

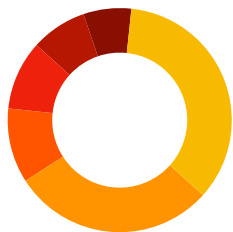
ESG ACCORD

Your compliance, ESG & Sustainability, in accord

ESG & Sustainable Finance:

A Compliance Guide for ALL firms striving to deliver best practice financial advice and outcomes that genuinely meet ALL client preferences

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INTRODUCTION

The investable universe of funds has dramatically changed in the last couple of years in response to the increasing availability of metrics for ESG and Sustainability.

The investment space is now awash with newly authorised ESG and Sustainable funds. In addition, many existing funds have been retro-fitted to include a host of newly available metrics.

This means it is now highly likely that ESG and Sustainability risks are, and will continue to be, financially relevant to a fund's investment process - even when they are not specifically marketed as ESG and Sustainable Funds.

For these reasons, this guide is for ALL firms striving to deliver best practice financial advice and outcomes that genuinely meet ALL client preferences.

We aim to give you insight on:

- **INCOMING SDR & EQUIVALENCE.** Key pointers on what you need to know about the SDR and the UK's stated EU equivalence for ESG and Sustainable Finance
- **PROD, COBS & CONSUMER DUTY.** Why your existing compliance procedures need to catch up with the changes in the investment space
- **ACTION.** What to do to update your compliance and prepare your firm for longevity in the face of additional regulatory actions or guidance

INCOMING SDR & EQUIVALENCE

The Government and Regulators are increasingly focused on Sustainability and this extends deeply into the financial services industry.

The FCA is now in the process of developing its own sustainability disclosure framework and whilst the UK did not transpose or apply the EU SFDR or Taxonomy Regulation after its withdrawal from the EU there is broad intention to be aligned with the EU.

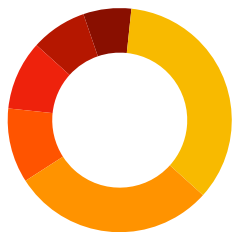
In April 2021 Rishi Sunak wrote to the FCA & PRC;

"The UK is aiming to ensure every financial decision takes climate change into account."

The FCA is already looking beyond its climate remit. The FCA response to the Committee's report, 'Net Zero and the Future of Finance' includes;

"We will also need to deepen our work on ESG issues, beyond climate change. For instance, we will need to consider more fully the role of finance in dealing with other environmental issues, such as biodiversity (as set out in the Dasgupta Review, February 2021), as well as social issues, such as racial equality, the living wage and diversity and inclusion."

In June 2021 the FCA wrote to AFM chairs for Authorised ESG & Sustainable Investment Funds: Improving quality and clarity. There are now guiding principles for asset managers for funds marketed with a sustainability and ESG focus to describe their investment strategies clearly and any assertions made about their goals are reasonable and substantiated.



INCOMING SDR & EQUIVALENCE continued...

The FCA Sustainability Finance Strategy is based on five themes;

- **Transparency** – promoting transparency on climate change and wider sustainability along the value chain
- **Trust** – building trust and integrity in ESG-labelled instruments, products and the supporting ecosystem
- **Tools** – working with others to enhance industry capabilities and support firms' management of climate-related and wider sustainability risks, opportunities and impacts
- **Transition** – supporting the role of finance in delivering a market-led transition to a more sustainable economy
- **Team** – developing strategies, organisational structures, resources and tools to support the integration of ESG into FCA activities

The UK Sustainability Disclosure Regime (SDR)

To coincide with COP26 Finance Day on Nov 3rd 2021, the FCA released the Discussion Paper DP21/4 - Sustainability Disclosure Requirements (SDR) and investment labels. It closed for feedback on Jan 7th 2022.

The DP21/4 is part of the FCAs contribution to deliver the Government's Greening Finance: A Roadmap to Sustainable Investing. DP21/4 outlines the FCA approach to the SDR and the sustainable label system that will apply. It will have significant implications for advisers, funds and the wider financial services industry.

The labels are set to cover ALL funds to aid consumer choice, capture opportunities to benefit consumers, reduce greenwashing and consumer risk. Key aspects of the product labels system will be a product classification and labelling system designated currently as 'not sustainable', 'responsible', 'transitioning', 'aligned' or 'impact' products.

The EU has moved 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 large cross-border financial services firms and meets Government plans for a sustainable economy.

