IIGCC response to HMT consultation on the Future Regulatory Framework Review

The Institutional Investors Group on Climate Change (IIGCC) is the European membership body for investor collaboration on climate change and the voice of investors taking action for a prosperous, low-carbon future. IIGCC has more than 275 members, mainly pension funds and asset managers, across 16 countries, with over €33 trillion in assets under management.

Our mission is to mobilise capital for the low-carbon transition and to ensure resilience to the impacts of a changing climate by collaborating with business, policy makers and fellow investors. IIGCC works to support and help define the public policies, investment practices and corporate behaviours that address the long-term risks and opportunities associated with climate change.

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__IIGCC's responses to key questions for consultation respondents__

Question 2: What is your view of the proposed post-EU framework blueprint for adapting the FSMA model? In particular:

What are your views on the proposed division of responsibilities between Parliament, HM Treasury and the financial services regulators?

What is your view of the proposal for high-level policy framework legislation for government and Parliament to set the overall policy approach in key areas of regulation?

Do you have views on how the regulators should be obliged to explain how they have had regard to activity-specific regulatory principles when making policy or rule proposals?

We acknowledge the benefits of establishing policy framework legislation for specific areas of regulated activity, which sets out the high-level policy objectives which regulators must consider during the process of designing and implementing financial services regulation. We believe that the proposed framework sets out a clear process for achieving this, and welcome the government's commitment to ensuring that regulators are empowered to respond to changing market conditions, emerging risks and new opportunities.

We welcome the inclusion of 'Green Finance and a low carbon future' as the first example of an area for policy leadership within the Ministerial Foreword to the consultation. However, more detail is needed within the framework proposal to explain what such policy leadership will look like in practice, and how this would deliver HMT's vision for green finance. The framework proposal as currently drafted could be interpreted as indicating green finance, in a regulatory context, to be a lower priority public policy issue. The Chancellor has already made clear the government's intention to support the channelling of capital into sustainable finance and its commitment to extending the UK's position as a global leader on green finance.[1] Establishing the appropriate regulatory framework to embed these critical policy objectives within financial services regulation will be critical if these commitments are to translate into tangible actions.

[1] https://www.gov.uk/government/speeches/chancellor-statement-to-the-house-financial-services

IIGCC notes the conclusions of the Advisory Group on Finance (AGF), set out by the Climate Change Committee (CCC) in their report on the role of finance in delivering the 6th carbon budget[2], which states that making finance consistent with the delivery of a net zero and resilient economy is the crucial third goal of the Paris Agreement. As the UK seeks to deliver its target of reaching net zero emissions by 2050 and updated 2030 climate target, a more systematic approach to embedding these objectives within financial services regulation is needed. As highlighted by the AGF, further steps are required to make the overall regulatory regime fit for the net zero age. HMT's Future Regulatory Framework (FRF) review presents a key opportunity to place the UK's climate change ambition at the heart of its reforms.

The framework proposal delegates a substantial level of policy responsibility to the UK financial services regulators. It is therefore critical that regulators are required to demonstrate how they have considered public policy issues (identified by government and Parliament) in their activities. Such issues should include climate change, given the central role financial services regulation has to play within other UK policy initiatives, notably the government's Green Finance Strategy and Ten Point Plan for a Green Industrial Revolution.

While the framework proposal does not intend to amend the UK's macroprudential regulatory framework, we would nonetheless highlight the important role of the Bank of England's Financial Policy Committee (FPC) in making recommendations and issuing directions to the regulators on important policy areas, like climate change, which pose risks to financial stability. As acknowledged by the government, the role of the FPC is a crucial complement to, but distinct from, those of the main financial services regulators, and we would recommend that the government ensures that the FPC continues to pay due regard to the relevance of the systemic risks posed by climate change to its primary objective. In addition, the FPC should continue to deliver on its secondary objective in seeking to support the government's Green Finance Strategy.

