AMI Response to FCA DP 23/1 – Finance for positive sustainable change: governance, incentives and competence in regulated firms

This response is submitted on behalf of the Association of Mortgage Intermediaries (AMI) and the Association of Finance Brokers (AFB). AMI is the trade association representing over 80% of UK mortgage intermediaries. AFB sits within AMI and represents second charge (formerly secured loan) brokers.

Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product to meet the individual consumer's mortgage requirements. AMI members also provide access to associated protection products. AFB members also provide access to unsecured products.

Our members are authorised and regulated by the Financial Conduct Authority (FCA) to carry out mortgage, insurance mediation and consumer credit activities. Firms range from sole traders through to national firms and networks, with thousands of advisers.

Question responses

Q1: Should all financial services firms be expected to embed sustainability-related considerations in their business objectives and strategies? If so, what should be the scope of such expectations? Please explain your views.

AMI welcomes the depth and ambition of this paper, and it is encouraging to see policy proposals rooted in academic research and recommendations from leading organisations and experts. We agree that environmental sustainability in the financial services sector needs to comprise more than just a drive to combat climate change. We also share the view that equal attention should be paid to the 'Social' and 'Governance' aspects of the ESG equation.

Our responses to the approaches proposed in the DP can be summarised as follows:

1. **May not translate well into a unified policy regime on ESG.**

   'Environmental' responsibilities and 'Social' responsibilities encompass such vast and complex policy areas that, whilst sometimes overlapping, each warrant their own independent guidelines and frameworks. Furthermore, different regulatory approaches are likely to be needed for different sectors within financial services, and in proportion to firm size. Here we would want to see a sector-specific approach to policy design, and a scope-dependent application similar to that of SM&CR (i.e., Enhanced, Core or Limited).

2. **Undue focus on targets and metrics.**

   As the DP notes, the government is pushing for regulators to 'have regard to the need to contribute towards achieving the Government's target of reaching net zero greenhouse gas emissions by 2050' with an amendment to FSMA, and this expectation was reinforced in a remit letter from the chancellor in December 2022. The FCA may be of the view that targets and metrics will be necessary to demonstrate to government that it is delivering on its anticipated remit. However, there is a substantial education gap amongst firms around the nature and timing of actions required to support the delivery of net zero by 2050.

The DP acknowledges this issue, but nonetheless many of the proposals in this paper presuppose an understanding of what needs to be done, and in what order.

Examples include:

- Appointing an individual 'responsible for oversight of sustainability-related risks and opportunities';
- Ensuring said risks and opportunities are 'reflected in the entity's terms of reference, board mandates and other related policies';
- The 'setting of targets related to significant sustainability-related risks and opportunities'; and
- Monitoring these targets against 'performance metrics' which 'are included in remuneration policies'.

Without specifying or at least providing more (sector-specific) clarity around the outcomes firms are expected to prioritise, there is a risk of firms wasting time on ineffective bureaucracy. Actions carried out to satisfy the demands of an audit trail could even be actively detrimental if more impactful but less 'trackable' measures are deprioritised as a result. This is arguably part of the reason greenwashing occurs. Most activity in our sector is based around EPCs as a proxy, with no clarity on what net zero carbon actually means.

We would therefore call for the FCA to support the industry on its education journey and work with trade organisations and other professional bodies to establish guidelines and best practices for firms before introducing formal reporting structures or new regulations.

3. Needs to factor in time and resource constraints.

Another dimension is that many of the DP's recommendations assume firms have considerable time and resource to dedicate to the creation of a firm-wide action plan on sustainability. We are currently undergoing a period of substantial regulatory change in the form of Consumer Duty and, to a lesser extent, the new AR regime – with the prospect of an SM&CR overhaul on the horizon and various other consultations in the pipeline. This may be less of an issue for large financial institutions and corporations with the budget to outsource work or even hire sustainability specialists to work in house. But for many firms in the mortgage intermediary sector, these options are not available.

We would therefore ask the FCA to factor in real-world time and resource constraints when formulating its policy on ESG, and not rely on firms being able to multi-task. If we can start with the assumption that most firms can't do everything – and many, especially smaller firms, can do very little – then it will be necessary for regulatory policy to specify priority actions that are likely to deliver the biggest impact, and ensure that the 'nice to haves' don't take precedence when capacity is limited.

4. Excessive focus on investment firms, to the detriment of consumer lending (and insurance)

Whilst we would expect governance and disclosure frameworks around sustainability (if introduced) to be initially targeted at larger firms in the investment, insurance and banking sectors, we feel a different approach would be needed for the mortgage intermediary sector. The lack of mention of mortgages and their potential to improve home energy efficiency is a blind spot in the DP that should be addressed.