EU Categories for financial promotions (refer to the taxonomy):

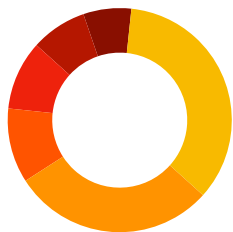
- **Article 6** - covers funds that don't integrate any sort of sustainability into their process. These must be clearly labelled as non-sustainable with reasoning. Likewise, the rules for rationale and reporting work both ways for the ESG and Sustainability exclusion or inclusion. Effectively this means ESG and Sustainability disclosures for ALL funds - not just those marketed as Green or ESG!
- **Article 8** - "products promoting environmental or social characteristics"
- **Article 9** - "products with a sustainable investment objective"

The rules work both ways for inclusion and exclusion rationale and reporting for ESG and Sustainability risks within the investment process of Article 6 funds. Effectively this means ESG and Sustainability disclosures for ALL funds - not just those marketed as Green or ESG!

At ESG Accord, we have considered the investment space, UK equivalence to the SFDR and the SDR Fund Labels and we have used the following model as a basis for our compliance framework:

The Investment Spectrum:

- **No ESG & Sustainability**
- **ESG**
- **ESG+ Screened Underpins**
- **Responsible & Sustainable**
- **UN SDGs & Impact Investing**
- **Ethical Screening**



PROD, COBS & CONSUMER DUTY

PROD is part of the FCA objectives to deliver better outcomes for investors. By using the term 'target market' the Regulator aims for the Manufacturers (Asset Managers) and Distributors (Advice Firms) to match target market descriptors with their client needs.

As set out in our introduction to this guide, the investable universe has dramatically changed in the last couple of years in response to the advancing availability of metrics for ESG and Sustainability.

The current MiFID II PROD structure for target markets is based on the investable universe.

Mark Manning, Technical Specialist. Sustainable Finance & Stewardship at FCA;

"In many respects, ESG is already in scope when advisers give investment advice. Under existing rules, firms have to act in a client's best interest and collect all necessary information to understand the client's investment objectives. In that context, suitability, within our conduct of business rules, already requires the consideration of ESG preferences. The rules set out the objectives that a firm is required to consider but this is not intended to be an exhaustive list."

COBS 9A.2 Assessing suitability: the obligations details the reasonable steps for suitable recommendations and obtaining necessary client information. COBS 9A.2 is mentioned in PROD 3.3.18. PROD 3.3.18 is about the procedures and measures for deciding target markets and assessing the services an Adviser will provide.

PROD 3.3 Distribution of product and investment services sets out items for UK Financial Advisers.

We encourage all advice firms, compliance firms and para-planners to read the following PROD overview on the next page. From this it is clear that existing compliance processes need to catch up with the evolved investment space.

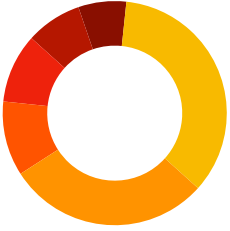
PROD participation can help ensure the flow of information and feedback. This, alongside Consumer Duty, can be viewed as a regulatory route to assist aligning client preferences and objectives for suitable outcomes and, indeed, the incoming Fund Labels.

Additionally, the FCA Discussion Paper DP21/4 - Sustainability Disclosure Requirements (SDR) and investment labels sets out the following for Advisers;

1.11 Building on existing rules, a key aim will be to confirm that they should take sustainability matters into account in their investment advice and understand investors' preferences on sustainability to ensure their advice is suitable.

ESG & Sustainability is a best practice and suitability imperative. Where you follow existing regulatory processes you will be able to rest assured that all advisers in your firm are handling ESG & Sustainability preferences and objectives in a standardised and reportable way in line with the PROD, COBS and Consumer Duty requirements.

- Challenging funds and dialogue with fund managers equates to influence and feedback on product design in this fast moving space
- Granular questioning and challenging of funds is an action to reduce greenwashing! Upping your due diligence will increase transparency right through the product life-cycle
- These actions have the potential to increase suitable client outcomes - and you will sufficiently demonstrate the Knowing Your Client requirement!



PROD, COBS & CONSUMER DUTY continued...

Key areas under current PROD requirements:

3.3.1

Distributors must understand financial instruments, they must assess compatibility with the needs of their clients and take account of the Manufacturer's identified target market.

3.3.3

Distributors should obtain information from Manufacturers to understand and have knowledge to ensure distribution is in accordance the needs, characteristics and objectives of the target market.

