STANDARDS BOARD FOR ALTERNATIVE INVESTMENTS

SBai
Standards Board for Alternative Investments

FCA Consultation Response

Enhancing Climate-Related Disclosures by Asset Managers, Life Insurers, and FCA-Regulated Pension Providers.

1. Introduction

The Standards Board for Alternative Investments ("SBAI") welcomes the opportunity to respond to the Financial Conduct Authority's ("FCA") Consultation Paper CP21/17 on Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers[1] ("CP").

At the SBAI we actively contribute to the global debate on Responsible Investment ("RI")[2] and have so far published two toolbox memos, a "Review of Responsible Investment Regulatory Expectations" and a "Responsible Investment Policy Framework", both of which are available in our Responsible Investment Toolbox.[3] The regulatory review highlighted the evolving regulatory landscape in this area and explored the spectrum of approaches and policy choices authorities face. Some of the findings of this review are set out further below (Section 2.1) allowing a comparison of the FCA's approach to global peers.

We support effective regulation and welcome efforts to enhance risk awareness and disclosure in relation to climate-related risks. Climate risk is one of many investment risks that (where applicable) need to be addressed as part of a fund manager's risk management process. In addition, adequate risk disclosure, of all types of risks, enables better investment decision making and facilitates the efficient pricing of risk and opportunities in global markets. Effective risk management and disclosure is at the heart of our Alternative Investment Standards[4].

We would welcome the opportunity to discuss any of the points raised below and our work on Responsible Investment in general with the FCA.

This consultation response contains:

1. Important high-level observations on the proposed approach (Section 2)
2. The responses to the consultation questions (Section 3)

2. High Level Observations on the Proposed Approach

Prior to responding to the specific questions in the CP, we would like to provide some context to the responses with observations on the below topics:

- Conclusions from the SBAI's own review of the global regulatory landscape for Responsible Investment,

[1] https://www.fca.org.uk/publications/consultation-papers/cp-21-17-climate-related-disclosures-asset-managers-life-insurers-regulated-pensions
[2] Also referred to as ESG
[3] https://www.sbai.org/toolbox/responsible-investment/
[4] https://www.sbai.org/standards/

- Considerations for effective regulation in Responsible Investment, and
- Observations on the key issues raised in the Consultation Paper.

2.1 SBAI Review of the Global Responsible Investment Regulatory Landscape

We published research into the global regulatory environment for RI in October 2020 (please find the full memo here). The research focused on regulation (both enacted and proposed) and guidance for issuers, investors, and asset managers. We intend to produce an updated version of this research in Q4 2021.

Observations from this memo, and our responses to similar consultations on this topic by other global regulators[5] that are relevant include:

- **Sequencing of Regulation:** There is a natural sequencing for RI regulation, with the mandating of issuers to disclose relevant ESG metrics as a starting point. This enables better informed investment decision making and reporting by fund managers and institutional investors.
- **Focus on Disclosure above Metrics:** Asset manager disclosure typically focuses on policy publication (detailing how RI-related risks are integrated into investment and risk management processes) rather than prescriptive metrics-based disclosure.
- **Concept of Standard and Enhanced Reporting Requirements:** For the most part, regulations only become more prescriptive and metrics-based where products hold themselves out to have a "Responsible Investment", "ESG" or "Sustainable" mandate. This is typically to address greenwashing concerns. Regulation generally includes a form of standard and enhanced reporting with enhanced reporting applicable to only a subset of the firms in scope.

In our responses below we refer also to CP21/18 Enhancing climate-related disclosures by standard listing companies and seeking views on ESG topics in capital markets[6]. This is due to the interrelated nature of issuer and asset manager disclosures as noted above.

2.2 Considerations for Effective Regulation in Responsible Investment

Effective regulation needs to consider many factors including the achievement of public policy objectives such as conduct, investor protection, market integrity, systemic stability, and market development. The proposed requirements in the CP focus primarily on disclosure to investors.