Much of the DP's focus is on incentivising firms to tackle their Scope 1 and 2 emissions before tackling their broader 'Scope 3 emissions' (such as those relating to the 'investing, lending and underwriting activities' of financial institutions). In the investment sector this makes sense, as Scope 3 emissions for an investment or pension advisory firm relate to more abstract issues around stewardship and ESG credentials of fund managers and other product providers. It's easier and more measurable to start with Scopes 1 and 2.

However, in the mortgage advice sector we can enable consumers to directly improve the energy efficiency of their homes via green mortgages and other home finance products. This activity falls under Scope 3, but has the potential to make a much bigger difference than prioritising reducing internal emissions as a business. Residential property produces c.13% of total emissions in the UK, so this is the area in which we believe intermediary firms should focus (unless the firm meets the SMCR 'Enhanced' criteria).

Broker firm-level ESG credentials, lender firm-level ESG credentials and matching these to client preferences are all still important, but they are not the area in which broker firms can deliver the biggest impact. We would therefore ask the FCA to be mindful of this distinction and not expect to be able to replicate frameworks that work for firms in the investment and banking sectors in other parts of the industry – mortgage advice firms in particular. A tailored approach is required.

It was encouraging to hear the FCA Green Mortgages speech on the 19th April, as this did demonstrate home finance sector-specific thinking on ESG – in respect of the green agenda in particular – and thinking around how ESG policy interacts with Consumer Duty requirements. However, we would still argue that if such an all-encompassing approach to ESG is to be taken by the FCA, then this needs to be truly joined up. A siloed approach isn't wrong per se, so long as the regimes/frameworks that apply to different sectors are appropriately labelled.

For example, an ESG policy that mainly addresses the challenges, priorities and standards expected of the investment sector – and which omits to mention (or only briefly touches upon) the consumer lending and insurance sectors – cannot be badged as a comprehensive ESG regime.

Q2: Beyond the FCA's ongoing work on diversity and inclusion, and introduction of the Consumer Duty, should we consider setting regulatory expectations or guidance on how firms' culture and behaviours can support positive sustainable change? Please explain your views.

ESG is often used interchangeably with the term 'Sustainability' and as shorthand for the green agenda, so there is a risk D&I could be overshadowed or deprioritised if it is subsumed under the wider ESG umbrella. The areas of knowledge are starkly different and experts in one tend not to have an extensive understanding of the other.

Many of those who are currently taking an active role in AMI's D&I initiative 'Working in Mortgages' have declined our invitation to volunteer for our MCAG/green mortgages initiative simultaneously, citing the dual workload as too onerous. Within AMI we have also taken on a new Senior Policy Adviser partly to ensure the D&I and Green remits could be allocated separately – as the workload was proving unmanageable for one individual. We would therefore encourage the FCA to ensure any responsibilities placed on firms in respect of D&I are done so separately, not under the banner of ESG as a whole.

Furthermore, we are keen to read the FCA's next D&I consultation and hope its publication will not be pushed back any further. We would particularly welcome an update on the proposal to issue some collated guidance around the FCA's expectations on non-financial misconduct. This is especially linked to firms' culture, behaviours and codes of conduct, as predatory behaviour and sexual harassment are usually only able to persist unchallenged if the wider workplace/leadership is prepared to 'turn a blind eye' or even passively condone certain behaviours as 'harmless fun'.

The recent revelations around sexual harassment whistleblowing reports tripling in the last year amongst financial firms, coupled with the wider impact of the CBI allegations on the corporate world, have reinforced the need for some clear guidelines and expectations for regulated firms.

Lastly, whilst we found the research findings on regulated firms' approaches to D&I in December 2022 useful as an indication of the FCA's direction of travel, many of the recommendations were only applicable for larger firms. We would therefore encourage the FCA to think more broadly about how future guidance can be tailored to suit smaller firms, especially for those who don't have the capacity to conduct large-scale staff surveys and carry out detailed data analysis.

AMI remains concerned that many firms find data capture of individual characteristics across the whole diversity spectrum difficult. Some are protected characteristics but firms would benefit from case studies and information on how others are breaking down barriers in this area. Firms and their people would benefit from guidance on what characteristics could be recorded and whether targets or aspirations are beneficial. Again, we are concerned that any 'targets' are applied proportionally to firms base on size.

Q3: What steps can firms take to ensure that they have the right skills and knowledge relating to material climate- and sustainability-related risks, opportunities and impacts on their boards? Should we consider setting any regulatory expectations or guidance in this area? If so, what should be the scope of such expectations?

