivery of their transition plans;

The remuneration and incentive plans should be meaningful, objectively measurable, controllable, and material to the company's sustainability-related objectives given the company's strategies and risks. It should include an appropriate balance of short, medium, and long-term targets. However, the FCA should not be prescriptive and should let each firm determine what is most appropriate for them at this time.

f. remuneration adjustments where sustainability-related targets (at either the firm level or individual level) have not been met. Please explain your views.

While adjustments such as clawbacks (as well as upwards revisions) may enhance accountability, the specifics need to be carefully considered because it needs to be meaningful, objectively measurable, controllable, and material. Therefore, the FCA should not be prescriptive and should let each firm determine what is most appropriate for them at this time.

Q9: Should we consider additional regulatory expectations or guidance in any of the areas considered in Q8? Please explain your views.

Additional regulatory guidance on linking pay to sustainability-related objectives, especially transition plans, would be welcomed to assist firms with implementation. However, specific regulatory requirements may be premature at this time given the complexities. For any regulatory requirements, a period of 12-24 months for firms to design, analyse, study, and apply the necessary measures would be welcomed.

We recognise there are various best practices in the field of remuneration and incentive plans. Any FCA guidance can further drive positive change and align management interest to sustainability. That said, we caution against creating new rules that are "too prescriptive too soon" and recommend further analysis on this important topic.

Generally, we would welcome a principle-based approach to drive positive sustainability-related change at this time, with discretion for firms to determine what would be the best way to comply. Over time, the FCA can review firms' practices and publish reports on common and best practices to provide firms with useful insights into how to achieve positive sustainable change.

Q10: Should we consider additional 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? Are there regulatory barriers that we should consider? Please explain your views.

The 2020 enhancement of the Stewardship Code has been met with a strong response, with the FRC highlighting there are now 235 signatories managing £41bn assets[6]. We believe it would be unwelcome and counter-productive for the FCA to launch a new wave of stewardship measures;

[6] FRC's Review of Stewardship Reporting 2022 (Nov 2022): https://www.frc.org.uk/getattachment/01673560-f17c-407b-995c-bc37bcfb051d/Review-of-Stewardship-Reporting-2022_November-2022.pdf

rather encouragement should be given to improving the quality, breadth and effectiveness of the FRC's existing Stewardship Code:

- With the FRC's Stewardship Code having achieved such a well-established list of signatories, we think the FCA should require all large asset managers, asset owners and service providers[7] to apply to become signatories. Consideration should be given to also making it mandatory for all medium sized UK asset managers (more than £50 billion AUM) and asset managers (more than £5 billion) perhaps 2-3 years later. We think the Stewardship Code needs to be adopted holistically and would not recommend the FCA went down the road of mandating certain Principles and not others;
- We understand that not every signatory under the Stewardship Code has found it a rewarding use of firm resources overall and encourage the FRC to engage in a thorough ongoing dialogue with signatories;
- At the time it was consulted upon in March 2019, CFA UK underlined to the FRC the importance of stewardship reporting being outcome and evidence-based[8] and we are pleased to note that the FRC continues to encourage improvement from signatories' reporting in this respect;
- We applaud the FRC's focus and efforts to promote stewardship in other asset classes besides listed equities;
- We note that the style and mission of stewardship varies from firm to firm depending on their investment philosophy. We note some managers might focus more on E, S or G, for example, rather than all three and that this is reflected in their stewardship reporting. There are countless examples of companies which might focus, say, on Social rather than Environment or Governance factors;
- There are advocates of the FCA mandating that firms vote a certain percentage of the proxy votes they have. We do not support this; very often stewardship is best when firms focus on one particular issue rather than spreading their resources across all. We perceive that there has been an improvement in the overall resourcing of stewardship since the 2019 discussion paper[9]. However, we feel some firms still do much more than others and wish we could think of a way the FCA could ensure that every investor contributed proportionately to the challenge.
- In respect of passive managers, we support the recent emerging trend of them enabling their underlying investors to proxy vote their share of the total holding themselves.