ESG Regulation Considerations – Investor Reporting

In general, regulation for RI-related investor reporting takes one of the following forms:

1. Disclosure-based reporting providing details of how ESG considerations are integrated into investment and risk processes, and
2. Metrics-based reporting that requires specific data points to be disclosed to investors on a portfolio or line by line basis.

Disclosure-based reporting includes descriptions of how ESG factors are considered in the investment process, and a written ESG policy. These disclosures are applicable to many asset managers. All financially material risks should be included in the investment process, and we view the integration of *financially-material ESG risks* as part of a robust investment and risk management process. Our

[5] https://www.sbai.org/regulatory-engagement/esg/
[6] https://www.fca.org.uk/publication/consultation/cp21-18.pdf

Responsible Investment Policy Framework memo[7] encourages the disclosure to investors of this process including the asset manager's approach to RI, process, data sources, and details of governance of the process.

Metrics-based reporting, however, relies on a chain of data availability. There are typically two ways for data to be obtained by asset managers:

1. Issuer Disclosure – Metrics data disclosed by the underlying issuers sourced either directly from issuer reporting or through a third-party data vendor, or
2. Engagement – Metrics data obtained or derived directly from through engagement with the issuer typically by the investment team.

We note that the FCA has mandated disclosure *aligned* with TCFD, currently for issuers with premium listings and proposes to expand this to standard listings in CP21/17. However, there are some inconsistencies between the two CPs that we discuss in Section 2.3 below.

UK asset managers are not restricted to investing solely in UK listed securities. Many portfolios will contain securities from other jurisdictions, private securities, and securities that are not equity related. This means that availability and quality of data will not be consistent for all UK asset managers regulated by the FCA.

Sourcing data via engagement with issuers is typically only practical in certain strategies and asset classes (as discussed further in Section 2.3). Third party vendors in this space will also have some limitations in terms of coverage, consistency, and reliability.

2.3 SBAI Key Observations on the CP

In general, we are supportive of regulation that encourages robust risk management processes and onward disclosure to investors. We support the FCA's consideration of other global regulatory regimes and internationally recognised reporting frameworks to promote standardisation within the industry. We have responded to the specific questions raised in the CP in Section 3. Prior to these responses we would like to highlight below what we view to be the key observations to the CP that may require some further attention.

Our Key Observations include:

- **Climate Focus** – As climate is a subsection of the environmental considerations in ESG risks, there are other facets of ESG that are material to the investment process. Climate will therefore have varied financial materiality depending on strategy, time horizon, and traded asset classes of the product amongst other considerations. We would support disclosure-based reporting in general but a more nuanced view on climate metrics reporting should be considered.
- **Lack of reliable ESG Data** – Whilst this is improving, the availability of data and agreed methodologies for the calculation of carbon-based metrics will be a substantial obstacle for the next few years. This will increase the risk of information-based gaps and potentially reduce accuracy. Considering this, we would be supportive of a phased implementation period with a series of milestones rather than one target date for full compliance.
- **Consideration of Asset Classes beyond Equities** – The data challenges detailed above are more acute for non-equity asset classes and in some cases for equity assets outside of

[7] https://www.sbai.org/wp-content/uploads/2019/05/SBAI-Toolbox-Memo-Responsible-Investment-Policy-Framework.pdf

developed markets. We would support a recognition of this via a level of flexibility in the requirements to explain where data is either unavailable or unreliable and therefore certain metrics or scenario analysis results cannot be provided.

- **Lack of Differentiated Standard and Enhanced Reporting** – All asset managers above the specified assets under management threshold are in scope for product level metrics-based reporting. This is inconsistent with other enacted and proposed regulations which typically have a concept of enhanced reporting for “ESG” labelled funds. We would support a degree of flexibility within the framework to allow firms to explain why certain metrics or scenario analysis is not appropriate for the product.
- **Level of Transparency Required in Reporting** – Product level reporting is mandatory for all in scope asset managers and full details of underlying holdings are required to be provided to a client on request. This level of transparency is inconsistent with similar proposed and enacted regulation and is likely to be inappropriate for commingled funds.
- **Inconsistency between Issuer and Asset Manager Regulations** – Issuers can report on a comply or explain basis, but full reporting will be mandatory for all in scope asset managers. Asset managers are subject to the same initial reporting deadlines as issuers. These points may present challenges for asset managers in collecting data and meeting the reporting deadlines. We would support appropriate sequencing of regulation showing an understanding that asset managers will be reliant on the production of data by issuers.