Ensuring firms are equipped to adapt to the challenges and opportunities presented by the green agenda is a core focus for AMI as a trade body at the moment. We have recently formed alliances with the Mortgage Climate Action Group (MCAG) and the Green Finance Institute (GFI) to help deliver our industry-wide initiative to ensure brokers are well-educated on green homes and energy efficiency, and that consumers receive the best support and guidance when navigating this complex landscape.

MCAG started life as a collaborative, non-commercial industry initiative led by Legal & General, Sesame Bankhall Group and SimplyBiz Mortgages. These founders were later joined by Home Loan Partnership, Mortgage Intelligence, PRIMIS, Openwork and Paradigm. We also now have several major lenders actively involved. The group was set up to act as a source of support for intermediaries, helping them to understand and address green issues when dealing with mortgage applications, and ensuring that advisers' interests are represented in the wider mortgage sector, and in front of regulators, trade bodies and government departments alike.

MCAG began working with AMI soon after its inception, and it quickly became apparent that the interests of AMI and MCAG were closely aligned. This led to the decision to make MCAG the official Steering Group for the development and delivery of AMI's green initiative, with the aim of providing resources, training and representation for the mortgage intermediary sector as we navigate the net zero transition.

The initiative is still in its early stages, but we are pleased to have launched the Green Mortgage Advice website last year – and are very grateful to the FCA for mentioning the website as a valuable resource for mortgage brokers in its latest Green Mortgages speech. Below we have outlined our manifesto and priorities, which give an insight into what we see as the most pressing matters to address for the mortgage advice sector:

AMI MCAG Manifesto and Priorities

1. **Education:** We need mortgage intermediaries to be familiar with – and comfortable talking to clients about – green home retrofit technologies, the financing options available, and the regulatory landscape that sits around it all. We also want to help broker firms understand the value of green mortgage advice and how to incorporate it into their wider service proposition, alongside ways in which firms can reduce their carbon footprints.

2. **Collaboration:** We need lenders, brokers, technology providers, trade bodies and education providers to work together, communicate a consensus view and put individual reputational and commercial interests aside in the name of the common good. We will also seek to map the stakeholder landscape to foster better cross-sector collaboration, including organisations in and outside of the mortgage sector, subject matter experts, think tanks, quasi-government bodies and other stakeholder groups.

3. **Impact:** We need to steer industry towards impact and authenticity in its approach to product and service proposition design, and away from greenwashing and the 'weaponisation' of green in a way that cuts across our collaborative ethos. We need to gain a deeper understanding of consumer motivations beyond cost savings, which may include self-sufficiency, social status and energy security. This will help us to create narratives that inspire positive behaviour change and circumvent some of the more politically charged aspects of the climate debate.

4. **Influence:** We need to speak with a unified voice on behalf of the industry to ensure swift action in priority areas. We need the government to foster a supportive policy environment and give clarity on key areas such as the rules for Buy to Let landlords, the future of the EPC rating system and the expectations to be placed on mortgage lenders. We also need buy in from regulators and a clear FCA policy position on ESG for the mortgage market and green home finance provision.

Lastly, a major outcome of last year's work was the publication of the Green Finance Institute's (GFI) Broker Handbook on Green Home Technologies and Retrofit, on which AMI was a key collaborator (this project began before our work with MCAG). We were instrumental in ensuring the handbook would be officially accredited as CPD by the LIBF, as well as providing feedback on drafts and promoting its use to our members and within the wider broker community. The handbook is designed to serve as a foundational resource for brokers looking to gain an understanding of the green home improvements and financing landscape.

We plan to continue working with the GFI, LIBF and SMP (CII) to promote the handbook, break down its contents into smaller sections to aid brokers on their education journey, and ensure the industry is working from a set of consistent, accurate and up to date learning resources.

Given the momentum and scale of this project, we feel the best role for the regulator to play in the mortgage intermediary sector would be a supportive one, providing guidance on feedback on our plans and projects, and basing policy formation on the insights shared as the initiative develops.

Q4: What are likely to be the most effective strategies in embedding climate- and sustainability-related considerations across a firm's operations? What is the potential benefit of initiatives such as the appointment of functional 'champions', or the creation of dedicated working groups or forums? And how can the value of such initiatives be enhanced?

As mentioned above, we are currently at the stage where industry and representative bodies are co-ordinating to establish a way forward for our sector. AMI MCAG is in the process of setting up workstreams to build knowledge and form a consensus view across four key areas:

1. **Adviser awareness –** raising the profile of the green agenda for mortgage professionals and business owners via a range of channels, including contributions to the greenmortgageadvice.uk website and promotion of the Green Finance Institute's green broker handbook.

