



**ESG ACCORD**

*Your compliance, ESG and Sustainability, in accord*

# ESG and Sustainable Finance— Proposed new Regulations

## A Guide for Financial Advice firms and Compliance Consultants



## Introduction

This guide is for those with Senior Management functions within advice firms, Compliance Officers, Compliance Consultants and financial services training firms.

It has been written with a focus on financial advice firms and their compliance procedures. It is a practical introduction to the potential compliance requirements and new procedures that will be needed to accommodate advice on ESG and Sustainable Finance.

Why should you care? *Because you are going to need to make some significant decisions about how you deliver advice in the future.* The Government and Regulators are increasingly focused on Sustainability and this extends to the financial services industry.

In April 2021 Rishi Sunak wrote to the FCA & PRC; *the UK is aiming to ensure every financial decision takes climate change into account.*

The EU is already moving ahead with their Sustainable Finance rules and it is expected that the UK will mirror many of the EU's proposals. This makes it easier for the large cross-border finance services firms and meets Government plans for a sustainable economy.

The FCA has released its Sustainability Finance Strategy and it aims;

*"...to make sure that our regulatory approach creates an environment in which market participants can manage the risks from moving to a more sustainable economy and capture opportunities to benefit consumers."*

The FCA strategy is based on 3 themes; **Trust, Transparency & Tools.**

## Outline of the issues facing financial advice firms



On 3 February 2021 the UK Government announced it had signed up to the International Platform on Sustainable Finance.

This is a significant step towards Sustainable Finance becoming part of UK financial advice; change for advisers, change for Compliance Consultants and change for clients. These new rules are anticipated to arrive by early 2022.

For the purposes of this guide, we are using the EU example to outline what might be coming for UK advisers. We believe that this is a sound starting point. It provides an opportunity for advice firms to consider how they will adapt to the new rules; compliance procedures and advice processes will need to change and training will be needed for advisers and admin staff.

Even if the UK rules are less onerous than the EU regulations, it will still involve the majority of firms having to make changes to how they operate. Some have likened the proposed changes to being of an equal magnitude to the RDR.

Some firms may decide not to give advice in this area at all; that is a commercial decision. However, in November 2020 Mark Carney made the following statement: *"By COP (26), a year from now, the absence of a transition plan will likely be seen as either an intention to wind down a business over the coming decades, or an assertion that the company is separate or views itself as separate from society. The former, winding down, may be logical. But the latter, being apart from society is unforgivable."*



## [ What advice will you give? ]

- I. ESG only
- II. ESG with a core 'no go' areas underpin
- III. Responsible investment
- IV. SDGs and Impact Investment
- V. Full Ethical Investment
- VI. None of the above

## Letting clients know what advice you can offer

Advice firms may need a statement on their web site declaring whether the firm advises on Sustainable Finance, incl ESG, Responsible Investment, Ethical Investment, Impact Investment etc.

This would meet the Government's obligations to demonstrate that Sustainable Finance is part of UK financial services—it puts the issue out there for the public to see.

## Asking 'the' question

It is unlikely that advisers will be allowed to limit their discussions with clients to something as simple as "do you want ESG as part of your financial plan?" This question doesn't even scratch the surface of what is currently available under a broad Sustainable Finance heading.

From a Compliance point of view, you'll want to make sure that you ask the right question, in the right way, to achieve best client outcomes. Don't make assumptions about what you think the client wants — that's only likely to lead to a problem further down the line.



*The new  
Sustainable  
Finance rules  
could be as  
impactful on  
advice firms  
as RDR*





## It's all in the process

- I. Ask clients whether they would like to incorporate Sustainable Finance into their financial planning
- II. Record the client's response on file
- III. Undertake suitable research (if applicable)
- IV. Include the response in your Reason Why Letter
- V. Repeat at next Annual Review (treat the same as Attitude to Risk updates)

## Getting the right information on file

Recording how the client would like to incorporate ESG/Sustainable/Ethical issues into their financial arrangements is the heart of the compliance process. The right information on file here will provide the right outcomes for the client and a better written reason why letter.

The best way of recording a client's values is via a questionnaire, but what questions do you ask? Well, you'll need to cover all of the different nuances of Responsible Investment, using the questions to ascertain which type of funds would be most suitable for each client.



## The Reason Why Letter—delivering the advice

Once you have selected the products and funds best suited for each client's needs (using your normal processes) it is time for the reason why letter (RWL).

It is important for good compliance that detailed reference is made in the RWL to the client's values and the priorities they placed on how they want to see responsible incorporated into their financial plan.

For clients that have chosen not to incorporate ESG or Sustainability in their financial planning, you will still need to reflect this in the RWL.



## Making your choice—meeting your PROD

Deciding what areas your firm will advise on is one of the critical aspects of the new rules.

The table below gives a simple overview of the outcomes needed depending how a client and the firm respond to a question on ESG and Sustainable Finance.

The danger for many firms is that they will simply start giving advice on Sustainable Finance without a detailed understanding of the compliance risks and pitfalls that might lay ahead.

Even those firms that have given advice on ‘green’ or ethical investment in the past are going to have to change the way they operate.