Climate Focus

We are supportive of the view that Environmental, Social, and Governance related risks (ESG risks) can be financially material to investment portfolios. We further believe that a robust investment and risk management process should include consideration of *financially material* ESG risks.

Climate is an important consideration for the global economy and beyond; however, it is a subset of environmental risks. Research by MSCI[8] highlights that G aspects are more financially material than E and S considerations over shorter time periods. Conversely, E and S indicators were more significant over longer periods (the study covered the period from 2006-2019). The study also highlights sectoral differences in terms of the impact of E, S and G, with G being particularly relevant in Financial and Consumer Discretionary GICS[9] sectors, while E showed strong significance in the Materials and Energy sectors. Information Technology, in contrast, was more affected by human capital issues (part of S). This research illustrates that, even looking purely at E risk, different issues have varying relevance for different industries.

This means that flexibility is needed to allow asset managers to focus their (sometimes limited) research and risk management resources on the risks that are most financially material to their portfolio. It would also avoid the appearance of elevating this single risk factor above other E, S and G related factors (alongside many other portfolio risks) irrespective of materiality to the strategy. This could dilute the effectiveness of a firm’s risk management process.

Note that the Principal Adverse Impacts under the EU’s Sustainable Finance Disclosure Regulation (SFDR) include environmental factors in addition to climate as well as social and governance factors.

Question:
Has the FCA considered that rather than a specific focus on climate-related risks, any process-based disclosures require details of all ESG risks that are material to the strategy and how these risks are integrated into the investment and risk management process?

[8] https://www.msci.com/esg/deconstructing-esg-performance
[9] Global Industry Classification Standard jointly developed by Moodys and Standard & Poor’s

Consideration of Asset Classes Beyond Equities

The asset management industry is diverse in terms of investment strategies and asset classes. Climate-related risk has varying financial materiality depending on:

- Investment Process - For example systematic vs. fundamental analysis,
- Asset Classes - Equities, fixed income, commodities, FX, infrastructure, and others,
- Investment Rationale - For example short term arbitrage strategies vs. long-term appreciation strategies, and
- Typical holding periods for the portfolio.

The below table illustrates some examples of how these factors can impact the benefits of disclosure of climate-related metrics for different strategies. Our Responsible Investment Working Group is currently finalising detailed guidance of the practical implementation of ESG within different alternative investment strategies which we would be happy to discuss with the FCA in more detail.

Typical Strategy and Asset Class Considerations[10]

Strategy	Considerations
Systematic or Quantitative Strategies	▪ Investment teams typically focus on quantitative analysis. Therefore, resource is not dedicated to fundamental research which may be required in asset classes where there is a lack of publicly available information. ▪ A larger number of individual positions and a typically shorter holding period limits direct engagement to source data. ▪ Metrics-based reporting will be a snapshot in time and may not be representative of the strategy over time. ▪ Shorter holding periods and the trading of asset classes such as Futures, Options, and FX, mean the materiality of climate-related risks can be limited.
Macro Strategies	▪ FX and Sovereign Debt instruments have limited scope for direct engagement. There will be heavy reliance on publicly disclosed data which is only available in certain (and typically more developed) jurisdictions. ▪ Macro strategies trade a wide range of asset classes not all of which will be materially impacted by climate-related risks. ▪ Metrics-based reporting may only be practical for a subset of the portfolio and would therefore not be representative of the strategy.
Equity Long/Short Strategies	▪ ESG data availability can be limited depending on factors such as mandated issuer disclosure in the relevant jurisdiction and the size of the companies in the investment universe (for example, large caps will tend to have more resources to report this information). ▪ Shorting of stocks can cause metrics-based reporting to be inaccurate if not treated properly. ▪ The use of short positions and derivatives may limit opportunties to source data via direct engagement. ▪ Private equity, private placement, or pre-IPO issuers may not routinely disclose this information and direct engagement will be required to source this data.

