vestra

Together, small changes can have a large impact

Regulation bolsters sustainable investment inclusion

To achieve more sustainable growth, everyone in society must play a role. The financial system is no exception. Re-orienting private capital to more sustainable investments requires a comprehensive rethink of how our financial system works. The European Union (EU) deems this shift necessary in order to develop more sustainable economic growth, ensure the stability of the financial system, and foster more transparency and long-termism in the economy.

On 24 May 2018, the European Commission (EC) presented a series of legislative measures that follow on from the inaugural EU Action Plan on Financing Sustainable Growth. As part of the package, the EC have proposed implementing a mandatory requirement for an adviser to understand a client's Environmental Social Governance (ESG) preferences, which would assist in realising objectives of the Action Plan. In March 2019, the European Parliament and EU Member States reached an agreement to publish new rules on disclosure requirements for sustainable investments and sustainability risks. The disclosure regulation details how financial market participants and financial advisers must incorporate ESG risks and opportunities in their processes, procedures and policies. The new rules impact all of us, from companies to end-investors and are intended to enable better informed choices to ensure that invested capital is used responsibly and supports sustainability.

As a result, this regulation means financial advisers will need to increasingly think about how to integrate ESG risks and opportunities into their processes, as part of their duty to act in the best interest of the client. In terms of a client or potential client's ESG preferences', advisers must provide choice as to whether and which environmentally sustainable investments, social investments or good governance investments should be integrated into the client's investment strategy. The EC propose investment firms "…demonstrate that they have in place adequate policies and procedures to ensure that they understand the nature, features, including costs, risks of investment services, and financial instruments selected for their clients, including ESG considerations where relevant…." (Amendments to Delegated Regulation (EU) 2017/565, 24 May 2018).

The EC has reported that suitability assessments usually do not include ESG preferences and the majority of clients are not inclined to raise the issue themselves. As a result, ESG considerations are not consistently factored into an advisory firm's process. The FCA will have to consider amending current suitability rules to incorporate sustainability preferences in line with the proposed changes from the EC. At present, advisers are required to obtain information about client's knowledge about investments and assess their risk profile in order to recommend suitable products. The addition of a sustainability element in these reports will mean sustainability preferences are also proactively taken into account in the suitability assessment.

It is intended that this regulation will strengthen and improve the disclosure of information by manufacturers of financial products, as well as the advice process carried out by financial advisers towards end-investors. They are an integral part of the EU efforts, under the EU's sustainable development agenda and the carbon neutrality agenda, to connect finance with needs of the real economy. The new rules also support the 2012 United Nations' Sustainable Development Goals and the 2016 Paris Climate Agreement targets.

Key messages for Financial Advisers

- In order for capital to be rerouted to the companies that are focused on the long term sustainable growth that the planet requires, more progressive regulation needs to be in place.
- The EU is at the forefront of implementing changes affecting the financial system with the intention of supporting the sustainability efforts required.
- By driving a behavioural change in the advice process through regulation, it is hoped that a better understanding and awareness of sustainable investing will be achieved.

These proposed regulations will provide a framework for financial advisers to offer robust sustainable investment solutions to clients.

For further information as to how LGT Vestra can help you integrate sustainable investment solutions into your advice and suitability then please contact your LGT Vestra Business Development Director.