CFA Society United Kingdom

30 September, 2020

Mark Manning and Federico Cellurale
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Submitted by e-mail to: cp20-03@fca.org.uk

Dear Mr. Manning and Mr. Cellurale,

CFA UK response to the FCA regarding CP20/3: proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations

The CFA Society of the UK (CFA UK)[1] is delighted to have the opportunity to share its views on this consultation paper from the FCA. We are also grateful for the dialogue we have been able to have on the topic over the past few months.

Climate change, and society's response to it, is having an increasingly profound impact on the global economy and in turn the investment world in which our members work. Investment professionals need high quality information to assess the risks and opportunities that climate change presents to the companies they invest in, and this is currently lacking. In a survey of our members[2], 82 per cent of respondents found the lack of reliable data and metrics to be a challenge in integrating climate considerations into investment decision-making.

Ensuring that the inadequate state of climate change reporting is quickly addressed is important to our members, their firms and clients. Fewer than 7 per cent of respondents to our membership survey said that they did not consider climate change to be a material risk or opportunity, while 60 per cent considered it to be material to their firms' entire portfolio.

Out of necessity the investment world is undergoing a major upheaval in a drive to measure, analyse, understand and respond to climate change and broader ESG risks. CFA UK and CFA Institute are playing their part in this:

- CFA UK last year launched its Certificate in ESG Investing[3]. More than 2,500 individuals (around 75% from the UK) have registered for the exam.
- CFA UK is also investigating the launch of a similar qualification specifically on the issue of climate change in investment;

[1] CFA UK's mission is to help build a better investor profession for the ultimate benefit of society. We refer you to Appendix 1 for a brief overview of both CFA UK and our umbrella organisation, CFA Institute.

[2] CFA UK conducted two surveys: (i) a full membership survey (https://www.surveymonkey.com/results/SM-QB27S8GG7/), sent to the entire membership of CFA UK, on the broad topic of climate change and investment, which received 330 full or partial responses, and (ii) an expert group survey (https://www.surveymonkey.com/results/SM-GN7HGM8B7/), which canvassed a subset of the membership survey sample composed of members willing to volunteer for our advocacy work on climate change disclosure. This second survey received 49 responses.

N.B. Please consider the make-up and sample size of these cohorts when reviewing the results we cite.

[3] CFA UK Certificate in ESG Investing (https://www.cfauk.org/study/esg#gsc.tab=0)

- CFA Institute is currently consulting on a set of ESG Standards for Investment Products[4]. These standards aim to provide a common global framework by which the ESG focus and/or activities of all pooled investment vehicles will be capable of being described to end investors and other stakeholders in standard and universal terms;
- CFA UK and CFA Institute advocate widely on stewardship, ESG and climate change issues. CFA Institute recently produced a specific report on Climate Change Analysis in the Investment process[5.] We are pleased to provide a list of CFA UK's other recent consultation responses in these areas as Appendix III.

CFA UK believes that good climate change reporting will help institutional investors allocate capital in a way which safeguards their clients' investments as much as possible from the impacts of climate change. It should also help to improve access to capital for those companies working to mitigate those impacts. Equally, good climate change reporting should result in capital becoming scarcer and more expensive for those companies and activities which contribute most to the climate crisis.

A team of CFA UK members with a strong interest in climate change reporting have collaborated to produce our detailed responses to the specific questions in your consultation paper, and these are set out in Appendix II. Due to the extended consultation period, the team has been able to shape and support these answers with (i) a membership survey that was sent to every CFA UK member (the membership survey), (ii) a follow-up survey, sent to a subset of the first, canvassing those especially interested in climate change reporting (the expert group survey), and (iii) approximately twenty interviews with issuers, financial intermediaries and investors. Details of the two surveys are provided in the links within footnote 2.