***Q11:* What additional measures would encourage firms to identify and respond to market-wide and systemic risks to promote a well-functioning financial system? How can the collective stewardship efforts of asset owners and asset managers best be directed towards the most pressing systemic issues? And how can remaining barriers best be reduced? Please explain your views.**

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[7] In their 2022 review of Stewardship Large Asset Managers are defined by the FRC as either (i) UK-based asset management firms with more than £250 billion AUM or (ii) Global firms managing more than £100 million from its UK subsidiary. In the same review, large asset owners are defined by the FRC as asset owners with more than £15 billion AUM.

[8] CFA UK response to the FRC (March 2019): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-uk-response-to-the-frcs-consultation-on-the-stewardship-code.pdf

[9] Please see point 2 of the covering letter in our response to the FRC and FCA's joint discussion paper (DP19/01) on the future of Stewardship (March 2019): https://www.cfauk.org/-/media/files/pdf/professionalism/cfa-letter-to-fca-on-dp19_01-final.pdf

Overall, CFA UK regards collaborative engagement as an area which has to develop organically and which does not require regulatory change.

However, EU Competition Law and the European Market Abuse Directive are being cited as barriers to investment firms participating in collaborative engagement. We believe these assertions are confusing, perhaps deliberately so, and inaccurate:

- There should be no risk of cartel behaviour in collaborative engagement situations if proper governance processes, such as those employed at Investor Forum, are followed.
- Equally, as regards insider dealing concerns, ESG collaborative engagements typically play out over the very long-term and so do not involve material price sensitive information.

We think it would be helpful if the FCA, the Takeover Panel and the Competition Authority intervened in these discussions and provided their guidance and views on the subject. Safeguarding market integrity is the FCA's and other global regulators' top priority. However, we believe the concerns that collaborative engagement runs a probable risk of firms breaching insider dealing or anti-competitive regulations are overplayed and need to be publicly addressed.

Firms and organisers of collaborative engagement can be encouraged to play their part in promoting successful stewardship by publishing case studies and explaining the processes they followed to ensure compliance with competition law and market abuse regulations. Such case studies can also become catalysts to help stewardship teams at other firms in deciding which issues to focus their stewardship and resources on. We note there are already some very good illustrative case studies in many code signatories' stewardship reporting.

Noting the PRI's assessment that "investment consultants advise on how trillions of dollars are invested worldwide, but most consultants are failing to consider the role that environmental, social and governance (ESG) issues play in investment performance", we ask the FCA to consider how they could require investment consultants to also record evidence of how they factor the quality of an asset manager's stewardship into their recommendations to asset owners, especially when the asset owner is a signatory of the stewardship code.

If the Stewardship Code were made mandatory for large asset owners and asset managers as proposed in our response to question 10 above, we believe that more attention might be given to Principle 4 and the requirement in the stewardship code for signatories to identify and respond to systemic risks.

ESG Training & Competence

***Q12:* a) What do you consider to be the main sustainability-related knowledge gaps across the financial sector and how can these best be addressed?**

Sustainability has many strands which is one of, if not the most, significant challenges to its integration into the investment process. Re-orienting investment from a two-dimensional Markowitz risk-return activity into a three-dimensional risk-return-sustainability one requires the acquisition by investment professionals of a wide range of new skills and knowledge.

As such, we believe that the FCA should be less concerned about addressing 'gaps' and more focussed on encouraging investment firms to ensure that all staff have a base level of understanding about sustainable investing and provide clearer guidance on the expectations for competency across an organisation and particularly with reference to the provision of advice to clients.

The regulator should not prescribe routes to competence, but should encourage the development of common competencies and should hold firms and senior managers accountable for their attainment.

