CFA Society
United Kingdom

10 September, 2021

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

Submitted by e-mail to: cp21-17@fca.org.uk

Dear Ms. Chender,

CFA UK response to the FCA regarding CP21/17: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers

The CFA Society of the UK (CFA UK)[1] is delighted to have the opportunity to continue to share its views on this topic with the FCA following on from our response letters to CP20/3 and PS21/17 last year and to BEIS in May 2021[2]. We are also grateful for the constructive dialogue with you and your team and for your participation in our webinar on 25th August which raised the profile of these matters among our members.

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 in which they invest. We acknowledge that around the world there has been a step-change in the level of commitment to and activity levels in climate reporting, but note that the ability to assess how companies are affected by and contribute to climate change is difficult and the timeframe for addressing these critical issues is limited.

These proposals will significantly increase the regulatory reporting efforts and costs of many of our members' firms, but they are consistent with the government's roadmap for the transition to mandatory climate-related reporting[3] and the large majority of our members recognise these reforms are necessary.

These reforms require investment professionals to learn new skills and increase their knowledge and understanding of climate risk and investment. CFA UK is addressing this challenge. We have followed the success of the Certificate in ESG Investing (which has had over 10,000 registrations and is now being marketed globally by CFA Institute) with the launch from 1 January 2022 of a Certificate in Climate and Investing[4].

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[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] These response letters can be viewed here on our Society's Professionalism web pages (https://www.cfauk.org/professionalism/advocacy/responses#gsc.tab=0)

[3] HM Treasury's "Roadmap towards mandatory climate-related disclosures" (Nov.202): (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933783/FINAL_TCFD_ROADMAP.pdf)

[4] Details of the new Certificate in Climate and Investing can be found on our website at https://www.cfauk.org/study/certificate-in-climate-and-investing#gsc.tab=0

Recognising the necessity of these reforms, we also wish them to be as effective as possible and we are grateful for the opportunity to comment on the proposals, especially as they are to be mandatory with effect from as soon as 1 January 2022 for many firms.

We convened a working group to respond to both this consultation CP21/17 and the parallel CP21/18 consultation with proposals for climate-related reporting for standard-listed companies. The working group's responses to your questions are provided in Appendix II of this letter, however, we wish to highlight and summarise the main points made in these responses as follows below:

SCOPE – SIZE THRESHOLD: we believe all firms and funds should in time be required to make these mandatory disclosures. Whilst we accept the case that firms with <£5bn AuM need not be initially included, we have concerns that their clients might suffer if climate risk is not being taken into consideration. Our intention is not to impose an additional burden or costs on small firms; rather our concern is that small firms could be left behind in the journey of recognising and understanding climate change, ultimately impacting their competitiveness and risk management. We suggest the FCA might now either (i) signal when firms with <£5bn AuM might come into scope or (ii) introduce some minimum or comply-or-explain requirements. Incentives or support could be given (either now or in due course).

SCOPE - FIRST IMPLEMENTATION: we believe the £50bn AuM threshold for first phase implementation should be lowered, so that more private wealth managers are included.

SCOPE – CALCULATION OF THRESHOLD: we also think that the calculation methodology for thresholds should make allowance for fluctuations in AuM levels between years.

SCOPE - ACTIVITIES: by extension we also believe that the activities of advisory portfolio management and one-off financial advice should also be brought into scope.

SCOPE – OVERSEAS FUNDS: we find it concerning that, as we understand it, the proposals do not create a level playing-field or give equal protection to investors since overseas domiciled funds available to UK investors are not captured by these requirements. These requirements are of course a global concern and TCFD is a set of global (not UK) standards. We suggest that the FCA seeks to reach reciprocal arrangements with other regulators to ensure that overseas funds marketed in the UK have at least comparable disclosures. From mid-2023 (aligned to the roadmap) it should not be possible for non-UK firms authorised to distribute funds into the UK not to meet these reporting requirements. We also regret the potential confusion for end-investors accessing an 'entity' or 'firm' report and then a range of both UK and non-UK funds with different climate-related disclosures via the same global website.

SCOPE - ASSET CLASSES: we have significant concerns about the lack of guidance on climate-related reporting on assets other than listed equities and corporate debt and so by extension multi-asset funds. Derivatives became a major concern for our members following the release of the DWP's rules for pension scheme climate-related reporting and we are considering publishing a paper on how they might be included.