In the second, expert group survey, the working group invited respondents to identify the methodological and data-related difficulties that they faced in establishing the materiality of climate-related risks. We felt this information might be useful to the FCA in shaping proposals, and we provide it here as the input did not fit with the specific questions in the consultation paper in all cases. While many respondents to our surveys referred to the lack of comparability, reliability and consistency of data, the breadth of opinions, concerns and issues which surfaced and are cited below is illustrative of the depth and complexity of the problem. Their concerns included:

1. The predictive quality of most disclosures is poor; they are predominantly backward-looking
2. Establishing opportunity costs (the cost of not doing something) and externalities (the unmeasured consequences of doing something) is a challenge
3. They need companies to use consistent calculation methods and verification
4. The actual cost of climate change and the probability of it occurring in the future (if at all) is unknown
5. The impact that future technological progress will have on the costs and extent of climate change should be acknowledged
6. There are differing methods of measuring data
7. The lack of a common framework across countries making global comparability difficult
8. Differences in disclosure obligations for debt and equity makes comparability across asset classes difficult

---

[4] CFA Institute consultation paper into proposed ESG Standards for Investment Products (https://www.cfainstitute.org/-/media/documents/code/esg-standards/consultation-paper-on-esg-disclosure-standards.ashx)

5 Climate Change Analysis in the Investment Process (https://www.cfainstitute.org/en/research/industry-research/climate-change-analysis)

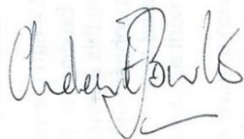
9. The lack of a carbon price or agreed future pricing hinders the assessment of future economic costs
10. The scale of the potential physical impact of climate change is unknown
11. There is a lack of timeliness, comparability and reliability of data
12. Measuring the second-order effects of climate change, e.g. life insurance, will be an important factor
13. The reliability of third-party disclosures along a complex supply chain is in question
14. There is a lack of confidence in the accuracy of measurements and the predictions of scenario models
15. The variability of impact on different industries hinders comparability
16. A lack of detailed guidance leaves much room for subjectivity
17. There is a difficulty in assigning probabilities to different scenarios
18. There is a lack of investee knowledge, understanding, and in some cases any motivation to disclose
19. Most companies do not disclose climate-related risks, so there any significant data gaps
20. There is a lack of relevant scenarios from the IPCC/IEA to determine risk in certain areas

CFA UK welcomes the FCA's consultation paper on this matter of fundamental importance to the investment profession and broader society, and we appreciate this opportunity to share our views.

Should you have any questions or points of clarification regarding this letter or our responses to the questions, do not hesitate to contact us.

Yours sincerely,

Will Goodhart,
Chief Executive
CFA Society of the UK



Andrew Burton
Professionalism Adviser
CFA Society of the UK

With thanks to contributions from:

Adam Forsyth (Chair), ASIP
Caroline Bault, CFA
Amit Bisaria, CFA
Robin Black, CFA
Irina Grossu, CFA
Peter Hyde, CFA
Caroline Lis, CFA
Jonathan Parker, CFA
Kevin Paul, CFA

and the oversight of the Professionalism Steering Committee.

APPENDIX I: About CFA UK and CFA Institute

CFA UK serves nearly twelve thousand leading members of the UK investment profession. Many of our members work with pension funds, either managing investment portfolios, advising on investments, or as in-house employees responsible for pension investment oversight.

- The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests.
- Founded in 1955, CFA UK is one of the largest member societies of CFA Institute and provides continuing education, advocacy, information and career support on behalf of its members.
- Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.
- For more information, visit www.cfauk.org or follow us on Twitter @cfauk and on LinkedIn.com/company/cfa-uk/.

CFA Institute is the global association for investment professionals that sets the standard for professional excellence and credentials.

- The organisation is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow.
- It awards the Chartered Financial Analyst® (CFA) and Certificate in Investment Performance Measurement® (CIPM) designations worldwide, publishes research, conducts professional development programs, and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.
- CFA Institute has members in 162 markets, of which more than 170,000 hold the Chartered Financial Analyst® (CFA) designation. CFA Institute has nine offices worldwide and there are 158 local member societies.

For more information, visit www.cfainstitute.org or follow us on Twitter at @CFAInstitute and on Facebook.com/CFAInstitute.

Context to our responses to the questions

The CFA UK supports CFA Institute by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society. This includes maintaining the public's trust in financial markets and in the investment profession.

One of the CFA Standards of Professional Conduct, germane to climate change disclosure, is:

> "Members and Candidates must:
>
> 1. Exercise diligence, independence, and thoroughness in analysing investments, making investment recommendations, and taking investment actions.
> 2. Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action."

We are therefore keen to see climate change disclosure being of practical use to investment professionals.

