10 September 2021

Response by FIA EPTA to the Financial Conduct Authority Consultation Paper on enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets. (CP21/18**)

The European Principal Traders Association (FIA EPTA) welcomes the opportunity to respond to the Financial Conduct Authority (FCA) Consultation Paper on enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets.

FIA EPTA members welcome the actions and responsibilities taken by the Government of the United Kingdom to work towards the common goals of reaching climate neutrality in 2050. This is illustrated by the FCA plans on enhancing climate-related disclosures which will be an important step towards more transparency on the disclosure of climate-related information. FIA EPTA members also would like to acclaim the FCA's work on shifting focus towards the Social and Governance components of ESG, which is an essential change towards inclusive and diverse capital markets. FIA EPTA members believe that to make a success of the economic transition and create sustainable capital markets it is needed for cross border cooperation between jurisdictions as divergence will delay this transition.

As this consultation paper is mainly focused on primary markets and FIA EPTA members are active in the secondary markets, we would like to emphasise below on issues that we believe are important for both the primary and the secondary markets. In addition, we would like to point out why we believe the secondary markets are a key component of the transition towards a more sustainable economy.

FIA EPTA members believe that the quality of available ESG data should be improved and harmonised. FIA EPTA members observe a large variety of ESG ratings in the market and would like to express their concerns on the comparability of the data. More standardisation is needed, there is an average correlation of .61 ['Aggregate confusion: the divergence of ESG ratings', Berg, Koelbel and Rigobon, 2019]). We also refer to the IOSCO consultation on ESG ratings[1], which aims at assisting IOSCO members in understanding the implications of the activities of ESG ratings and data providers and in establishing frameworks to mitigate risks stemming from these activities.

This is mainly because of measurement divergence, meaning that agencies 'measuring the same attribute using different indicators. Next to measurement divergence, weight, scope, and aggregation of indicators play a role in the lack of correlation between the different ESG ratings. This makes it difficult, if not impossible, to come up with truly meaningful and harmonised ESG

[1] https://www.iosco.org/news/pdf/IOSCONEWS613.pdf

ratings between the different rating agencies. FIA EPTA members would like to encourage more standardisation so that the comparability of these ratings increases.

FIA EPTA members also believe that other parts of the financial market's infrastructure should be further developed. This will positively impact the market as a whole and it will make sure that all parts of the financial infrastructure contribute and diminishes the possibility of a skewed transition.

While the focus of the climate-related disclosure requirements is mostly on primary markets, it is the belief FIA EPTA members that secondary markets are another important part of the success of the green transition, in particular, to enable asset holders to effectively manage their fiduciary duty in regard to their sustainable holdings (e.g. to buy or sell ESG products on behalf of end investors, insurance holders, or pension participants) and to enable sound financial risk management for these end-investors.

In addition to capital market infrastructures, we note that derivatives exchanges increasingly engage in sustainable finance to address the increased demand for sustainable products from an exchange-traded derivatives point of view. Collaboration among benchmark providers, and market participants, has resulted in successfully introducing sustainable derivatives products. The derivatives have a clear potential to optimise the allocation of capital to support or complement investment into sustainable projects and activities and represent a flexible solution to attend the demand from investors towards new sustainable investment strategies, but also at the same time manage undesired sustainability risks, trade longer-dated maturities, align their ESG investment mandates and to manage the granularity of the client's risk exposure while reducing trading costs.

To support this, a mature and healthy secondary markets ecosystem of exchange-traded derivatives and ETFs, based on underlying assets, is in the process but needs time to be developed alongside the primary and secondary market for sustainable shares and bonds. This will foster a liquid market for sustainable investment and risk management which is needed to ensure that Sustainable Finance is fully embedded into the mainstream of the financial markets ecosystem.

Markets will innovate towards this demand for sustainable alternatives with adapted risk managing products. The financial policy framework should use this momentum to ensure markets can adjust efficiently. They have already begun a transition to more sustainable products with the various exchanges having listed sustainable contracts in parallel or in addition to traditional contracts. However, there is room for more products and innovations. Markets react to supply and demand from investors and market participants, who have recently been much more focused on sustainable products.

FIA EPTA members are committed to supporting the shift towards more sustainable products. Our members have the ability to support buy-side participants with the migration towards a green investment portfolio. To achieve the green transition, financial participants including asset managers, pension funds, and hedge-funds will want to significantly reduce or completely close their holdings in products that, over time, will be deemed "brown". As FIA EPTA members are an important source of liquidity they can play a vital role in this evolution, making sure there is still a market to sell these products while facilitating a smooth transition towards "green" products.

FIA EPTA members further believe that global coordination will be key to the success of any policies, not only to ensure a positive global impact on our climate but also to avoid arbitrage opportunities or the industry moving away, thereby jeopardising the commitment of the UK and dislocating markets.

FIA EPTA is committed to supporting policymakers and regulators in ensuring the success of the sustainable finance project at all levels of the capital market ecosystem. We would welcome the opportunity to provide further background to the FCA on the issues raised in our letter.