Nevertheless, the main gaps which we would wish to highlight are:

- The relative under-development of knowledge of certain ESG factors, for example, Social and Bio-diversity factors relative to others such as, Climate and Government factors;
- The gaps between the expert and in-depth knowledge possessed by academics and scientists in the various different ESG fields (governance, climate, biodiversity, etc.) and the generalist knowledge currently held by the average investment professional;
- The gaps in application between different asset classes and in the knowledge bases of investment professionals active in those different asset classes;
- The gaps in knowledge of new sustainability regulations and standards as they come into force and evolve at a different pace across the globe across different activities in the investment chain;
- The relatively low level of sustainability knowledge amongst operational middle- and back-office staff;
- The current lack of in-depth sustainability knowledge or expertise at fund board level which can start to be addressed through training and diverse recruitment;
- The gaps in knowledge particularly in parts of the retail distribution-side of the investment chain which is then amplified by most retail clients' lack of sustainability knowledge, leading to encounters of 'the blind-leading-the-blind'.

In our opinion, there is no single silver bullet to address these gaps. The solution rests with a basket of measures and the responsibility for the provision of these lies with a number of different organisations:

- Investment firms stand in the front-line. They need to be accountable for the investment activities of their staff and to ensure that the collective and individual knowledge of their staff meets the new requirements of sustainable investment;

- Professional and training organisations, such as CFA UK have an important role in developing curriculum and other materials which effectively repackage the science-based knowledge of experts and academics into readily usable generalist knowledge for investment professionals;
- Trade associations have a role to promote examples of good practice in sustainable investment amongst their members;
- Governments too can continue to articulate the importance of sustainable investment goals to investors to encourage end-investor demand for sustainable investment products;
- The FCA and other regulators can assist the market-driven process in a number of ways. Firstly, by updating SM&CR certification requirements to include sustainability criteria, as mentioned earlier; secondly, by making sustainability training mandatory, requiring that it is effective (yet not specifying what it is); thirdly by providing guidance and promoting examples of good practice of investment sustainability; and fourthly by providing a baseline of definition and prescription, which is likely to increase over the long-term as sustainable investment processes become more embedded. Together these and other actions should present firms with a clear idea of what the required competence looks like.

b) What do you consider to be the potential harms to market integrity, consumer protection or competition arising from these knowledge gaps?

Market integrity, which the FCA has a primary objective to defend, will be deeply harmed if investment firms make sustainability-related claims which are untrue or misleading. Investors with sustainability-linked goals looking to preserve people and planet will become disillusioned if they invest in products which claim to be sustainable but ultimately are not. Healthy competition amongst investment firms, which the FCA is also mandated to protect, will be undermined and investment markets will not function effectively. Comparisons between products will be inaccurate and money will flow to areas where its rightful owner did not want it to go. Consumers will likely not meet their sustainability nor their financial objectives.

Q13: a) Do you think there is a need for additional training and competence expectations within our existing rules or guidance?

Yes. However, the FCA should firstly explain and clarify how much of the existing regulations (such as the competence requirements) as well as incoming regulations (like the new Consumer Duty) already apply to matters of ESG and sustainability.

b) If so, in which specific areas do you consider further rules and/or guidance are required? Please explain your views.

There are nonetheless areas where the FCA could also update existing rules and guidance to reflect the investment profession's needs today specifically in relation to sustainability training and competence.

For the most part this should take the form of principles-based guidance and shared good-practice examples, leaving it up to individual firms to assess what effective training and baseline and target competence represent for their business. The case studies and articles at the end of this Discussion Paper are an excellent example of this.

- We think the FCA could usefully seek to define certain sustainability terms in a common lexicon or taxonomy to sharpen the wider understanding of sustainability in the finance sector. Ideally this will be closely aligned with definitions used in other leading markets. Similarly, the FCA could help firms and trade bodies in the generation of a set of fit-for-purpose standardised sustainability disclosure templates for retail products.
- As mentioned already in our responses to questions 2 and 6 above, certification requirements of senior managers should be updated to reference sustainability.
- We believe the FCA should strongly encourage investment firms to further their own staff's sustainability knowledge by taking relevant education courses and exams. This includes CFA UK's own Climate Investing[10], Impact Investing[11] and CFA Institute's ESG Certificate[12] as well as other qualifications from members of the Sustainable Finance Education Charter group. However, we do not advocate in favour of the FCA mandating specific sustainability CPD or specific education courses. We believe education materials are best aimed at raising the bar on the minimum knowledge and understanding of all investment staff as opposed to targeting the attainment of expert knowledge by a select few. The above exams are 'level 4 qualifications or A' level equivalent; we believe there is also a gap for an entry level 2/3 sustainability course targeting junior back- and middle-office staff and for appropriate sustainability training at board executive level.