CFA Society members are present in many types of firms and in a variety of professional roles. Some examples will bring this to life:

Supporting fair valuation

Objective valuation of equity and debt instruments by investors is essential for robust capital markets. Valuation disciplines require the forecasting of cash flows, the determination of risk premia and discount rates, comparability across companies, etc., and material upside or downside due to climate change needs to be reflected in valuations. Research analysts and sell side brokers will be particularly interested in understanding the climate change risks and opportunities faced by the firms that they cover.

Disclosure and transparency

As the asset management industry gears up for greater transparency on ESG and climate change, the quality of information it provides will depend on what is reliably and consistently available from the underlying issuers of equity and debt into which its funds invest.

Incorporation in portfolio construction

Consistent data and metrics on climate change, and disclosure of the same, will feed into the portfolio construction process and allow better incorporation of climate-change-related risks and rewards into the process. As climate change is seen to be largely a non-diversifiable risk, it could have a material impact on risk expectations.

Fund design

A better understanding of climate change will assist the investment process of equity and debt funds while facilitating the construction of appropriate fund mandates reflecting, for example, any constraints on climate-change-related risks and impacts. ESG-oriented funds, needless to say, will benefit even more from meaningful disclosure.

Stewardship & Engagement

Improved climate change disclosures will enable analysts and portfolio managers to raise climate change issues much more effectively with company boards where they are a matter of concern. This engagement could then also extend to the tabling and voting on well calibrated and focused climate change related resolutions at company AGMs.

We would also like to take this opportunity to highlight the case studies within Part II of CFA Institute's recent publication on Climate Change Analysis in the Investment Process as examples of how investors use climate change data in their work today[6].

[6] Climate Change Analysis in the Investment Process (https://www.cfainstitute.org/en/research/industry-research/climate-change-analysis)

APPENDIX II: Responses to questions

Here we provide our answers to the 19 questions of the FCA's consultation paper, adding context from the interviews we conducted where pertinent.

Q1 **Do you agree that our new rule should apply only to commercial companies with a premium listing, at least initially? If not, what alternative scope would you consider to be appropriate, and why?**

CFA UK

CFA UK agree with the FCA's proposed approach as a practical solution in the short-term.

We believe, however, that the new rules should soon come to apply to all commercial companies that pass a materiality threshold, whether determined by turnover or market capitalisation or both. Such a materiality threshold ought to be set such that it includes a wider range of companies.

Additionally, in an investment context, many climate change related risks cannot be diversified away and so become a systemic consideration applying to all companies.

Private firms should be in scope once issues with the policy have been ironed out and there is more clarity and harmonisation with respect to the metrics that are to be disclosed.

We note that the Companies Act already has definitions of medium and small companies and that the medium definition (Section 465) might provide an established materiality criterion for the purposes of bringing unlisted companies mandatorily within scope. In the meantime, private companies could make use of the voluntary provisions in the Wates Proposals of the FRC's Corporate Governance Code to adopt TCFD reporting.

Surveys

In CFA UK's expert group survey, 60 per cent of respondents felt that ultimately the new rule ought to apply to all UK-listed companies plus private companies above a certain size, and 82 per cent felt that size ought to be a function of sales (40 per cent) or market capitalisation (42 per cent).

Interviews

Interviewees agreed that the rule should be extended beyond premium listings at some point, noting that requiring listed companies to make additional disclosures without applying the same treatment to private companies may disincentivise companies to list. One interviewee involved in private equity noted that IPOs remained a common exit route for their investments and so they were adopting TCFD reporting across all their portfolio investments.

Q2 Do you agree that sovereign-controlled commercial companies with a premium listing should also be in scope? If not, why should these companies not be included?

CFA UK We do not see any strong commercial or regulatory reason why government-controlled commercial companies should not be included.

We think that including all companies, including sovereign-controlled commercial companies, will strengthen rather than detract from London's brand as a listing venue. It will also contribute to a level playing field.

Sovereign-controlled companies are presented here with an opportunity to show leadership. Perhaps they can be encouraged to do so.

Surveys 60 per cent of the CFA UK expert group survey respondents felt that the new rule ought to apply to all UK-listed companies.

Interviews One Finance Director we interviewed commented that he found it ironic how often UK government companies were late-payers even though UK government policy was to speed up invoice settlement. He hoped that UK government controlled companies would show leadership in this area.

Q3 Do you agree with our approach?

CFA UK We agree with the FCA's approach of starting with asset managers that are premium-listed in their capacity as companies and not their capacity as managers of client assets.

However, we encourage the inclusion of asset managers, in their capacity as managers of client assets, fairly quickly thereafter.