[10] Observation: Within each of these investment strategies, some managers will have dedicated products marketed with attributes such as "ESG", "Responsible Investment", or "Sustainable" with a higher resource allocation to researching these issues and therefore capability for more comprehensive reporting catering to specific investor preferences.

Credit	▪ Whilst debt issued by listed companies can rely on issuer disclosed data (where this is mandated), data for other debt instruments such as distressed credit, structured credit, and syndicated loans may not be available or easily obtainable. ▪ Depending on the duration and seniority of the debt instrument, climate-related risk may be less financially material than, for example, governance risk.

Carbon metric reporting is still in its infancy and most work on methodologies has been focused on equities. Methodologies for other asset classes are not yet well understood or standardised.

Question:
Has the FCA considered making any carbon metrics mandatory for equity investments and other listed company issued assets only, with other asset classes reported on a best-efforts basis?

The FCA's cost benefit analysis indicates that climate risk disclosures would improve investment decision making processes and transparency, and therefore investor outcomes. Whilst this is true in situations where climate risks are financially material, there are some caveats to this view that should be considered:

- The dedication of resources to producing carbon-based metrics reporting where climate risk is not financially material could be detrimental to the investment process by reducing the resources available to consider other financially material risks.
- The proposed reporting frequency is annual. We are not proposing this be increased but it should be noted that, outside of long term buy and hold strategies, this will be reporting on a snapshot in time and could therefore be misleading to investors if there is a high turnover of positions in the portfolio during the year.

Lack of Differentiated Standard and Enhanced Reporting

In our research on the global regulatory environment and responses to other global regulatory consultations on the topic of climate related risks, we have observed that enacted or proposed regulation typically has two levels of reporting:

- Standard or Core Reporting: Applicable to all asset managers that are in scope.
- Enhanced Reporting: Applicable to a sub-set of in scope managers based on a prescribed threshold or criteria.

As an example, the reporting of Principle Adverse Impact metrics under SFDR can be opted out of by companies with less than 500 employees.

We note that the FCA consultation states that only firms with assets under management (AUM) greater than GBP 5 billion will be in scope, however, we would also note that AUM does not necessarily correlate with the number of employees and therefore resources available.

Question:
Has the FCA considered adding a firm size threshold to the reporting of carbon metrics in addition to an AUM threshold?

Level of Transparency Required from Reporting

Product level reporting is proposed to be mandatory for all in scope asset managers. In addition, there is a requirement for asset managers to provide details of underlying positions to clients on request. This level of transparency is unusual in this type of regulation, note that in SFDR entity level disclosures are

required for all asset managers, but product level information is only mandatory for funds that are marketed as considering or focused on sustainability.

Providing full transparency of underlying positions to clients who request this may also result in some investors having more information than others about the workings of the fund.

Question:
Has the FCA considered making only entity level reporting mandatory for non-ESG funds?

Inconsistency between Issuer and Asset Manager proposed Regulations

We note from CP21/18 for issuers, that the current Premium Listing rules are proposed to be extended in the same format to Standard Listing Issuers. These rules currently require "TCFD-Aligned disclosure" on a comply or explain basis (noting that the expectation is that issuers comply rather than explain). For clarity, the issuers are not mandated to provide carbon-based metrics, but the CP indicates that this will be mandatory for asset managers above the AUM threshold.

As noted previously, asset managers (and many third-party data vendors) will be heavily reliant on publicly disclosed data from issuers. Should issuers choose to explain all or part of the TCFD disclosures then this data will not be available for onward reporting by asset managers.

Question:
Has the FCA considered proposing mandatory requirements for asset managers that are in line with the disclosure requirements from issuers?

The proposed implementation timeline for asset managers matches that given for issuers in CP21/18. As asset managers will be heavily reliant on the disclosures from issuers, this may present challenges to the reporting timelines.

