

Louisa Chender
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

Sent by email to cp21-17@fca.org.uk

10 September 2021

Dear Louisa,

Consultation response: Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers

I am writing to respond to the Financial Conduct Authority's consultation *Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers*, on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices by pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. Among other activities, we work with the financial services sector to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the views of clients, beneficiaries and pension scheme members.

We welcome the work that has been done by the FCA in extending climate-related disclosure requirements to asset managers, life insurers and FCA-regulated pension providers. We have provided specific comments in response to the questions below on the FCA's proposals for reporting. We also wish to make the following broader points:

- **Enforcement:** The FCA should ensure that it has the powers and capacity to review and assess climate-related reporting, as well as taking appropriate enforcement action where reporting is not of an acceptable standard. Without proper resourcing to do this work, the purpose of climate reporting risks being undermined. We would recommend that the FCA undertakes a review of the effectiveness of reporting, following the first cycle of reporting.
- **Risk management and portfolio alignment:** We welcome the FCA's intention to refer to TCFD guidance on transition plans. However, we believe there should be a clearer distinction between risk management (assessing physical & transition risks for the firm) and portfolio alignment (assessing progress to meet the goals of the Paris Agreement / deliver a net zero ambition and report on intended pathway to meet these goals). The FCA should encourage financial institutions to rely on a credible 1.5C aligned scenario to define alignment and/or set targets.
- **Guidance:** We understand that the FCA is introducing a new 'Environmental, Social and Governance (ESG) Sourcebook' in the FCA Handbook to set out proposed rules and guidance. We would like to know if the wording of the rules and guidance will be subject to public consultation, as with guidance produced by the Department of Work of Pensions

(DWP). Clearly much of the effectiveness of climate reporting will depend on the detail of rules and guidance, so we believe it is appropriate for this to be subject to public comment.

Q1 Do you agree with our proposed scope of firms, including the £5 billion threshold for asset managers and asset owners? If not, please explain any practical concerns you may have and what scope and threshold you would prefer

Our view is that there should not be a minimum threshold for asset managers and asset owners. Climate risk and impact is relevant to all entities regulated by the FCA, and these reporting requirements should apply equally to all. As ClientEarth highlights in its own response to this consultation, this is consistent with recent recommendations by the Advisory Group on Finance for the UK's Climate Change Committee that net-zero targets and plans must be mandatory for financial institutions.¹ We recognise that it was appropriate for the DWP to introduce a threshold, at least initially (since it has committed to look at expanding its scope) of £1 billion AUM, since smaller schemes have fewer resources with which to conduct TCFD reporting. However, climate reporting should be a normal cost of doing business for any regulated entity and will be far outweighed by the financial detriment of runaway climate change.

Q2: Do you agree with our proposed scope of products? If not, what types of products should, or should not, be in scope and why?

We agree with the proposed scope of products.

Q3: Do you agree with our phased implementation and timings? If not, what approach and timings would you suggest and why?

We believe that the proposed phased implementation and timings should be shortened. As in question 1, we understand why it made sense for the DWP to introduce reporting on a phased basis, given the limited resources of smaller pension schemes. However, entities regulated by the FCA should not require such a delayed start to reporting. We would recommend requiring all firms to report in the first phase from 1 January 2022, with a publication deadline of 30 June 2023. This is commensurate with the urgency of reducing emissions and averting the worst effects of the climate crisis, as emphasised in the IPCC's 2021 report.²

Q4: Would there be significant challenges in using proxy data or assumptions to address data gaps? If so, please describe the key challenges and implications as well as any preferred alternative approach.

We recognise that there will be climate-related data gaps for some time as the TCFD reporting framework beds in, but equally note that data is improving all the time. It is far better for firms to commence reporting on a 'best efforts' basis, using proxy data and assumptions to address any gaps, than wait any longer to start this work.

Q5: Do you agree with our proposals for the provision of a TCFD entity report, including the flexibility to cross-refer to other reports? If not, what alternative approach would you prefer and why?

We agree with the FCA's proposal to retain the TCFD's recommendations as the basis for entity-level rules, rather than deviate from this framework. We believe this is the approach most likely to maintain consistency and avoid confusion.

We have concerns that the proposal to allow firms to cross-refer to other reports may present the risks of reporting becoming too high level and generalised. It may also present barriers to clients

¹ [The road to Net-Zero Finance \(Sixth Carbon Budget Advisory Group\) - Climate Change Committee \(theccc.org.uk\)](https://www.theccc.org.uk/publication/the-road-to-net-zero-finance/)

² <https://www.ipcc.ch/report/ar6/wg1/>

and other stakeholders accessing key information, as weblinks can break and it can be difficult to locate relevant material when moving between reports.