Even at this later stage, disclosure requirements should be proportionate, and CFA UK supports a mechanism that prevents undue impositions on smaller investment firms. A threshold such as assets under management or the exclusion of small and non-interconnected investment firms (SNIs; we refer to article 12 of the EU's Investment Firms Regulation in relation to MiFID firms) may be in order for a period of time.

The asset management industry is global in nature – funds are raised and invested globally – and the FCA ought to harmonise its approach with other regulators to keep the UK asset management industry at the forefront.

For example, there is pressure for asset management companies to comply with the EU taxonomy. The Sustainability Accounting Standards Board (SASB)

and the Global Reporting Initiative (GRI) are worth considering, but the TCFD reporting framework is the best available and is supported by the EU taxonomy, which will eventually require disclosure at the fund level. We are also aware that EU requirements on disclosure for asset managers, which go further than TCFD, are set to be implemented from end-2021 onwards.

Several issues around asset managers as managers of client assets require further investigation, including the impact of where assets are located and the legal entity they fall under. Even now, a number of specialist advisory and infotech firms are providing fund-level analysis to asset managers to assist with disclosure issues we examine here.

We believe that the FCA's supervisory role with regard to fund managers is as relevant here as its role in setting reporting standards. The ability to encourage asset managers both to report on TCFD and to integrate climate considerations into their work and their understanding of fiduciary duty to their clients, is potentially an effective route to achieving the goals of the consultation proposals.

We note also the recently released consultation paper from the Department of Work & Pensions[7] on climate change reporting for pension funds and that the proposal therein is for mandatory compliance for the largest schemes representing 80% of UK DB and DC pension AuM within 2-3 years. Whilst acknowledging that pension schemes are different to funds and that pension scheme members may at times have different needs to investors in funds, we believe the UK's regulators should be broadly consistent and that the UK asset management firms should not become laggards in the adoption of climate change reporting obligations. We note that many asset managers will wish to compete for pension business and that TCFD compliant disclosures at the fund level will quickly become a pre-requisite of doing so.

Q4 **Do you agree that our rule should reference the 4 recommendations and 11 supporting recommended disclosures included in the TCFD's June 2017 final report? If not, what alternative approach would you prefer, and why?**

CFA UK The TCFD framework encourages companies to report on the current intensity of their operations while looking ahead to how they might address risks and opportunities. This lays the foundation for a discussion about strategy and capital allocation.

[7] https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes

Moreover, TCFD provides a clear path to incorporating climate factors into the financial statements, outlining a number of channels through which transition risk and physical risk may influence the income statement and balance sheet.

If companies follow these recommendations, investors will be in a better position to gauge materiality and to make a rounded assessment of corporate performance and valuation.

Surveys

Our CFA UK expert group survey found that 58 per cent think that the TCFD framework reflects the pertinent topics embedded in other leading frameworks such as SASB and GRI.

Interviews

Given the lack of comparability with respect to TCFD disclosures, several interviewees said that neglecting to be more prescriptive about the measures that are to be reported represents a missed opportunity.

Q5 **Do you agree that we should make explicit reference in Handbook guidance to the TCFD's "guidance for all sectors" as well as the "supplemental guidance for the financial sector" and the "supplemental guidance for non-financial groups" accompanying each recommended disclosure? If not, what alternative approach would you prefer, and why?**

CFA UK

Yes.

Because the TCFD approach is principles-based, and because it leans more towards guidance than prescription, the supplemental documents should be well received.

Expertise on the topic varies, and some issuers may benefit from a primer on the materiality and impact of climate-related issues. Not only do these documents provide companies with templates for describing their exposure, they also point to a hierarchy of metrics.

This paves the way for incremental improvements in disclosure as issuers develop expertise, and laggards look to catch up with leaders in a deeper understanding of their footprint. As the scope of companies caught by climate change disclosure requirements broadens, CFA UK would expect guidance to become more detailed and relevant, and improved by iterative feedback on their use and application.

Q6 **Do you agree that we should include additional guidance which references the wider set of materials that have been published both within and**

alongside the TCFD's final report, as useful sources of guidance and interpretation when complying with our proposed rule?

Frameworks from organisations such as the Sustainability Accounting Standards Board, the Global Reporting Initiative, and CDP (formerly the Carbon Disclosure Project) can be harnessed to promote consistency and the comparability of disclosures, especially when dealing with intensity metrics.