Question:
Has the FCA considered moving the implementation timeline for asset managers to a date later than that for issuers for example one year after issuers are required to report?

3. Responses to CP Questions:

Please find below our responses to the specific questions raised in the CP. We would be happy to discuss any of these further with the FCA.

Question 1: 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.

We support the adoption of a concept of proportionality in this CP. We also agree that for any benefit to investors to be meaningful, there should be broad coverage for the regulations.

As highlighted above, AUM does not necessarily correlate with the number of people or resources in an organisation. Given the complex nature of the requirements, the SBAI would be more supportive of an additional exemption for firms with less than a specified number of people. This is the approach taken by the EU under SFDR which allows firms with less than 500 employees to opt out of reporting the individual metrics.

The FCA could consider applying this threshold with a requirement to provide the reporting on request to investors who require it to meet their own climate related regulatory requirements.

We note that the proposed threshold would many smaller or more niche funds, but asset owners may be required to report where they are invested in these funds. The FCA may wish to consider a lighter or more flexible reporting framework for smaller firms.

Question 2: Do you agree with our proposed scope of products? If not, what types of products should, or should not, be in scope and why?

The current proposal requires that the in-scope products will be mandated to provide a core set of metrics as well as additional metrics and make these available publicly on a website or similar. This is applicable regardless of the strategy of the fund or whether it has an ESG objective or not. Products run for single clients would be subject to a requirement to produce this reporting once a year if requested by the client.

We believe the FCA should consider core and enhanced reporting where only a sub-set of these products would be in scope (for example those that market themselves as ESG funds) to regularly provide these metrics at a product level. As noted in the FCA's cost benefit analysis, the collation and potential calculation of these metrics is time consuming and requires specific expertise. Where a fund does not have or market an ESG objective, and particularly in cases where climate-related risks are not as financially material as other risks, the requirement to report these metrics could divert time and attention away from the proper running and risk management of the product.

In addition, we believe the FCA should consider a comply or explain basis for portfolios that do not trade equities or debt securities issued by listed issuers. This is because methodologies to calculate the required metrics are not necessarily in place for other asset classes and the difficulties in collating the data described in Section 2 above. We note that in Section 3.34 of the CP it states that "we are providing limited flexibility for firms to provide some disclosures on a "best efforts" basis, for example where methodologies for certain metrics are not yet widely established.". It may be useful to provide some clarity on where this approach is likely to be acceptable to the FCA.

Question 3: Do you agree with our phased implementation and timings? If not, what approach and timings would you suggest and why?

We support the phased implementation of these regulations which allows smaller firms more time to prepare for reporting.

As discussed in Section 3 above, we note that the reporting deadlines match those proposed for issuers in CP21/18. In our opinion, it would be better to include the issuer reporting deadlines in the phased implementation of these regulations. Issuer deadlines would be first, followed by larger firms after an interval, and then smaller firms after another interval.

Asset managers will be heavily reliant on the data provided by issuers and with similar reporting timelines this may not leave enough time for asset managers to complete their reporting by the deadlines.

Question 4: 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.

For assets domiciled in a jurisdiction where many listed assets provide either mandatory or voluntary disclosures the use of proxy data and assumptions may be appropriate to address any data gaps.

For assets domiciled in a jurisdiction where there is little or no disclosure, or asset classes that are not linked to a corporate entity (such as FX, some structured credit, or interest rate securities), there may not be a suitable level of proxy data or information available for appropriate assumptions.

Clarifying that certain asset classes, such as non-corporate linked securities, could provide these metrics on a best effort or comply or explain basis may solve this issue.

Question 5: 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?

The provision of a TCFD entity report for all in scope asset managers is in line with other regulations such as SFDR. We agree with the approach to be able to cross-refer to other reports to avoid duplication of work; however, these reports must be clearly linked and easily accessible to the investor.

Question 6: 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 disclosures under the governance, strategy, and risk management pillars of TCFD reporting; however, would suggest that the scenario analysis section of the strategy pillar should not be mandatory for all asset managers in scope.