In the medium and longer term we believe sustainability regulation will need to become more prescribed as expectations and practices coalesce to a common understanding of what best practice looks like. At present, sustainable investment is still developing so quickly that too much prescription could be (i) counter-productive to innovation and also (ii) soon after implementation, likely then require further updating within an unwelcome short timescale.

We would strongly urge close collaboration, particularly with the EU, in terms of the development of any prescriptive sustainability rules. It would be very unproductive for firms active in both the UK and EU markets to have to comply with two widely different sets of sustainability rules.

The FCA have stated that they expect SDR to come into force within the next 12-15 months; this will clearly represent a major new body of sustainability regulation and guidance and we conceive that it will require further updating as sustainable investment practices advance.

***Q14:* Which aspects of the training and capability-building initiatives discussed above, or any others, would be particularly useful to consider (for example in identifying which skills and/or training is needed) and how best should we engage with them?**

In addition to the many initiatives enumerated in the Discussion Paper, we recommend the FCA's ESG department seeks to liaise with Heads of Stewardship and CIOs at leading UK

[10] CFA UK's Certificate in Climate Investing was launched in 2023: https://www.cfauk.org/study/certificate-in-climate-and-investing#gsc.tab=0

[11] CFA UK's certificate in Impact Investing is in development and expected to be launched within the next 12 months

[12] Originally launched by CFA UK, this course is now run by CFA Institute. See Certificate in ESG Investing: https://www.cfainstitute.org/en/programs/esg-investing

investment firms to gain granular feedback as to the skills gaps that they perceive within their own workforces.

Due diligence is a critical activity in promoting sustainability within the investment chain and we note that there is a plethora of due diligence checklists available to firms. Amongst these, the EU's[13] and the OECD's[14] are perhaps the most prominent from government and supranational organisations. Perhaps the FCA could consider promoting its own or another.

***Q15:* a) Have you seen misrepresentation of ESG credentials among ESG professionals and, if so, what are the potential harms?**

The lack of clear industry-wide recognised definitions of sustainability-related terms lays open the inadvertent risk of inaccurate claims, especially in a global industry where many participants who in communicating in English are also doing so for the most part outside of their mother-tongue.

We would like to highlight our dislike of the above use of the term "ESG professionals" in the above question. The whole point about ESG and sustainability is that it should be integrated into the investment process and that all employees now need, admittedly to varying degrees, to acquire ESG and sustainability knowledge as part of their professional development and to play their part in the transition to net zero.

We look forward to the FCA publishing of its Position Statement on SDR in Q3 and the introduction of clear sanctions for inaccurate claims. We trust that the FCA will provide clear guidance so that funds with genuine sustainability claims continue to market these in a measured way based on the evidence they possess at the time and do not opt for over-conservativism, watering them down for fear of being subsequently proven inaccurate.

We articulated our view of the potential harms arising from misrepresentation of ESG claims and credentials in our response to question 12b above.

Have you seen any consistent training metrics that can help compare firms' knowledge/ capabilities? Please describe.

As regards the status of sustainability training at different firms, we perceive that many of the large UK-based and global investment firms are continually developing their own in-house ESG and stewardship expertise and that this function often assists an in-house education team to develop sustainability training within the wider firm. Small and medium-sized firms on the other hand lack the resources and the central infrastructure of an education department and are more likely to look externally to upskill their staff, not just on sustainability issues, but also generally.

[13] Corporate Sustainability Due Diligence (Feb 2022): https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en

[14] The OECD Manufacturing Sustainability Toolkit (May 2011): https://www.oecd.org/innovation/green/toolkit/48661768.pdf