Q6: Do you agree with our proposed approach to governance, strategy and risk management, including scenario analysis? If not, what alternative approach would you prefer and why?

We agree with this approach, subject to the FCA ensuring that it has the powers and capacity to review and assess climate-related reporting, as well as taking appropriate enforcement action, to ensure that 'material differences' in a firm's approach do not impact on the quality and usefulness of reporting.

Q7: Do you agree that firms not yet setting climate-related targets must explain why not? If not, what alternative approach would you prefer and why?

We would recommend that all firms within scope are required to set climate-related targets. As stated above, this is consistent with recent recommendations by the Advisory Group on Finance for the UK's Climate Change Committee that net-zero targets and plans must be mandatory for financial institutions.³

Q8: Do you agree with our proposals for AFMs that delegate investment management services to third-party portfolio managers? If not, what alternative approach would you prefer and why?

No view.

Q9: Do you agree with our proposals for asset owners to cross-refer to group-level, third-party or delegate reports, where relevant? If not, what alternative approach would you prefer and why?

Please see our answer to question 5.

Q10: Do you agree with our proposed requirements for product or portfolio-level disclosures, including the provision of data on underlying holdings and climate-related data to clients on demand? If not, what alternative approach would you prefer and why?

We agree that the proposed requirements for certain firms only to provide data to clients on demand is proportionate. However, we would like to know what plans the FCA has to ensure that this data is of good quality and in a format that is accessible to clients, if it is not subject to external scrutiny.

Q11: Do you agree with the list of core metrics, including the timeframes for disclosure? If not, what alternative metrics and timeframes would you prefer and why?

We are concerned by the FCA's proposal that firms should report only Scope 1 and 2 emissions as a starting point, with no reporting of Scope 3 emissions until 2024. While we appreciate that full company data will not be available initially, we do not think a total absence of Scope 3 reporting is acceptable, given that these are usually the greatest share of an organisations carbon footprint by a significant margin. Many organisations report that 80% of their emissions fall under the auspices of Scope 3 and, for some, Scope 3 accounts for as much as 97% of their overall emissions.⁴ As we comment in our 2020 report, *Point of No Returns Part III – Climate Change*,⁵ considering the large gaps in scope 3 data availability and in light of the fact that indirect emissions make up the majority of companies GHG emissions in most sectors, it is key that the reporting and reduction of

³ [The road to Net-Zero Finance \(Sixth Carbon Budget Advisory Group\) - Climate Change Committee \(theccc.org.uk\)](https://www.theccc.org.uk/publication/the-road-to-net-zero-finance-sixth-carbon-budget-advisory-group/)

⁴ <https://www.edie.net/downloads/edie-Explains--Scope-3-carbon-emissions/492>

⁵ <https://shareaction.org/wp-content/uploads/2020/06/ShareAction-Climate-Report-III-Final.pdf>

emissions occurring in company value chains remain firmly within investors' engagement focus. We would strongly recommend requiring Scope 3 reporting from the outset, using proxies and estimates while certain information is not yet available. For example, the DWP has allowed trustees to report 'as far as they are able' for certain sections of TCFD reporting. The pace of climate change is too urgent to wait for companies to report in full. In addition, delays to requiring disclosure from asset managers will have a knock-on effect on assessment and reporting by pension trustees.

While we welcome the mandatory reporting of total carbon emissions, we were not clear from the consultation document if the proposal was for this to apply to a whole fund or on an aggregated basis. We would suggest requiring funds to include a sectoral breakdown in their reporting of total carbon emissions, so that their position is clearer.

Q12: Do you agree that firms should calculate metrics marked with an asterisk according to both formulas set out in columns A and B of Appendix 3? If not, please explain why, including any challenges in reporting in accordance with either or both regimes.

No view.

Q13: Do you agree that, subject to the final TCFD guidance being broadly consistent with that proposed in the current consultation, our proposed rules and guidance should refer to:

a. The TCFD Final Report and TCFD Annex in their updated versions, once finalised

b. The TCFD's proposed guidance on metrics, targets and transition plans and the proposed technical supplement on measuring portfolio alignment

If not, what other approach would you prefer and why?

We welcome the FCA's intention to refer to TCFD guidance, particularly on transition plans, in assessing whether firms' climate-related financial disclosures are consistent with TCFD Recommendations.