We note that Section 4.30 of the CP regarding scenario analysis states "The process and outputs can help firms identify key drivers of climate-related exposure and thereby enhance their risk and investment decisions". As noted above, this is not necessarily true in all strategies and asset classes. Where there is limited financial materiality from climate related risks compared to other ESG risks this approach could be detrimental to risk and investment processes by requiring a disproportionate amount of time to be spent on climate scenario analysis to satisfy these regulations. It could also be misleading to investors by focusing prominently on this risk when other risks may be more financially material.

An alternative approach could be to provide the flexibility for asset managers to not provide the detailed scenario analysis information in their annual reports. These managers could instead be required to provide an explanation for why this is not appropriate. The explanation should include detailed reasons why climate related scenario analysis would not be beneficial to the risk or investment process. An example of where this might be appropriate is in a momentum or trend following systematic strategy that trades only FX and futures. In this instance there is likely limited financial materiality of climate related risks, particularly in fast trading or high frequency trading funds.

Question 7: 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?

Assuming that these climate-related targets are at the entity level as opposed to the portfolio level then we agree with this approach. Requiring these targets at a portfolio level would mean that all funds run by UK authorised asset managers would essentially become "ESG" funds.

Question 8: 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?

We support the proposal to allow these AFMs to cross-reference or link to relevant climate-related financial disclosures made by delegated managers where available.

Section 4.4 of the CP states "We recognise that it may not always be possible to link to delegated managers' reports, for instance if these are overseas firms that do not have mandatory climate-related disclosure obligations. Where this is the case, the firm should produce its own disclosures according to the rules and guidance set out earlier in this chapter".

We would note that if investment management has been delegated to a third-party manager, that the resources and skill sets that remain inhouse at the AFM may not be adequate to complete the proposed entity level and product level reporting, in particular the scenario analysis and metrics-based reporting. This will be compounded where investments are in asset classes where there is limited data availability or agreed methodologies for carbon-based metrics. We also note that the requirement for all asset managers to complete climate scenario analysis is beyond what is required in other enacted or proposed legislation and as such is unlikely to already be completed by any overseas managers.

Our earlier proposals of limiting climate scenario analysis to entities that run strategies where climate risk is financially material may alleviate some of this operational burden.

Additionally, the requirements in 4.44 (asset managers) and 4.48 (asset owners) to account for climate-related matters in their selection of managers may be challenging in some settings, for example a relationship established prior to the reporting obligation coming into effect. The FCA may wish to consider extending this to include an explanation of how climate-related matters are factored into the ongoing monitoring of such delegates.

Question 9: 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?

We support the ability for asset owners to be able to cross reference relevant reports. In addition, we support the TCFD entity level reporting to be restricted depending on the level of involvement in the investment decisions.

Question 10: Do you agree with the 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 public disclosure of portfolio level information is not appropriate in certain circumstances such as separately managed accounts and single investor funds.

Public disclosure may be appropriate for other funds; however, we would repeat our suggestion that detailed climate specific metrics-based reporting may be more appropriate for a sub-set of in scope products such as those that have specific ESG objectives or where climate is a financially material risk.

The provision of details of the underlying positions in the portfolio is out of line with many other proposed or enacted regulation in this area. It is not clear what benefit this would provide to investors if the provision of metrics and scenario analysis to clients is already mandated. By providing this on request to investors it could mean that some investors would have more information on the workings of the fund than others. Reporting exposures at a GICs sub-industry level may be more appropriate and, combined with other frameworks such as the Sustainability Accounting Standards Board (SASB) materiality map provides the information for investors to have the appropriate discussions with asset managers on where financially

material ESG risks are present in the portfolio. This is the approach that the SBAI will be taking with an update to the Open Protocol Risk Reporting[11] template in September 2020.

Question 11: 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?