PROXY DATA: we have significant concerns about the potential misuse of proxy data and our working group suggests ways the FCA might mitigate against these risks.

CROSS REFERENCING: links can assist in the presentation of reports both at "firm" and "fund" level but they can also be a recipe for confusion. Our working group has suggested some ways that firms might be encouraged to and dissuaded from using them.

TARGETS / CASE STUDIES / SCENARIO ANALYSIS: at this stage we prefer forward-looking metrics, especially if they can illustrate a journey with interim milestones, to both case studies and scenario analysis. We believe case studies are susceptible to 'marketing' and, in the absence of clear and extensive disclosures on methodologies and assumptions and good data, scenario models could be mis-represented. We fully agree scenario analysis should for now only be required at the 'firm' level and not at the 'fund' level.

'ON-DEMAND' REPORTS: generally, we suggest that climate-related disclosures for institutional fund arrangements are allowed to be client-led and so determined by each client's particular needs. We expect the majority of these will be TCFD-based and -oriented so institutional assets should still swing behind the rallying-cry for standardisation of metrics.

SCOPE-3 METRICS: Scope-3 data is not yet available in sufficient quality or frequency and we suggest the timeline for mandatory Scope-3 disclosures be further deferred. This will allow focus on Scope-1 and Scope-2 disclosures. In the meantime, an approach for double-counting issues, such as also apply to derivatives and sovereigns, can be consulted on and agreed.

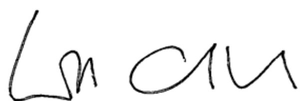
TCFD / SFDR: we believe only the TCFD climate-related reporting should be mandatory for UK funds. SFDR reporting can be provided alongside if the investment firm wishes or is required to do so by being inside the scope of SFDR.

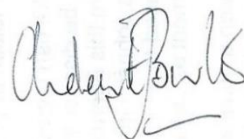
PROPOSED CHANGES TO TCFD GUIDANCE: the working group has responded to both CP21/17 and CP21/18 as requested in the consultations, i.e., on the assumption that the changes proposed by the TCFD in its consultation, which closed on 18th July[5], are fully adopted.

COST / BENEFIT ANALYSIS: we support the government's agenda on climate-related disclosures and Roadmap [3] and agree the benefits of this proposed regulation outweigh the costs. In consideration of the cost-side over the longer-term, we encourage the FCA to promote firms' up-skilling of existing staff rather than necessarily relying on hiring additional specialists or third-party consultants.

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,





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[5] TCFD Public consultation on proposed guidance on climate-related metrics, targets & transition plans (June-July 2021): (https://www.fsb-tcfd.org/publications/)

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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/CFA Institute.

Context to our responses to the questions

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.

APPENDIX II: Responses to questions

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

We support the government's desire to move towards mandatory TCFD-aligned disclosures across all sectors (financial and non-financial) over the coming years, as detailed in the Roadmap. However, we have a number of concerns and suggestions relating to scope.

Size Threshold

We have concerns with the proposal to entirely exclude asset managers and asset owners below £5 billion AUM.

We propose that climate-related disclosures should be mandatory for all authorised firms irrespective of AUM. We understand the rationale of proportionality in terms of a tiered- and phased approach, and not creating an additional cost and resource burden for smaller firms, but also believe that:

- Climate-related risks and opportunities apply to all participants (and investors) in financial markets and consequently smaller firms should be in scope so that the end-investor clients of smaller firms are not denied the benefit of this disclosure for decision making.
- Excluding smaller firms could result in their clients being inadvertently exposed to additional risk by firms incorrectly assuming that climate change is not relevant for their investments, for example if the larger firms in scope act on their disclosures in the market it could potentially impact the liquidity of some stocks in smaller firms' positions.