However, as metrics become more advanced in terms of scope (e.g. extending into supply chains) and perspective (forward-looking versus backward-looking), we face a trade-off between insight and comparability.

For example, as expertise deepens, issuers may look to expand their assessment to include Scope 3 issues alongside Scope 1 and 2. This may introduce greater subjectivity. Similarly, as metrics become forward-looking – shifting focus from intensity to value at risk, for instance, – issuers will necessarily rely more on assumptions and forecasts.

While such projections provide much-needed insight into the thinking of management teams, they also confound peer comparison. Systematic benchmarking will prove problematic as soon as issuers move beyond the most narrowly defined indicators.

One step towards reconciling this tension may be to harmonise key parameters pertaining to transition and physical risk in the context of scenario analysis. The TCFD's *2019 Status Report* suggests this is a priority: 'the Task Force is considering additional work … developing process guidance around how to introduce and conduct climate-related scenario analysis, and identifying business-relevant and accessible climate-related scenarios'. A set of constructive common scenarios could drive consistency, for example, 'How will the company perform in a fully Paris Agreement-compliant or a net zero world?'

Q7 **Do you agree that we should introduce the new rule on a 'comply or explain' basis? If not, what alternative approach would you prefer, and why?**

CFA UK We believe the new rule should be introduced partly on a mandatory basis and partly on a comply-or-explain basis.

Our key consideration is to arrive at a robust investment-decision-making process, for which adequate and consistent disclosures are a prerequisite. Clear climate disclosures will facilitate more efficient capital allocation.

Climate change is widely recognised as a critical global risk. A higher degree of urgency and regulatory focus is justified given the wide societal impact. A purely comply-or-explain framework risks implying that climate change is a

lower priority, which may send the wrong signal; in time it should probably become fully mandatory.

We therefore support the consultation's proposal on strengthening the compliance basis and recommend that the pace of strengthening reflects the criticality of the risk.

Even a proportionate approach at inception should allow for some degree of mandatory disclosure. In line with the TCFD framework, we propose mandatory disclosure for the following:

Governance

a) Describe the board's oversight of climate-related risks and opportunities.

Strategy

a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.

Risk Management

b) Describe the organization's processes for managing climate-related risks.

Metrics and Targets

a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.

We agree with the FCA's proposal that allows for the remaining disclosures to be made on a comply-or-explain basis at inception, at the outset. However, it is clear that over the next few years the remaining disclosures probably should become mandatory.

Premium-listed firms likely have the wherewithal to make the reasonable disclosures above. By limiting the obligation initially to these firms at first, the overall approach remains proportionate.

Surveys

While 83 per cent of respondents to the CFA UK expert group survey supported the FCA's approach, on further probing 46 per cent preferred a balance of some mandatory disclosure and some comply-or-explain, with a further 22 per cent preferring exclusive mandatory disclosure.

Interviews

Organisations should provide a timeline for providing the recommended disclosures when they cannot comply, according to 74 per cent of respondents to CFA UK's expert group survey.

Two of our investor interviewees argued for a mandatory approach as without it they did not see how comparability would ever be possible. A third

suggested starting with comply-and-explain but making disclosures mandatory within 2 years.

Q8 **Do you agree that the recommended disclosures under the "governance" and "risk management" recommendations should not be subject to a materiality assessment? If not, what alternative approach would you prefer, and why?**

CFA UK As we outline in our response to Q7, CFA UK believe key aspects of governance and risk management disclosure should be mandatory for all companies in scope, regardless of a materiality threshold.

With regard to non-mandatory disclosures, firms should perform an assessment of climate impacts on their strategy and operations in accordance with TCFD guidance, and a summary of that assessment covering the medium- and long-term horizons should be made available to stakeholders. Leaving companies to determine materiality would lead to inconsistency and the risk of potential avoidance.

The new IFRS definition of materiality is useful in this context:

> Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general-purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Surveys 90 per cent of respondents to CFA UK's expert group survey felt that boards ought to describe their oversight of climate risks. The same proportion felt firms ought to describe their process for identifying and assessing those risks and make transparent disclosures around the key metrics they use to make climate-related assessments.

Interviews One Finance Director commented that materiality involved too much subjectivity especially when the issue concerned was one with a 30-year time horizon. They said a company could always disclose and say why it was not considered material.