3.3.9

Distributors should determine the target market even if not defined by the Manufacturers.

3.3.10

Distributors identify target markets and distribution strategy with the information from the Manufacturers and the information they hold on their own clients.

3.3.11

For the target market and distribution strategy, Distributors should take into consideration the nature of the financial instruments and recommend how they will fit with their clients' needs and risk appetite.

3.3.12

Distributors must identify target markets for each financial instrument at a sufficiently granular detail.

3.3.15

Distributors must have adequate product governance to ensure financial instruments and services are compatible with the needs, characteristics and objectives of the identified target market. Their distribution strategy is consistent with target market. Distributors must identify and assess the needs of clients so their interests are not compromised by commercial or funding pressures. They must identify groups of clients whose needs, characteristics and objectives for which the financial instrument or investment service is not compatible (negative target market).

3.3.16

Distributors should periodically review product governance arrangements under PROD 3.3.15R and take appropriate actions when needed to ensure they remain robust and fit for their purpose.

3.3.21

The management must have effective control over the product governance when determining the range of financial instruments offered or recommended and the services it provides to each target market.

3.3.22

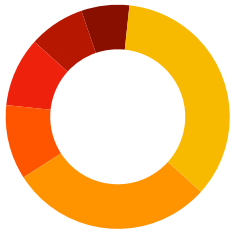
Relevant staff must have the necessary expertise to understand the characteristics and risks of the financial instruments they will distribute, the services provided and the needs, characteristics and objectives of the identified target market.

3.3.26

To regularly review the financial instruments which are distributed and the services provided, this must take account of any event that could materially affect the potential risk to the identified target market.

3.3.27

Distributors must assess at least if the financial instrument or investment service remains consistent with the needs, characteristics and objectives of the identified target market and if the intended distribution strategy remains appropriate.



ESG & Sustainability - Example Integration into Financial Advice Firm

ACTION

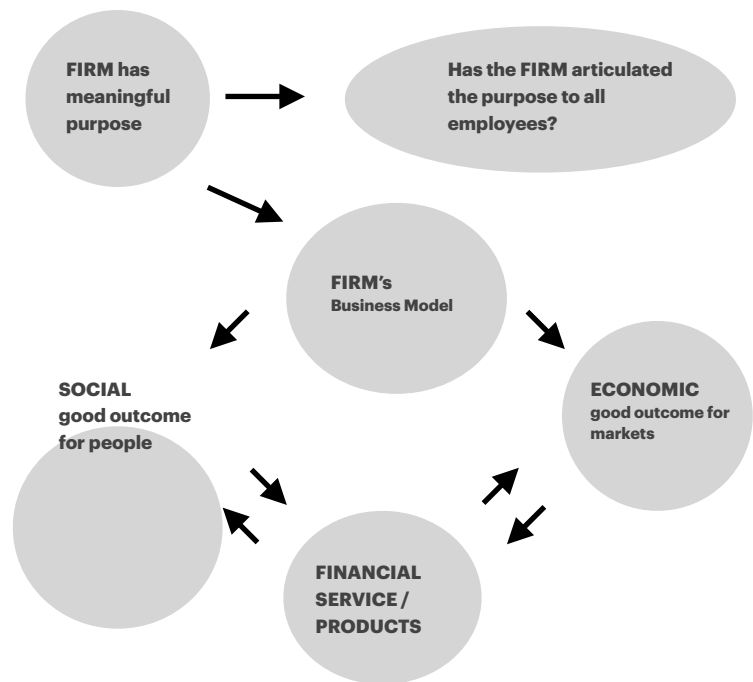
PROD participation is linked to the culture of a company/firm, by how (and if) the firm articulates its purpose and values through its systems, controls, and arrangements.

Good research and due diligence starts by bringing attention to the KYC and PROD requirements. The outcome from a firm's KYC and PROD procedures drives the MiFID II participation/dialogue/due diligence with fund groups. And this equals delivering best practice advice to clients which genuinely meets their needs.

- **Decide what advice your firm will give.** Maybe it will be the whole spectrum of investment strategies under Sustainable Finance, or could stop short of full ethical investment advice and instead refer to a specialist firm.
- **Review your firms PROD Target Markets.** Do the selected funds target markets still match your client segmentation? How will you categorise your clients' preferences to span the full spectrum of funds, including ESG and Sustainable Finance?
- **Let your clients know what advice you can offer.** This can be a simple website statement or dedicated section containing information on ESG and Sustainable Finance options.
- **Update your Internal Compliance Statement and Due Diligence for Fund Groups.** Are you asking sufficient granular detail covering the Investment Space / ESG & Sustainability Spectrum?
- **KYC.** Assuming the full spectrum of funds broadly spans 6 Levels (see Page 3), you'll need a comprehensive series of questions which cover these levels and gather information about client preferences.

