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# FCA Publishes Discussion Paper on Sustainability-Related Governance

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On February 10, the UK's Financial Conduct Authority (FCA) **published** a discussion paper titled "Finance for positive sustainable change: governance, incentives and competence in regulated firms." The paper considers whether regulated firms – which include banks, insurers and asset managers – should be expected to incorporate sustainability into their strategy along with the existing regulatory expectations of senior management as they carry out their firm's climate transition plans. In referring to "sustainability," the FCA makes clear it takes a broad view of that concept that goes beyond climate, stating that "attention is turning also to other – often inter-related – sustainability topics, such as human rights, diversity and inclusion, nature and biodiversity. There is increased scrutiny from investors and a demand for wider sustainability-related measures to be considered." In this vein, the FCA also referred to ISSB comments that "'sustainability is a condition for a company to access over time the resources and relationships needed (such as financial, human, and natural), ensuring their proper preservation, development and regeneration, to achieve its goals.'"

The FCA is seeking views on a broad range of topics, many of which are focused on the intersection of governance and ESG issues. For instance, one topic on which views are being sought is connecting pay to sustainability goals, including adjusting remuneration when sustainability-linked targets are not achieved. The FCA states that "[t]he credibility of ESG targets rests upon their stretch and rigour," and that "high bonus payouts against ESG goals cannot continue alongside limited progress on real-world ESG outcomes." The FCA also "wants to understand how far firms are setting sustainability-related objectives and building these into their business models and strategies." Additionally, the FCA will seek views on how companies are approaching conflicts of interests, stating that "policies are often generic and do not specifically consider issues as they relate to stewardship."

The FCA states that it is "committed to supporting the role of the financial sector in enabling an economy-wide transition to net zero, and to a sustainable future more broadly." Furthermore,

the FCA claims to be "encouraging an industry-wide dialogue on firms' sustainability-related governance, incentives, and competence." The discussion paper includes "commissioned articles from experts with relevant and interesting perspectives on firms' sustainability-related governance, incentives, competence and stewardship arrangements."

Interested parties have until May 10 to submit responses to the discussion paper by answering the questions set out in Annex 1.

The FCA is also taking steps to counter the risk of greenwashing by informing asset managers, in a **"Dear Chief Executive" letter**, of its intention to test ESG and sustainable investing claims made in communications with investors. The letter makes clear that the FCA will seek to ensure that asset managers' governance structures are appropriate to "oversee and review management information about product development, ESG and sustainability integration in investment processes, third-party and proprietary ESG information providers, and other ESG and sustainability claims made by the firm."

This announcement follows various other ESG-related steps taken by the FCA, including the **establishment** of an ESG Advisory Committee to assist the board of the FCA with executing its ESG-related responsibilities. Additionally, the FCA has **convened** an independent group to develop a voluntary code of conduct covering ESG data and ratings providers. The **FCA's consultation** on the regulation of sustainability claims by investment firms, first announced in October 2022, concluded on January 25.

**Taking the Temperature: The FCA's obvious emphasis on governance issues in its discussion paper underscores that it is not possible to separate climate or other ESG issues from the board and management's discharge of their obligations. For example, the FCA states that "of particular relevance," "the governance pillar of the Task Force on Climate-Related Financial Disclosure's (TCFD) recommendations emphasises the importance of board and management focus on climate-related issues. The TCFD notes that, in gauging the effectiveness of an organization's climate response, investors and other stakeholders need to understand "the role an organization's board plays in overseeing climate-related issues as well as management's role in assessing and managing those issues. Such information supports evaluations of whether climate-related issues receive appropriate board and management attention." The other pillars of the TCFD's recommendations go on to consider:**

- **how climate-related issues may affect an organization's "businesses, strategy, and financial planning over the short, medium, and long term" (Strategy)**
- **how "climate-related risks are identified, assessed, and managed and whether those processes are integrated into existing risk management processes" (Risk Management)**
- **the metrics used to measure and manage climate-related risks and opportunities by an organization and key climate-related targets (Metrics and Targets)**

**The discussion paper also cites the International Sustainability Standards Board's governance-related disclosure requirements, which cover virtually all aspects of director and officer conduct in assessing and managing climate-related risks, opportunities and other material issues. Likewise, the SEC's proposed climate rule focuses extensively on**

**climate-related governance and related disclosure. The bottom line is that financial regulators, globally recognized standard-setting organizations and others all have commented on the need to proactively address climate issues from governance and disclosure standpoints. While the various regulations and frameworks are not uniform, they are consistent in recognizing this underlying principle.**