Q9 **Do you agree that issuers should ordinarily be able to make the recommended disclosures under the "governance" and "risk management" recommendations?**

CFA UK Governance is key and all reasonably sized firms should be able to make the disclosures that fall under both these rubrics.

We refer to our response to Q10 for context, and to our response to Q7 wherein we propose areas suitable for mandatory disclosure.

We agree with the determination in the TCFD's final report that disclosures related to its governance and risk management recommendations be included in annual financial findings, and we are comfortable with making them mandatory at the inception of the new rule. The TCFD's final report states:

> Because climate-related risk is a non-diversifiable risk that affects nearly all industries, many investors believe it requires special attention. For example, in assessing organizations' financial and operating results, many investors want insight into the governance and risk management context in which such results are achieved. The Task Force believes disclosures related to its Governance and Risk Management recommendations directly address this need for context and should be included in annual financial filings.

Interviews

One interviewee noted that the TCFD's recommended disclosures for governance calls on the board to describe its oversight of climate-related risks and opportunities, and opined that answers provided in good faith should inform investors' understanding of climate-related best practice by boards. One large investor noted that at present climate change was often best understood by employees not on the board and advised that investors and regulators will need to work hard to avoid this becoming a box-ticking exercise.

Q10

Do you agree that no explicit guidance is needed to clarify that it would be acceptable for an issuer to explain non-disclosure of these recommended disclosures only on an exceptional basis?

CFA UK

We advocate that the 'explain' option under comply-or-explain requires a meaningful explanation by the firm.

A poor-quality explanation may itself indicate whether investors should be concerned, and therefore should not be accidental due to lack of guidance.

Any guidance making it clear that the 'explain' option must be adequately supported by management's rationale and the facts would be welcome.

Interviews

One interviewee from a broker was of the opinion that many companies will struggle to see the relevance of this reporting to them.

Q11 **Do you agree that the statement of compliance and the proposed disclosures should be made within the issuer's annual financial report? If not, what alternative approach would you prefer and why?**

CFA UK We support the FCA's position that the annual report is the appropriate medium for the disclosures.

In the interest of transparency and accessibility, the disclosures would also find a logical and visible place on company websites.

We note that the appearance of the disclosures within the annual report will secure attention from accounting firms, which can only support the development of advisor expertise, assurance, audit, and the level of focus on climate disclosures generally.

CFA UK also brings the FCA's attention to the Brydon Review and our official response to the same of 16 August 2019, wherein we emphasised that a company's annual report is produced for shareholders (not the company) and that its primary purpose is to provide shareholders with all material information which they require to make and monitor their investment.[8] The annual report should be complete and of high quality, and CFA UK believes, as a matter of policy, that climate disclosures should appear in the annual report and not elsewhere, nor incorporated by link or by reference, given their importance to shareholders.

Lastly, CFA UK would note that even today many reports are read in hard copy and that links do not work in such documents (unless the full web-page address is provided).

Surveys Our expert group survey found that 90 per cent of respondents felt disclosures should be published in the annual report.

Interviews One Finance Director we interviewed felt the disclosures should either be in the annual report or incorporated by a link. Their company claimed full compliance with TCFD reporting in their annual report and incorporated the TCFD reporting via a link.

Q12 **Do you agree that an issuer should be required to include within the statement of compliance a description of where in its annual financial report (or other relevant document) its TCFD-aligned disclosures can be found? If not, what alternative approach would you prefer and why?**

[8] Peters, Sandra J., Brydon Review response [letter to Sir Donald Brydon] (16 Aug. 2019) <https://www.cfainstitute.org/-/media/documents/comment-letter/2015-2019/20190816.ashx> accessed 26 Aug 20.

CFA UK Given the disclosures will be new to issuer and investor alike, we agree that clear guidance about the disclosures' whereabouts (e.g. section heading and section and page number) will support their usefulness and a spirit of transparency.

Q13 **Do you agree that the FCA should not require third-party assurance of issuers' climate-related disclosures at this time? More generally, we welcome views on the role of assurance for climate-related disclosures.**

CFA UK While assurance will enhance the credibility of climate-related disclosures, CFA UK agrees that requiring a third-party review is currently premature.

As cited in the FCA's consultation paper, climate change reporting and risk management practices among issuers are largely evolving. While there are distinct benefits to the flexibility within the TCFD framework, the range of reporting practices creates challenges as assurers necessarily tailor the scope of each review. We believe it may impede progress in the development of climate change reporting practices if we seek to overlay audit procedures on them when it is still at such an early stage.