We also note the government's intention to issue remit letters to the regulators on a more frequent basis, which would provide additional clarity on how they must pay regard to particularly topical issues or challenges that would be difficult to reflect in legislation. While it will be essential to ensure that climate-related risks and the delivery of net zero emissions are reflected formally in the cross-cutting regulatory principles, we see merit in the use of remit letters as a secondary vehicle for ensuring the regulators consider wider policy issues when advancing their objectives and discharging their functions. Going forward, we recommend that provisions for managing climate-related risks and supporting the transition to net zero are reflected in HMT's remit letters to each regulatory authority.

Robust and enhanced scrutiny and public engagement arrangements will be central to ensuring regulators are accountable for their actions, and stakeholders are fully engaged and consulted throughout the policy-making process. Clear governance and communication mechanisms, to monitor progress and evolution of regulatory requirements, are also central to this.

[2] The road to Net zero Finance (Sixth Carbon Budget Advisory Group) - Climate Change Committee report, available to download here.

Question 3: Do you have views on whether and how the existing general regulatory principles in FSMA should be updated?

The Advisory Group on Finance (AGF) formed by the Climate Change Committee (CCC) notes in their report on the role of finance in delivering the 6th carbon budget [3] that legacy rules within the existing regulatory framework for financial services in the UK may not be fit for purpose. The framework should provide mechanisms to consider how these legacy rules in regulation could hinder the UK's progress towards and achievement of net zero emissions by 2050, with remedial actions and/or mechanisms identified. In turn, this would ensure that regulators are more able to respond to changing market conditions and new regulatory challenges.

As highlighted by the AGF, most of the UK's core financial regulations have not been designed with climate change in mind. The future regulatory framework should support investors who are working to align their portfolios to net zero emissions and maximise the contribution they make in tackling climate change.[4]

The framework proposal provides for policy considerations that are relevant to many areas of regulation to be reflected in cross-cutting regulatory principles, which are designed to inform the regulators' activities across the full range of their responsibilities. The consultation states that some of the cross-cutting regulatory principles are now 20 years old and the regulatory landscape has changed considerably over time.

Green finance principles, the UK's updated 2030 climate target and net zero emissions by 2050 target should be considered as cross-cutting regulatory principles that inform the regulators' activities across the full range of their responsibilities. These should be enshrined in the future regulatory framework for financial services, to ensure alignment with the UK's economy-wide greenhouse gas emissions reduction targets and with the goals of the Paris Agreement. Moreover, such an approach could complement the potential shift away from a regulatory framework focused on prescriptive rules that may quickly become outdated to one that is based on outcomes. By setting a cross-cutting, clearly articulated outcome for regulators to deliver on the UK's net zero ambition, compliance burdens on firms can be reduced (for example through greater flexibility for the regulators to produce guidance rather than additional rules) and regulators will be better equipped to respond to a dynamic landscape.

The future UK regulatory framework for financial services would have greater impact when accompanied by clarity on the net zero transition pathways per sector, alongside enhanced cross-economy and sector-specific measures. In general, with respect to investors, the overall preference is for guidance and clarifying existing requirements over further regulation. Any additional regulation of investors should be based on an evaluation of the impacts, a clear understanding of the intended outcomes, and ensuring that these requirements are proportional to their anticipated environmental benefits.

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[3] The road to Net zero Finance (Sixth Carbon Budget Advisory Group) - Climate Change Committee report, available to download here.

[4] The road to Net zero Finance (Sixth Carbon Budget Advisory Group) - Climate Change Committee report, available to download here.

Question 4: Do you have views on whether the existing statutory objectives for the regulators should be changed or added to? What do you see as the benefits and risks of changing the existing objectives? How would changing the objectives compare with the proposal for new activity-specific regulatory principles?