Ensuring that your research and advice process is fully aligned to the needs of clients and the funds and products are suitable, will involve more work.

### Where will your firm stand on the ESG Question?

Client	Adviser	Outcome
No	No	Record on FF & File, add to RWL
Yes	No	Record on FF and File—Refer client
Yes	Yes	Record on FF, complete full Values Questionnaire, update file, undertake research, include results in RWL

## Sticking to the basics

Despite everything we’ve said regarding the importance of assessing each client’s attitude to ESG and Sustainable Finance, it is unlikely that advisers will be required to move away from the basic principles of good advice.

This means ensuring that the products, funds and, critically, investment risk are all suitable. There may be occasions when a client’s ESG or Sustainable Finance preferences produce investment options that are far outside their Attitude to Risk parameters. In these instances, advisers will need to have a discussion with the client about the mismatch in their risk and values objectives, remembering that basic investment principles will come before non-financial issues.



*A little bit of Triage  
can go a very long  
way*

## Being comfortable with the advice you offer

As we've already indicated, giving advice on ESG and Sustainable Finance doesn't fit neatly into a 'one solution suits all' advice process.

Being comfortable with the processes and research needed to cover all aspects of advice on Sustainable Finance is essential for every firm. Operating in this space doesn't mean a firm has to give advice on every area; some firms may decide that advice on ESG options will be as far as they want to go. This limits the amount of research needed but a strict compliance process is still required. It may lead to poor compliance and client outcomes if advisers stray from the firm's chosen path.

Being able to 'triage' clients that say Yes to the ESG/Sustainable Finance question is a critical part of the fact-finding process. Identifying where a client fits on the spectrum from light ESG to full-on strict ethical screen will ensure a smooth advice process.

For example, there is little point asking a client only interested in light ESG to complete a detailed ethical questionnaire. A triage process would lead to a different questionnaire being used, one that is suitable to the client's needs and one that slots into the firm's research process.

### Examples of possible Triage categories\*

ESG	Level 1
ESG + screened underpin	Level 2
ESG, ESG+ and Sustainable investment	Level 3
ESG, ESG+, Sustainable investment and SDGs	Level 4
ESG, ESG+, Sustainable investment, SDGS, full ethical screening	Level 5

Deciding which areas you want to advise on will be one of the first decisions to be made ahead of the new rules. Building a compliance process around your decision is the next step

\* not comprehensive



*This is not a 'one fund suits all' advice area - different clients, with different values, will need different solutions*

## Support for financial advice firms

There is a great deal of really good support for advice firms at the product and fund end. Service providers can support fund selection processes and filters for different nuances of value-based investment. Fund Managers are increasing the amount of information on their investment processes and funds and how these relate to ESG and Sustainable Finance.

But there has been a gap in the development of a compliance process which both protects the firm, underpins the market participation for meeting PROD/ MiFID II requirements and ultimately to support good outcomes for clients. Until now.

ESG Accord was established because we believe many financial advice firms need to be supported in transitioning to giving advice on ESG and Sustainable Finance.

We provide the support to help advice firms draft a suitable web site statement and make amendments to their ToB. We provide templates for an ESG/Sustainable Finance section in the Compliance Manual and example questions for Due Diligence for product and fund providers. Our templates for ESG / SF Triage and full Values Questionnaires across the whole Sustainable Finance spectrum are independent and granular.



We don't plan to reinvent the wheel by offering advice on fund and product selection. What we will do is provide support and advice to firms to deal with the areas raised in this guide and where needed, we can also help with training requirements for ESG / SF.

Our support is not based on a purely theoretical understanding of day-to-day life as an adviser – it is based on front line experience. That is combined with an comprehensive experience of what constitutes good compliance, good record keeping and what makes a compliant file.