When the time is right, the FCA should clarify its intentions for mandatory assurance and should communicate an implementation timeline.

We think it is worth raising the possibility that climate-related assurance may at this stage be limited in effectiveness as it is likely to take the form of a check of the firm's process, inputs and governance. For now, comprehensive assurance is limited because the data does not exist. In addition, we expect that assurance providers will need dedicated climate specialists to be able to review scenario analysis as part of the assurance process.

CFA UK believes the roll-out of the initial assurance efforts should focus on the areas that are most relevant to investors' understanding of the business and its opportunities and risks. This would ensure that the cost-benefit balance of getting assurance is met. In taking this approach, we reduce the risk of imposing costs for services that may not be required when working practices are better established on all sides, including the users, the preparers and the assurance providers.

Further standardisation of disclosures, a competitive market for the requisite assurance services, a market for climate specialists, and the commoditisation of methodologies and data are likely to reduce assurance costs.

On a related note, there is some evidence[9] that, following supply chain issues at Boohoo, there is a move toward less reliance on external rating agencies

9 For example: (eg https://www.ft.com/content/ead7daea-0457-4a0d-9175-93452f0878ec)

across the ESG space and more direct analysis of original data. As a result, the need for high quality source material is more relevant.

Surveys 88% of our respondents in the expert survey thought third-party assurance would improve their quality.

Interviews Investors and financial intermediaries we interviewed were overwhelmingly in favour of auditors ultimately being require to sign-off on climate change disclosures, but all agreed it was currently premature to do this. Third party verification by unregulated agencies was generally not regarded as sufficiently independent and reliable. One Finance Director was concerned about the cost of using "the Big-4".

Q14 **Do you have any feedback on the interactions between our proposed rule and the role of sponsors in assisting premium listed issuers?**

CFA UK The assurance that sponsors provide will likely involve external advisors, which may incur additional fees. We expect, however, that these fees will not be material, especially against the backdrop of typical fund raising costs. NOMADs may well look to the FCA for guidance on these matters.

CFA UK believes that fixed-income credit investors have the same appetite for TCFD-compliant disclosures as equity investors. Sponsors should be obligated to ensure these disclosures appear in programme and stand-alone bond documentation and should ensure they are vetted by them or their advisors.

Q15 **Do you have any other feedback related to the interaction between our proposed rule and existing legislative and regulatory requirements and industry standards and practice?**

CFA UK The interpretation of materiality could create friction between the TCFD framework and existing regulations and practices.

Issuers with differing scopes (operations versus supply chain) and perspectives (backward-looking versus forward-looking) might come to a different assessment of materiality. This concern is captured in the TCFD's warning that issuers should not 'prematurely [conclude] that climate-related risks and opportunities are not material based on perceptions of the longer-term nature of some climate-related risks' (FCA Consultation Paper CP20/3, 2.17).

It is worth considering whether SASB and GRI materiality frameworks are aligned with the TCFD's goals. Equally, there may be a case for extending the

principles of the TCFD across a range of natural capital issues, including, for example, biodiversity, where there are externalities that require attention.

As industry standards and practices are evolving rapidly, there may be further demand for standardised ESG disclosures related to material risks and opportunities in addition to those related to climate change. Further integration of financial and non-financial reporting initiatives such as the Corporate Reporting Dialogue's Better Alignment Project seek to enhance the comparability of various ESG disclosure frameworks.

CFA UK notes that under section 172 of the Companies Act, directors have a duty to 'promote the success of the company … and in doing so have regard (amongst other matters) to (a) the likely consequences of any decision in the long term … [and] (d) the impact of the company's operations on the community and the environment'. As such, company directors have a statutory legal requirement to consider their company's contribution to climate change and its impact on the environment. CFA UK considers that effective governance and risk management processes will already account for these duties.

Interviews

One large UK investor interviewed underscored the UK's obligations under the Paris Agreement. Clause 2.1(c) "Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development." How can this be done by investors if the right information is not consistently, comparable and transparently made available to them?

Q16 **Do you consider that our proposals adequately address the challenges, risks and unintended consequences described above? If not, what additional measures would you suggest?**

CFA UK

We acknowledge the difficulties raised in the informational, institutional, structural, and regulatory spheres, which were reflected in the interviews, surveys and the internal discussions CFA UK undertook in preparation for this response. We support the FCA's effort, as stated in 4.57 of the consultation paper, to 'encourage industry guidance initiatives to support implementation'.