Our intention is not to impose an additional burden or costs on small firms; rather our concern is that small firms could be left behind in the journey of recognising and understanding climate change, ultimately impacting their competitiveness and risk management. We appreciate the FCA's consideration of the cost impact on smaller firms if they are in scope, and accordingly suggest the following implementation options for consideration:

- Convey the intention to include all firms but bring smaller firms into scope later in the timeline, once the reports of the larger firms have been reviewed and key issues addressed.
- Start with a limited set of disclosures for firms with an AUM of below £5 billion.
- Require a "comply or explain" approach as the first phase for smaller firms before full disclosure becomes mandatory at a later date, once lessons have been learned from implementation by larger firms.
- Consider incentives or support for smaller firms, until such time as reporting becomes mandatory, to support the development of their capabilities. The FCA could conduct a further cost benefit analysis focusing on those firms with AuM <£5bn and examining the merits of different reporting options, before extending climate-related reporting requirements to those firms.

Calculation methodology

We also have a suggestion for the methodology to calculate AuM for the purposes of the application of the regulation. This would avoid instances of large firms falling below a threshold

due to variable asset levels in the past three years. We propose that the benchmark firm size should be enhanced to make it “the higher of:

- the FCA proposed SM&CR threshold based on the 3-year rolling average AuM or
- the AuM of the asset manager as at the end of the last reporting year”.

Overseas Funds

Finally, we find it concerning that, as we understand it, the proposals do not create a level playing-field or give equal protection to investors since overseas domiciled funds available to UK investors are not captured by these requirements. These requirements are of course a global concern and TCFD is a set of global (not UK) standards. We suggest that the FCA seeks to reach reciprocal arrangements with other regulators to ensure that overseas funds marketed in the UK have at least comparable disclosures. From mid-2023 (aligned to the roadmap) it should not be possible for non-UK firms authorised to distribute funds into the UK not to meet these reporting requirements. We also regret the potential confusion for end-investors accessing a range of UK and non-UK funds via the same global website.

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

We have two areas of feedback with regard to the scope of products proposed:

a) We propose the FCA clarifies the approach to the advisory aspect of the distribution of investment products:

For a retail investor entering a product via financial advice, it would be reasonable to require their financial adviser to provide the client with the proposed disclosure, similar to what would be expected for other key features of a product, such as objectives, cost, or performance, . In particular we are conscious of two scenarios:

- Advisory portfolio management: While discretionary portfolios are in scope, a similar disclosure should be required for advisory portfolios that are reviewed on an ongoing basis and a fee charged
- One-off financial advice (to invest in one or more funds/products in scope): There should be an onus on the financial adviser to “procure and provide” the proposed disclosure materials relating to its recommended investments, as part of the recommendation and explain the same if required or needed by the client.

We understand that climate-related disclosure as part of the financial advice process is not in the scope of this consultation. However, it is a prominent distribution channel conspicuous by absence in the proposals (as portfolio managers and direct to investor channels are effectively covered) and we ask the FCA to signal its intended future approach.

b) We have concerns about data challenges for reporting in certain asset classes:

The proposed scope extends to funds in all asset classes and multi asset funds and portfolios, whereas sectors such as sovereign bonds, commodities, alternatives, and the assessment of derivatives in general, are not sufficiently evolved in terms of climate impact data.

The relative under-development of many asset classes is not surprising, given for example, the PCAF (Partnership for Carbon Accounting and Financials), the Global GHG Accounting and

Reporting Standards for the Financial Industry, provide detailed methodological guidance to measure and disclose GHG emissions for six asset classes, of which the ones of interest to most asset managers are listed equity and corporate bonds. We understand, for example, that the PACTA (Paris Agreement Capital Transition Assessment) investor tool used by more than 1,000 financial institutions globally, applying it to more than 7,000 portfolios, primarily covers equity and corporate bonds.

We also have concerns with regard to double counting of data, for example in sovereign bonds, in multi asset fund of funds, and fund-based portfolios.

Our suggestions in this regard are that:

- FCA guidance should be extended to cover the issues and challenges posed by certain asset classes in its regulatory proposals. More guidance could be provided to help firms required to disclose across their entire AuM. New and innovative ways to progress disclosure in less developed sectors could also be encouraged.
- Provide more guidance in relation to the data assessment for derivatives, the climate impact of which needs to be correctly estimated to make the climate-related reporting credible across most asset classes and particularly funds that rely heavily on derivative usage.
- The FCA should use its monitoring of compliance by firms to improve firms' understanding in these difficult areas.

In relation to derivatives, CFA UK's Pension Expert panel held exploratory discussions following the release of the DWP's final guidance in June and is considering to write a position paper on the subject. CFA UK would be pleased to engage with the FCA (and the DWP) further on this topic.