As outlined in Section 2, the proposed metrics are not aligned with the proposed reporting requirements for listed issuers. This will mean that data may not be readily available. In addition, as also discussed in Section 2, for asset classes outside of equities this information is not necessarily mandated to be disclosed and as such could require extensive resources to collate – this may mean resources are dedicated to sourcing climate related data in a strategy where climate is not necessarily financially material.

We note that section 5.13 of the CP states that an aim of these mandatory metrics is that "Clients and consumers would be able to…hold their providers to account for any claims made." We support this as an objective but note that this could also be achieved by applying the scope for products to produce these mandatory disclosures to products that make these claims as opposed to all products.

Question 12: 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.

Section 5.17 of the CP requires that where TCFD calculations differ from SFDR that the metrics should be produced using both methodologies. To achieve the comparability between products, it may be more appropriate to allow firms to select one or both methodologies in line with their requirements providing that clear disclosure it made on which methodology has been used.

Question 13: 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 agree that it makes sense to use the final TCFD guidance.

Question 14: Do you agree with our approach to additional metrics and targets? If not, what alternatives would you suggest and why?

Section 5.27 of the CP states that "firms **must** supplement the core, mandatory, metrics with certain additional metrics on a **"best-efforts"** basis" (emphasis is ours). It may be helpful to provide more guidance on this. Does the FCA expect that all firms should do this unless there is a valid reason not to and if so, what scenarios would the FCA envisage as an acceptable reason not to provide these metrics?

We agree that where a firm makes a claim to achieve certain climate-related targets at the product level that they should determine and communicate key performance indicators. In our ESG/RI Policy Framework guide[12] we recommend that for any ESG related objectives in a portfolio, asset managers should establish and disclosure how these will be measured and monitored on an ongoing basis.

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[11] https://www.sbai.org/toolbox/open-protocol-op-risk-reporting/
[12] https://www.sbai.org/wp-content/uploads/2019/05/SBAI-Toolbox-Memo-Responsible-Investment-Policy-Framework.pdf

Question 15: Do you agree with out 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 the approach that quantitative scenario analysis would not be mandated for portfolios that do not have concentrated or higher exposures to more carbon-intensive sectors. We would also refer to Section 2 above noting some of the strategy specific considerations that should be taken into account here. As an example, in a short term or fast trading strategy any such reporting will be a snapshot of a point in time. A snapshot that provides a favourable scenario analysis at that point in time may not be representative of the strategy over time, and vice versa. Point in time reporting on portfolios that regularly change their positions may be misleading to investors in the absence of proper discussions on the topic with the asset manager.

Section 5.53 of the CP states that "we note that specialist service providers are available to help firms in conducting their scenario analysis or building the capabilities to do so." It should be noted here that this may not be an accurate statement for asset classes outside of those issued by corporations such as derivatives, structured credit, and syndicated loans amongst others.

Question 16: What form(s) could quantitative scenario analysis outputs at product or portfolio-level take? What do you consider the cost and feasibility of producing outputs might be? How useful would such outputs be for users' decision-making?

The usefulness for decision-making of this scenario analysis will be highly dependent on the strategy and the asset class. As noted previously, point in time reporting is not necessarily representative of portfolios in general for certain strategies.

This also assumes that investors are making their decisions based on climate factors which may not necessarily be the case where climate is not a financially material risk. Where other ESG factors are more financially material, for example the G in credit assets, dedicating resources and attention to climate factors may be a distraction within the decisions making process.

Question 17: 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?

Noting our concerns raised previously on providing portfolio-level information, we agree that for the clients stated, on request reporting is appropriate. The FCA could also consider making this the approach for products where asset managers can demonstrate that climate is not a financially material risk.

Question 18: 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?

This approach would appear to make sense.

Question 19: 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?

This is outside of the scope of the SBAI, so we have no comment on this proposal. We do note however, that a threshold to exclude smaller funds from product level disclosures exists for this category of asset

owners, but there is no such threshold for asset managers. This means that smaller funds, or funds in wind-down would still be required to produce product level information at asset managers.

Question 20: 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.

We welcome the FCA's consideration that there will be a cost involved in regulation of this type and the attempt to quantify this against the perceived benefits.