Our research revealed an additional material concern that greater standardisation and more fulsome requirements may yield boilerplate disclosures from issuers. We reiterate the delicate trade-off between insight and comparability.

Q17 **Do you agree that our new rule should take effect for accounting periods beginning on or after 1 January 2021? If you consider that we should set a different timeframe, please explain why?**

CFA UK CFA UK agrees that both public interest and the urgency of transitioning to a low-carbon economy are consistent with the implementation of the new rule as soon as is practicable. Our preference is that the rule take effect for accounting periods beginning on 1 January 2021.

If a delay were necessary, however, we recommend that the delay not persist beyond 1 April 2021, consistent with the extension of the consultation.

Surveys From our expert group survey, 66 per cent of respondents felt that the new rule should take effect for accounting periods beginning on or after 1 January 2021.

Q18 **Do you agree with the conclusion and analysis set out in our cost benefit analysis (Annex 2)?**

CFA UK Compliance with the FCA's proposals will require a mix of time, resources and relevant knowledge. Some organisations can rely on existing staff; others will require heavy external support.

On balance, we feel that the one-off costs are broadly accurate. We submit, however, that given scope and materiality concerns, the hourly-equivalent salary and the hours modelled for the effort may be too low. The exclusion of incremental data-sourcing costs also underestimates upfront and ongoing costs. The issuers we spoke to who are already implementing voluntary disclosures were unable to determine an accurate figure for their one-off costs.

As for ongoing compliance costs, again we feel the figures used in the cost–benefit analysis are broadly accurate, but we highlight the possibility that over time disclosure requirements become more granular and detailed and thereby more costly. Scenario analysis in particular is likely to become increasingly complex and require greater technical expertise.

Compared to the benefits of better capital allocation, however, these costs of compliance are minimal or negligible. If we consider the £2.3 trillion market cap of premium-listed issuers, the estimated compliance costs amount to 0.005%, or 0.002% on an ongoing basis, indicating that even a small improvement in share-price efficiency will generate a net benefit.

Given the sheer difficulty of measuring costs and benefits, in particular the qualitative benefits, the FCA's conclusion and analysis seems fair and adequate. To illustrate the point, the industry participants polled by CFA UK were unable to quantify the incremental costs they have incurred by implementing TCFD-related disclosures.

Surveys In CFA UK's expert group survey, 69 per cent of respondents felt that the FCA's proposals could be handled by existing company resources, but 59 per cent will still require external support to comply with the new rule. The FCA's estimates of *c*.£250,000 upfront and *c*.£100,000 of ongoing annual costs are reasonable according to 56% of respondents.

Q19 **Do you agree with the guidance provided in the draft Technical Note set out in Appendix 2? Are there any changes that you would suggest? If so, please describe.**

CFA UK We agree with the guidelines. Many disclosure guidelines pertinent to ESG, including those concerning climate change, are found in other regulations.

More precise guidance around climate-related data and scenario analysis may be necessary, whether through the Prospectus Regulation or ESG disclosures more generally. Issues may arise, however, given the proprietary nature of this information and its impact on business competitiveness.

APPENDIX III: Recent CFA UK response letters on stewardship, ESG and green finance issues

Response to the BSI (PAS7341) 'Responsible and Sustainable Investment'
(February 2020)
<link to file from CFA UK>

Response to the FCA consultation (CP19/15) "IGCs: Extension of Remit
(July 2019)
<link to file from CFA UK>

Response to the FRC and FCA joint discussion paper (DP19/1) 'Building a regulatory framework for effective stewardship'
(April 2019)
<link to file from CFA UK>

Response to FRC's consultation on the proposed revision to the Stewardship Code
(March 2019)
<link to file from CFA UK>

Response to FCA consultation CP19/07 on proposals to improve shareholder engagement
(March 2019)
<link to file from CFA UK>

Response to the Investment Association's consultation on sustainability and responsible investment
(March 2019)
<link to file from CFA UK>

Response to FCA Discussion Paper (DP18-08) on Climate Change and Green Finance
(January 2019)
<link to file from CFA UK>

Response to FRC's consultation on proposed revisions to the UK Corporate Governance Code and the future direction of the Stewardship Code
(Feb 2018)
<link to file from CFA UK>