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

We have two concerns in this area:

a) The proposed £50bn asset manager threshold for the First Phase

While a meaningful number of UK regulated asset managers operate to the £50bn AuM plus scale (the mean size is £50bn and the median £10bn AuM)[6], the number of UK wealth managers / discretionary investment managers over this threshold is small. In fact, the IA report that only c. 30% of its members are of an AuM of £25bn plus[7]. To capture a meaningful set of firms active in this sector, we believe the threshold should be lower, for example £25bn.

b) The challenges that alignment with other moving parts in this space poses for disclosure.

Our concern with regards to alignment with other data availability and reporting initiatives, is the potential for confusion and changes in the coming years – potentially adding cost and undermining confidence. In particular:

[6] The Investment Association's Annual Survey 2019-20, p99; (https://www.theia.org/sites/default/files/2020-09/20200924-imsfullreport.pdf)
[7] The Investment Association's Annual Survey 2019-20, p100; (https://www.theia.org/sites/default/files/2020-09/20200924-imsfullreport.pdf)

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- Underlying reporting from corporates will be key to enabling asset managers/owners to report under the climate-related disclosures. However, corporate reporting on climate risks and opportunities will still be under "Comply or Explain" when the mandatory reporting for asset managers and owners comes into effect.
- The DWP requirements on place certain schemes and master trusts into scope for mandatory TCFD reporting from October 2021 (for schemes with AuM over £5bn) and October 2022 (for schemes with between £1-5bn AuM). These timings do not align with the FCA's proposals which could result in scheme trustees captured by the DWP being unable to meet their obligations if the requirements on the scheme's asset managers have not come into force.
- There will be participants which are also covered by the EU SFDR which came into force earlier in 2021, who have put in place differing disclosures
- Different reporting periods could impact comparability, albeit over time this should be less of an issue

An alternative approach to an AuM based timeline would be a "nature of disclosure" based timeline e.g., more qualitative initially and increasingly granular and quantitative over time. To drive change in a short time frame we agree large AuM firms should lead the way, but the alternative approach could be considered for smaller firms as also referenced in the response to Q1.

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

We understand that until the entire ecosystem of data provision is synchronised, some flexibility will be required for meeting a mandatory requirement.

However, we have concerns around the potential risks of allowing too much leeway within the context of a mandatory disclosure that may defeat the spirit of the disclosure in the first place.

The three key risks we are concerned about with suggestions for mitigating them are tabulated below:

KEY RISKS	MITIGATION SUGGESTIONS
• Greenwashing risk by firms misusing the flexibility provided by picking and choosing assumptions that would work in favour of their portfolio	• Required disclosure of the proportion of the asset metric reported that relies on proxies, for example the disclosed emissions are based x% on proxies and y% on actuals
• Unreliable data not leading to the intended purpose of leading to informed decision making; instead undermining the disclosure process, if the view develops that much of the data is based on assumptions and proxies	• Required disclosure of the downside of the model; not as a marketing message but focusing on transparency and also not in the smallest print that no investors would typically see

• Displaying data that is not audited or difficult to audit without global accounting standards can actually be misleading to the end investors	• Required disclosure of a description of both the process involved and the assumptions in the model used (and why these assumptions are used). We acknowledge this disclosure has the potential to be boilerplate, and it may still be unreliable, but it is nonetheless a starting point to build from

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

TCFD Entity Report
We agree with the concept of a TCFD entity report.

However, we caution that the use of 'entity' as a terminology may cause confusion – for example, is not an OEIC or a Unit Trust also an 'entity'?

We suggest using instead the term 'firm' to capture the intention of the FCA for the proposed firm level reporting (in our response we use these interchangeably).

We support a standardised set of mandatory disclosures that are understandable to and add value to a wide range of investors. However, the drawback of engaging less sophisticated investors is that for investment analysts and informed investors, the data provided could be too high level.

We therefore suggest that both the firm level report and the product level report have easy to understand summaries and explanations for all investors, rather than only the detailed data understood by analysts.

We also suggest clear signposting between the two, as the manner in which investors engage with investments may lead them initially to either report.

For example, an investor searching for a fund may overlook the firm level report unless clearly directed to it from the product disclosure.