○ Revisit Purpose & Governance - Drivers for culture / best practice*

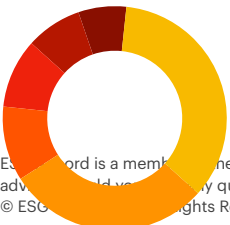
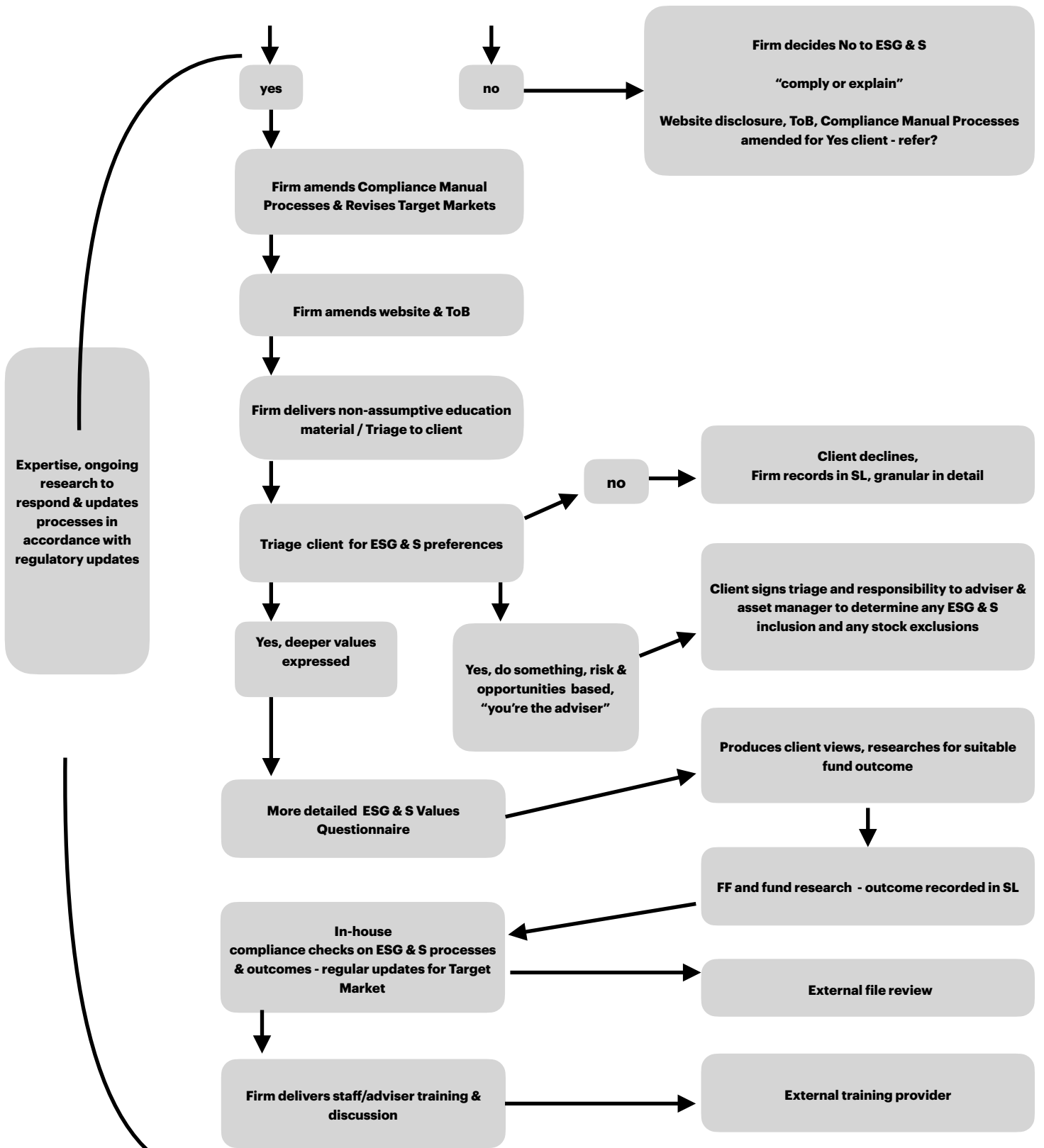
- **Leadership** - top down, SM&CR, to act in the best interests of ALL clients.
- **People policies** - incentivised behaviour, cumulative effect (recruitment, diversity, progression etc).
- **Governance** - The firm's systems and controls arrangements. How decisions are made and implemented, avoid group think, manage & reduce risk to the firm from assumptive behaviours, accommodate all views, look at the board committees.
- **Purpose** - a combination of the business model and the way a firm thinks about the social or economic contribution it provides.