We are aware that the TCFD's guidance on metrics, targets and transition plans is yet to be finalised and we have fed our views back to them directly. However, we think it would be worth sharing these views here as well. These were our main comments on the TCFD's guidance:

- **Using a climate scenario aligned with a reliable 1.5C pathway:** While the report discusses the difference between exploratory and normative scenarios, it could be more explicit on what a "preferred future" should be and the implications of different pathways to get there. "Paris-alignment" can and has been interpreted in different ways (e.g. from low 1.5C to high 2C warming) which has important consequences on the companies' climate strategy, transition plans and targets. The TCFD should encourage its audience to use climate scenarios compatible with a reliable 1.5C pathway (defined as a 1.5°C outcome with no or limited overshoot and limited reliance on negative emission technologies).
- **Disclosing climate scenario's underlying assumptions:** Financial institutions should also disclose the underlying scenario's assumptions (including temperature outcome, probability, reliance on offsets, Carbon Capture Storage, Negative Emission Technologies) so that stakeholders can assess the credibility of their approach. Simply stating that a scenario is or is not "Paris aligned" or "net-zero aligned" is not sufficient for users to make a judgement on the company's target. The consultation paper should also remind the audience of the need to make realistic assumptions in terms of technologies not yet available at scale or presenting important social and environmental risks (e.g. negative emissions technologies) as highlighted by the IPCC's special report on 1.5C.

- **Going beyond what the climate scenario suggests:** considering the uncertainties associated with both climate and portfolio modelling, financial institutions should aim to go beyond what the models suggest and allow for an additional “buffer” when setting climate-related targets and/or measuring alignment. This buffer should take into account the probability associated with the scenario's carbon budget and any other caveat relating to the pathway the company or financial institutions is relying on (e.g. the IEA's Net Zero scenario makes unrealistic assumptions around deployment of CCS over the next 10 years. A financial institution should take this into account when setting a target for its energy portfolio and not simply “track” the scenario.
- **Complementing metrics and targets with robust sectoral policies:** Financial institutions should be reminded that metrics and targets will not necessarily prevent them from allocating capital to activities that are not Paris-aligned. A robust sector policy framework for the most carbon intensive sectors (e.g. thermal coal) is therefore necessary to complement the model. Sector policies and transition plan assessment frameworks should be articulated around clear expectations for clients' transition plans failing which they will be excluded within a specific timeframe.

In addition to the above, we were not sure if the FCA is asking firms to disclose their assumptions in reporting on their progress against targets. For example, it would be important to know what scenario the firm is using, how the firm sees this scenario, and whether it is reliant on technology such as carbon negative technology that does not exist.

Q14: Do you agree with our approach to additional metrics and targets? If not, what alternatives would you suggest and why?

No view.

Q15: Do you agree with our approach to governance, strategy and risk management, including scenario analysis at product or portfolio-level? If not, what alternative approach would you prefer and why?

We agree with this approach, subject to the FCA ensuring that it has the powers and capacity to review and assess climate-related reporting, as well as taking appropriate enforcement action, to ensure that ‘material differences’ in a firm’s approach do not impact on the quality and usefulness of reporting.

Q16: What form(s) could quantitative scenario analysis outputs at product or portfolio-level take? What do you consider the cost and feasibility of producing such outputs might be? How useful would such outputs be for users’ decision-making?

We would query whether two scenarios are sufficient, given the uncertainty around the various emissions pathways, and would recommend giving more direction on what firms should use. This will improve clarity and comparability in the data that is produced. We would recommend that one of these scenarios is a credible 1.5C aligned scenario.

Q17: Do you agree with our proposed approach that would require certain firms to provide product or portfolio-level information to clients on request? If not, what approach and what types of clients would you prefer and why?

We agree that the proposed requirements for certain firms only to provide data to clients on demand is proportionate. However, we would like to know what plans the FCA has to ensure that this data is of good quality and in a format that is accessible to clients, if it is not subject to external scrutiny.

Q18: Do you agree with our proposed approach for life insurers when mirroring an external asset manager’s strategy? If not, what alternative approach would you prefer and why?

Q19: Do you agree with our specific proposals for asset owners, including the proposed threshold to exclude the smallest default schemes? If not, what alternatives would you prefer and why?

No view.

Q20: Do you agree with the analysis in our CBA? If not, we welcome feedback in relation to the one-off and ongoing costs you expect to incur and the potential benefits you envisage. Contextual information about your firm's size and structure would be helpful

As we commented, climate reporting should be a normal cost of doing business for any regulated entity and will be far outweighed by the financial detriment of runaway climate change.

Yours sincerely,

Rachel Haworth

Policy Manager, ShareAction