Climate change is a relevant consideration for the delivery of the regulators' existing statutory objectives (e.g. the PRA's objective to promote the safety and soundness of the economy and the FCA's commitment to support transparency and the integrity of the markets), and regulatory expectations in this area continue to grow.

In light of the significant challenge that climate change presents, IIGCC would welcome an overarching requirement for regulators to ensure alignment with net zero emissions by 2050 and the goals of the Paris Agreement, including *Article 2.1.c Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development*[5], enshrined formally in the framework.

IIGCC recognises the efforts of the regulators to date in this area. For example, the PRA's Supervisory Statement 3/19 acknowledges the importance of supervising the financial risks stemming from climate change, and the FCA has pressed ahead with its plans to mandate TCFD-aligned disclosures across a wide range of listed and regulated firms.

However, establishing a net zero commitment as an overarching requirement for regulators to consider at a high-level, tailoring as required to the specifics of the financial services being regulated, will ensure that the goals of the Paris Agreement and net zero alignment are consistently integrated into regulators' decision-making processes. A clear set of parameters that sets out how this requirement would function within the framework should be defined (e.g., objectives, enforcement powers, tools) so that regulatory alignment to these goals can be evaluated over time.

The inclusion of climate change into the regulatory process in such a way offers the UK the opportunity to cement and establish its leadership position on finance internationally. It would also help to achieve the recommendations made by the Advisory Group on Finance (AGF), formed by the Climate Change Committee (CCC), on the role of finance in delivering the 6th carbon budget[6], including the recommendation that the UK should commit to becoming the world's first net zero financial system and fully integrate climate risk and net zero into financial regulation and monetary policy.

Question 7: How do you think the role of Parliament in scrutinising financial services policy and regulation might be adapted?

Alongside an overarching Paris Agreement and net zero alignment requirement for regulators, parliamentary committees should be given a specific remit to call on regulators to explain how this requirement has been considered in the development of regulation. Parliament should have the appropriate level of resource and expertise to properly undertake this function and hold regulators to account. For example, a specific financial services parliamentary committee could be beneficial to support the work of the Treasury Select Committee (TSC) and help the TSC access the right level of

[5] Paris Agreement 2015, available here.

[6] The road to Net zero Finance (Sixth Carbon Budget Advisory Group) - Climate Change Committee report, available to download here.

expertise. Any policy recommendations that arise from parliamentary committee inquiries should inform government policy and the design of regulation.

Question 9: Do you think there are ways of further improving the regulators' policy-making processes, and in particular, ensuring that stakeholders are sufficiently involved in those processes?

A rigorous approach must be taken by financial regulators when considering the goals of the Paris Agreement and the UK's net zero ambition in the design and implementation of the future regulatory framework. A parliamentary committee with a specific remit that is focussed on this topic could initially play a role in questioning regulators and calling on them to provide evidence as to how they are meeting this requirement.

IIGCC encourages regular dialogue between governments and investors. For example, a formal stakeholder engagement mechanism to ensure ongoing input from a broad range of stakeholders with relevant experts. In addition, the government should continue to make use of existing mechanisms to facilitate coordination between regulators and industry stakeholders, ensuring their remits are amended to pay due regard to support the transition to net zero. For example, the Climate Financial Risk Forum (CFRF), established jointly by the PRA and FCA, engages collaboratively with industry experts. The government could consider updating the CFRF's terms of reference to focus more specifically on supporting the transition to net zero alongside its objective of advancing the financial services sector's approach to managing the financial risks stemming from climate change.

These forums and engagement mechanisms can further reinforce the effectiveness of the effectiveness of the regulatory framework and support the UK's leadership on green finance, and delivery of net zero emissions by 2050. These forums can be used to share best practice, develop policy guidance (which reflects this best practice), and flag any overlapping or duplicative burdens on firms between different regulators.

IIGCC would welcome the opportunity to discuss our response in more detail with HMT. Please contact, Emelia Holdaway, IIGCC Policy Programme Director at eholdaway@iigcc.org.