2. **Outreach and engagement –** forging connections with firms and organisations within our sector and externally to promote joined-up conversations about green mortgage advice and home energy efficiency across the value chain.

3. **Setting standards –** building an understanding of what ESG best practices might look like in the advice process, the regulatory direction of travel and compliance implications for firms, and how to tackle issues around greenwashing, trust and quality control.

4. **Knowledge building –** organising events and training for advisers on important issues, and helping to build a knowledge bank on green technologies, products and processes for the benefit of the mortgage broker community.

We are happy to engage with the FCA to report on our progress and in turn relay regulator feedback to steer our activities. If policy formation can be organic and led by real-world insight from business leaders and professionals working within the sector, it has a far greater chance of being adopted and embedded as best practice.

There is also a general sense that, given the urgency of the climate crisis, regulators and governments want to apply more pressure in the financial sector to accelerate progress. It is true that regulation can drive actions that might not otherwise have occurred through market forces alone. However, there are also risks (chiefly the incentivisation of greenwashing) around prematurely calling on firms to produce evidence of progress and results. An upfront investment in education and insight-gathering before setting specific regulatory expectations could yield far better long-term results (at least for our sector and especially in small to medium-sized firms).

At firm level, depending on firm size and capacity, the appointment of functional 'champions' could help to ensure Sustainability and ESG remain priority agenda items at board level, serving a similar role to Consumer Duty champions. However, we would echo our earlier comments here that D&I should not be a sub-category of ESG. If such guidelines or requirements were to be introduced, we would rather Sustainability be kept separate from D&I as distinct areas of responsibility.

Clarity from the regulator on what aspects of the broad ESG agenda should be apportioned to lines 1,2 and 3 would be a positive step.

Q5: What management information does senior management use to monitor and oversee climate- and sustainability-related developments, and to monitor progress against public commitments? Should we set expectations or guidance for decision-making processes, including systems and controls, audit trails and the flow of management information to key decision-makers? If so, what should be the scope of such expectations?

See previous comments. Larger firms and financial institutions who have already made significant progress towards the development of a sustainability/net zero action plan may be in a position to apply more rigour to their decision-making processes, systems and controls and audit trails. However, for the rest of the industry this question may not be relevant at present.

Q6: Should we consider setting new regulatory expectations or guidance on senior management responsibilities for a firm's sustainability-related strategy, including the delivery of the firm's climate transition plan? If so, which existing SMF(s) would be the most suitable to assume these responsibilities? Please explain your views.

See previous comments – we do not believe it would be appropriate at present to introduce regulatory expectations on sustainability as part of the requirements to fulfil any Senior Management Functions. Sector-specific guidance would be welcome, provided it has been developed through close engagement with industry. It is also important to remember that large parts of intermediary distribution are captured under the AR regime and not subject to SMCR in the same way.

Q7: Should we consider introducing specific regulatory expectations and/or guidance on the governance and oversight of products with sustainability characteristics, or that make

sustainability claims – for example to clarify the roles and expectations of governing bodies such as Fund Boards? If so, which matters in particular would benefit from clarification?

No comment.

Q8: What matters should firms take into consideration when designing remuneration and incentive plans linked to their sustainability-related objectives? In particular, we welcome views on the following:

a. **the case for linking pay to sustainability-related objectives**
b. **whether firms should break down their sustainability-related commitments into different factors, allocating specific weightings to each**
c. **whether short-term or long-term measures are more appropriate, or a combination of both**
d. **whether sustainability-related incentives should be considered for senior management only, or a wider cohort of employees**
e. **how firms could consider remuneration and incentive plans in the design and delivery of their transition plans**
f. **remuneration adjustments where sustainability-related targets (at either the firm level or individual level) have not been met.**

Please explain your views.

We do not feel this question is relevant to the mortgage intermediary sector given the need to prioritise education and insight gathering over setting targets/designing incentive structures in the first instance. Firms don't yet know which sustainability-related outcomes to incentivise.

Q9: Should we consider additional regulatory expectations or guidance in any of the areas considered in Q8? Please explain your views.

In our sector no, for reasons stated previously – we feel this would be premature. We cannot comment on other sectors.

Q10: Should we consider additional regulatory measures to encourage effective stewardship, particularly in relation to firms' governance and resourcing of stewardship, and associated incentive mechanisms and conflict of interest policies? Are there regulatory barriers that we should consider? Please explain your views.