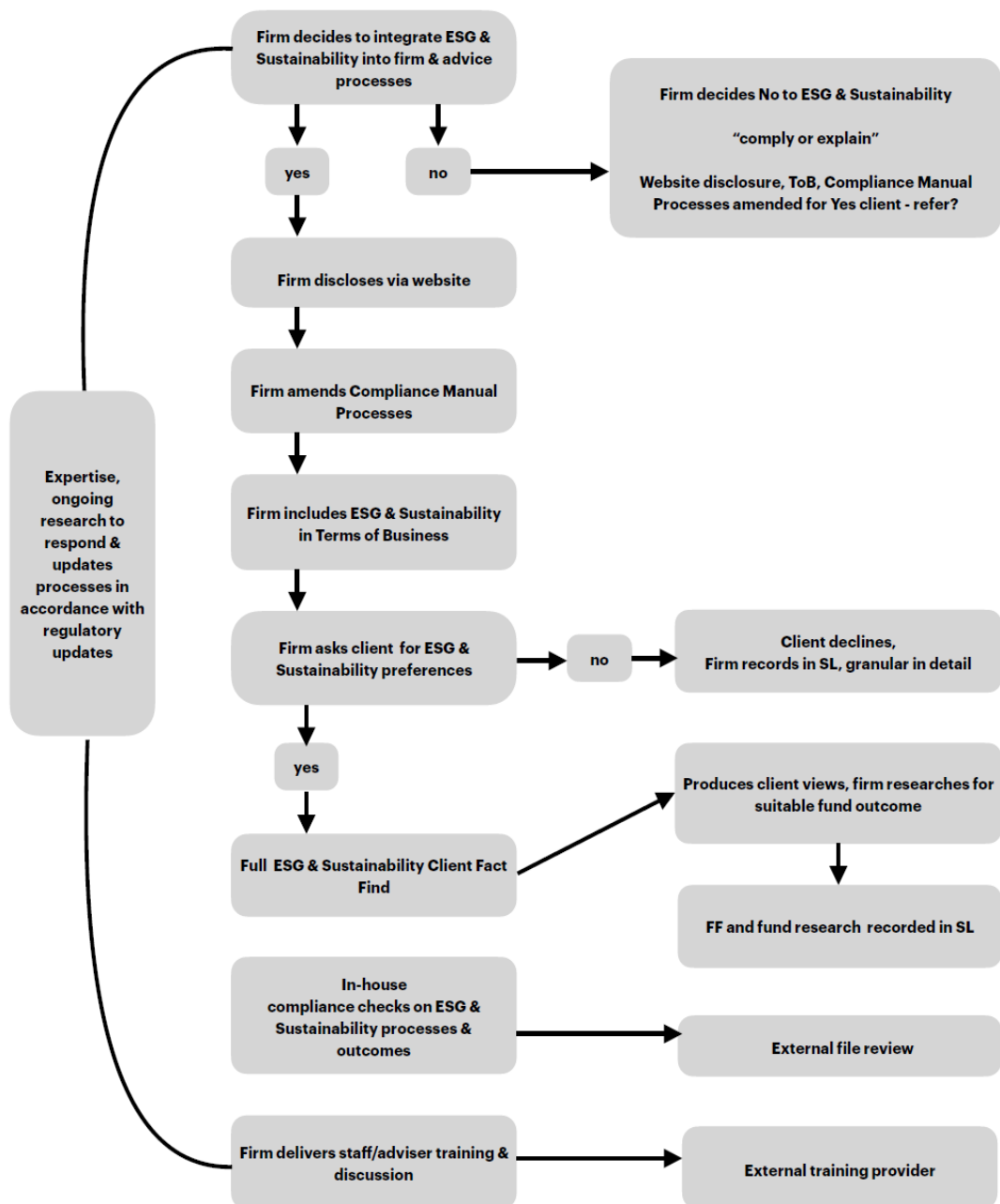
## Examples of how we can support your business:

- Web site statements on Sustainable Finance
- Customer facing Sustainable Finance statements and amendments to Terms of Business
- Example Sustainable Finance Compliance Manual section
- Example Fact Find questions + Triage assessments for clients interested in ESG and Sustainable Finance
- Full Values Questionnaires covering ESG, Sustainable Finance, Responsible Investment, Ethical Investment, SDGs and Impact Investment
- Suitability Letter example wordings covering all aspects of client *Yes* and *No* responses
- Due Diligence framework for product and fund providers
- File reviews for all Sustainable Finance advice





### 3. ESG Example Integration



## Some useful links and service providers



### ESG and Ethical Fund Research

Ethical Screening: ESG, Responsible and Ethical funds online database. Free to access for advisers.

<https://www.ethicalscreening.co.uk/>

### ESG information from Product Providers

Novia: Platform provider with dedicated section to ESG

<https://www.novia-financial.co.uk/investments/esg/>

Fidelity: Investment Manager and Platform provider with useful information on ESG

<https://www.fidelity.co.uk/funds/esg-investing/>

Aviva: Product Provider with useful information for advisers on ESG

<https://connect.avivab2b.co.uk/adviser/resources/product-support/investment-centre/esg-investing/>

Legal and General Investment Mngnt: useful information on ESG and Sustainable investment

<https://www.lgim.com/uk/ad/responsible-investing/>

### Due Diligence services

Due Diligence Solutions: [www.duediligencesolutions.net](http://www.duediligencesolutions.net)

### ESG and Sustainable Model Portfolios

LGT Vestra: long established Sustainable MPS

<https://www.lgtvestra.com/en/financial-advisers/sustainable-model-portfolio-service/index.html>

Copia Capital Management: range of ESG Model Portfolios

<https://copia-esg-portfolios.novia-ig.co.uk/>

Sarasin: Responsible Model Portfolios

[Responsible model portfolios | Sarasin & Partners \(sarasinandpartners.com\)](https://www.sarasinandpartners.com/responsible-model-portfolios)

Brooks Macdonald: a range of risk-rated Responsible Model Portfolios

<https://www.brooksmacdonald.com/investment-management/services/responsible-investment-service>

PSIGMA: SRI Model Portfolios incorporating ESG <http://bit.ly/psigma-sri-page>

### Trade body

UK Sustainable Investment & Finance Assoc

<https://uksif.org/>

### Regulatory issues

Letter from Rishi Sunak to the FCA

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/972445/CX Letter - FCA Remit 230321.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/972445/CX_Letter_-_FCA_Remit_230321.pdf)

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