We would raise the below points:

Section 18 of the Cost Benefit Analysis (CBA) states: "Asset managers and asset owners have a fiduciary responsibility to protect and enhance the value of assets for clients and consumers. This includes accounting for all financially-material risks. As set out in Chapter 2, asset managers and asset owners are not currently disclosing sufficient climate-related information to enable clients and consumers to make informed financial decisions and hold their providers to account". Whilst we agree with the first part of this paragraph, the final sentence in this paragraph appears to assume that climate is always a financially material risk. As noted throughout our response this may not necessarily be the case in all strategies.

Sections 21 and 22 of the CBA note that many in-scope firms are signatories to the Principles for Responsible Investment (PRI) and as such the findings of the PRI's analysis on level of progress in reporting against the TCFD's recommendations is illustrative of firm's readiness for this type of reporting. We would like to draw your attention to the issues that have been faced by many PRI signatories in reporting under the TCFD framework which has resulted in 2020 reporting being delayed until 2023[13]. The FCA may wish to consider the issues that arose here as similar issues may appear on the adoption of any regulation.

Section 24 of the CBA details some of the assumptions that have been made. Under "Sourcing data" there is the following statement "Where data already exist, some firms may choose to subscribe to data services to facilitate access to the public sources, and many firms already do so." We would qualify this statement in that it is likely mainly true of equity investors and not necessarily representative of strategies that invest outside of equities.

Section 28 of the CBA states "Greater transparency about how firms are managing climate-related risks and opportunities will lead to better outcomes for clients and consumers". This is one of the main assumptions that underly the benefits in the CBA. We would note that this statement would not always be true – where climate is not a financially material risk the dedicating of resources to source the required data and report to investors could be detrimental to the investment and risk management processes and therefore lead to potentially worse outcomes for clients and consumers.

Section 36 of the CBA assumes that it will take approximately one and a half hours to read the policy document and understand the requirements. It appears that this is based on 20 people at large firms and 5 people at medium firms reading this documentation. We would note that AUM does not necessarily correlate with number of employees and that many firms may require external party costs in addition to internal resources.

[13] https://www.unpri.org/reporting-and-assessment/reporting-framework-pilot-next-steps-for-signatories/8159.article

Within Table 4 there is a section that estimates the cost for "Coordination of disclosure inputs across functions". Bullet point 4 notes the various functions that may provide input into this process. Notably, Investment Teams, are missing from this list. Whilst this may be appropriate in strategies such as equities where underlying data is more readily available, it is likely that investment team input for these disclosures would be required for other asset classes or non-developed market equities. This would increase the cost section under the methodology that has been used. Bullet point 8 estimates the cost of data, this appears to be underpinned by an assumption that climate data is available for the asset classes and does not consider strategies or asset classes where sourcing this data may require direct engagement for each underlying position, likely making use of the investment team.

Section 44 of the CBA states the benefits of the proposal. The fourth bullet point states "This should encourage [financial providers] to manage climate-related risks and opportunities effectively and direct capital towards projects and activities that better support the transition to a more sustainable, low-carbon economy." We would note that disclosure of climate-related risks does not necessarily mean that investment decisions will be taken on this basis (outside of funds that have dedicated climate objectives). This proposed benefit seems to imply that all funds will eventually become "ESG" funds i.e., funds that have specific ESG objectives as opposed to those that simply account for financially material ESG risks. In our view, whilst investors may choose to direct their capital to funds that align with their own ESG objectives, any focus on moving towards a sustainable, low-carbon economy should be in regulation directed at corporations as opposed to asset managers.

Section 45 of the CBA states "As the estimated costs of compliance are low relative to assets under management, only a small improvement in investment decision-making as a result of these proposals would be sufficient to outweigh the costs and produce a net benefit." This sentence is underpinned by the assumption that disclosure and measuring carbon metrics results in better investment decisions – this is not necessarily accurate as an investment with "better" carbon metrics could still be a bad investment from a fiduciary point of view – particularly if risks other than climate are more financially material.