No comment.

Q11: What additional measures would encourage firms to identify and respond to market-wide and systemic risks to promote a well-functioning financial system? How can the collective stewardship efforts of asset owners and asset managers best be directed towards the most pressing systemic issues? And how can remaining barriers best be reduced? Please explain your views.

No comment.

Q12: What do you consider to be the main sustainability-related knowledge gaps across the financial sector and how can these best be addressed? What do you consider to be the potential harms to market integrity, consumer protection or competition arising from these knowledge gaps?

The knowledge gaps we perceive in our sector have been outlined in question 3, and in the four key workstream areas we have set out in response to question 4. These are the issues we as a trade body (alongside other key stakeholders) are working to address.

We also feel there is a potential knowledge gap within the FCA as to how best to support the mortgage intermediary sector in respect of ESG policy. There is a sense that the DP is largely centred on financial products and less on the intermediaries who deliver services and make product recommendations, often based on long-term relationships. These relationships mustn't be overlooked, as they provide valuable opportunities to educate consumers and promote positive behaviour change, as well as recommend products that support customers to upgrade the energy efficiency of their homes.

Admittedly the FCA's Green Mortgages speech (which came out after our initial response to this DP had been drafted) acknowledges the pivotal role intermediaries can play, and generally gave encouraging messages that industry and regulators are pulling in the same direction. But this either needs to be integrated within the FCA's wider ESG policy, or else treated as a distinct regime in its own right (i.e., with the proposals in this DP limited to the investment sector only, and mortgage intermediary firms only expected to adhere to sector-specific guidance and frameworks). Consistency and collaboration in this regard are arguably even more important now that home finance lending and home finance intermediation sit in different departments within the FCA after a recent restructuring exercise.

If the FCA doesn't pay enough attention to the role of intermediaries, there is a risk of creating a regulatory regime that puts undue pressure on lenders to improve the energy efficiency of their back books in an unachievable timeframe. This could lead to a situation whereby lenders directly encourage consumers to seek out green home technologies and retrofit solutions by themselves. Whilst brokers cannot be expected to become energy efficiency consultants, they could help provide a vital layer of education and support that may prevent customers from making ill-informed decisions.

Q13: Do you think there is a need for additional training and competence expectations within our existing rules or guidance? If so, in which specific areas do you consider further rules and/or guidance are required? Please explain your views.

We do feel education on sustainability could be better integrated into standard adviser training, and that 'competence greenwashing' is a valid concern where no industry standard qualification exists to enable advisers to officially label themselves as green home finance 'specialists'. This is an issue we hope to help resolve through our ongoing work with the LIBF and the SMP within the CII.

We would also appreciate the opportunity to engage with the FCA's sector-specific roundtables on green education in the industry to be held in 2023, as we feel our initiative could play a central role in both policy formation and adviser engagement.

Q14: Which aspects of the training and capability-building initiatives discussed above, or any others, would be particularly useful to consider (for example in identifying which skills and/or training is needed) and how best should we engage with them?

See previous answers (in particular the response to question 3).

Q15: Have you seen misrepresentation of ESG credentials among ESG professionals and, if so, what are the potential harms? Have you seen any consistent training metrics that can help compare firms' knowledge/capabilities? Please describe.

We have not seen examples of misrepresentation of ESG credentials within our sector, but we are aware that the wider market for green home technologies and retrofit – as a relatively nascent unregulated sector – has difficulties around quality control and trust, and can be hard for consumers to navigate successfully.

Another concern is similar to the issue we have seen within the home buying and selling process in relation to the Building Safety crisis – all parties involved in the value chain, reporting to different regulators and with different priorities and legal obligations, are nervous about shouldering the responsibility for guiding or even providing signposting for consumers in an area they feel is 'beyond their remit' (in this case, in respect of green home improvements). Where will accountability lie – estate agent, builder, mortgage broker, lender, surveyor or conveyancer (buyer or seller)?

Taken together, these issues create a lack of trust in the quality and legitimacy of third-party suppliers, and uncertainty around the liability of any adviser or salesperson in the value chain who makes a referral (or even strays into providing 'too much' information). Without clear expectations and reassurances from the FCA on what is permitted within the rules, industry may be reluctant to fully embrace the opportunities and stave off the risks posed by the green/net zero agenda.

We were pleased to see clarification that mortgage brokers will not be expected to become sustainability experts or consultants in the FCA's Green Mortgages speech, but further clarity around how this can be achieved in practice without overstepping boundaries (e.g. perhaps with case studies or similar guidelines) would be helpful.