*Interpretation from SOURCE <https://www.fca.org.uk/news/speeches/regulatory-perspective-drivers-culture-and-role-purpose-and-governance>

- **Opening client education.** This is a requirement from the FCA. How will you ensure and record that your clients understand what they are being asked?

Firm decides to integrate ESG & S into firm & advice processes at each new client and review



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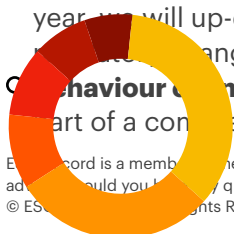
Here are three key barriers to behaviour change: knowledge, cost and hassle. This is how ESG Accord can help you:

- **Active engagement with clients** - deepen your client retention over generations by upping your KYC to current PROD requirements via our Triage & Values Questionnaires (VQ) & Due Diligence Questionnaires
- **Clear communications** - website & ToB amendments, our Triage, VQ & Due Diligence Questionnaires model process to help you deliver and fully record best practice outcomes
- **Integrity** - deliver your advice from a clear & neutral perspective
- **Specificity** - ready made templates, granular in detail, spanning the Sustainability spectrum, raise your market participation in this fast evolving space. Have greater ability to match funds to target (and negative target) markets
- **Demystifying** - OK, you don't know what you don't know and what is it that you should learn so you can talk about all this? Our compliance framework will help you see through the fog! If you have any training needs - we are here to help
- **Modelling behaviour changes** - New clients and annual reviews; start using our VQ's, see how positively staff and clients react, share the news, tell the story - a compelling incentive for client engagement at multi-generational advice
- **Tailored messages** - this is for the longevity of your firm! Your client bank - wealth shift - intergenerational planning
- **Clear calls to action** - simple action via our templates, future-proofed compliance framework, sign up for a year you will up-date and respond to incoming changes
- **Behaviour change** - make behaviour change a central part of a comprehensive strategy

- **Fairness** - The ESG Accord framework covers the full ESG and Sustainable Finance spectrum - it is for ALL clients - putting client values first in a repeatable, reportable, compliance friendly way



- **Cutting costs:** Saving many work-hours and staff training costs to your firms; we've made all the templates you'll need
- **Foresight and phasing** - when you've got the right framework you can make the real planning decisions - which clients first, when to introduce? Exit planning strategy for firm - retain your value by demonstrating appropriate client segmentation
- **Making it easy** - Raised likelihood of suitable outcomes!
- **Get in touch.** Let's book a no obligation meeting
- **admin@esgaccord.co.uk**
- **www.esgaccord.co.uk**



RESOURCES

www.esgaccord.co.uk

LinkedIn - ESG ACCORD

LinkedIn - Elly Dowding

LinkedIn - Lee Coates OBE

Trade body

- UK Sustainable Investment & Finance Association
<https://uksif.org/>

Regulatory issues / further reading

- 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
- FCA Handbook PROD 3.3 <https://www.handbook.fca.org.uk/handbook/PROD/3/3.html?date=2018-04-01&timeline=True>
- FCA A new Consumer Duty, Feedback to CP21/13 and further consultation <https://www.fca.org.uk/publication/consultation/cp21-36.pdf>
- FCA Discussion Paper DP21/4 - Sustainability Disclosure Requirements (SDR) and investment labels <https://www.fca.org.uk/publication/discussion/dp21-4.pdf>
- FCA COBS 9A.2 Assessing suitability: the obligations <https://www.handbook.fca.org.uk/handbook/COBS/9/2.html>

- FCA Sustainability Finance Strategy <https://www.fca.org.uk/publications/corporate-documents/strategy-positive-change-our-esg-priorities>
- Greening Finance: A Roadmap to Sustainable Investing https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1031805/CCS0821102722-006_Green_Finance_Paper_2021_v6_Web_Accessible.pdf