Cross Referencing
We appreciate the benefits of avoiding duplication and costs that cross-referencing provides. For example, the flexibility to have a TCFD report at a group level is useful for large groups that contain many FCA-regulated entities and the requirement to issue a TCFD report for each FCA-regulated entity may increase the reporting burden on the company. Another key advantage of links is that text used in many places need only be updated once and then it is updated everywhere automatically. Cutting and pasting sections may easily lead to obsolescent text hanging on if all relevant documents are not updated.

However, we have concerns around the impact on less sophisticated investors of an unchecked cross-referencing approach, and also feel there is room for more clarity for firms.

Our concerns with regard to very flexible cross-referencing are:

- Possible confusion for investors in trying to navigate cross referenced reports.
- Less sophisticated investors could find it hard to get to and decipher the relevant portions of large / global asset managers group level disclosure.
- Hyperlinks can cause issues that dissuade some customers e.g., pay walls, disclaimers, jurisdiction etc.
- Where some of the holdings are not public funds.
- Where the managers are not always going to be in scope of the FCA regulations.
- Linking to reports piecemeal could be confusing for the end user and linking to very large full reports could be unwieldy.

Our suggestions to address some of these issues are:

- It should be made clear that the firm cross referencing still carries the accountability for disclosure, and in case of follow-on investor queries should address them rather than also pass those on.
- Firms cross referencing should be required to provide additional guidance to investors about the relevant (and non-relevant) portions of the cross-referenced disclosure, including ideally some summary commentary that can help investors.
- Hyperlinking to the relevant section(s), rather than simply linking to the whole report would be ideal for many investors.
- Cross-referenced (or relevant sections of) documents linked in the report should not be behind a paywall.
- The disclosures should be made "freely available" (mirroring DWP's statutory guidance on the availability of Implementation Statements)
- FCA providing best practice or expectation examples of how this would work in practice (two suggested examples: asset manager within a large financial group; different asset and wealth managers with a group).
- Clarify how private holdings will be handled and what constitutes an appropriate cross-reference for these types of holdings.
- FCA providing a summary of work that is underway to harmonise and simplify the climate reporting for financial firms in UK and worldwide.
- Clarify what kind of reporting outside the TCFD framework is considered to satisfy the requirements (SFDR, EU Sustainable Finance Action Plan, of which the SFDR forms part).

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

We are unsure about the mandatory and immediate use of case studies/scenario analysis, especially as it relates to risk management and governance.

We understand that this is part of the TCFD recommended framework, and that the visual illustration of scenarios helps investor engagement.

However, we have the following concerns:

- This seems to invite undue subjectivity and could be used for marketing, rather than the transparent statement of fact which seems to be the FCA's goal.

- It is recognised in paragraph 4.31 of the consultation that scenario analysis is the least developed part of the TCFD recommended framework and we doubt many customers' ability to understand and engage with scenario analysis so that it is useful for their decision making.

- At present firms can use a wide range of assumptions and forecasts for their scenarios which make comparability difficult (but equally we do not believe a prescribed set of scenarios is the solution).

- There could also be further challenges in developing informative and fair scenario analysis for firms that invest in multiple corporates.

- We also wonder if the entity level is the correct place for this detailed disclosure. What if an organisation's approach differs dramatically across strategies, but only some are in scope for public product vs. on-demand?

Given these issues, we do not believe scenario analysis is ready for being made a detailed mandatory disclosure at this time, and instead support a simple description of scenario approaches used by firms, with examples of scenario conclusions provided as appropriate, on a best effort or comply-or-explain basis.

Our proposal would also be to keep the entity level disclosure more concise but propose a twinned statement describing general differences across the organisation's strategy range. The entity report should also state how embedded a consideration of climate risk is within a given organisation, from strategy range to the firm level.

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

We agree that an absence of climate related targets should be explained, as it raises many questions about the strategy and governance of the firm and how they monitor progress.

However, we also propose more guidance is provided in the rules around the disclosure of targets.

Firms who purport to have climate related targets should explain clearly what they are, how they are proposed to be attained, and how progress is monitored by the Board of the firm.

Targets should also remain consistent over time so that progress is visible to investors; disclosure of changes to targets, and the rational for those changes, should be required to avoid the risk of moving goal posts.

The details of a firm's or product's path to net zero are much more instructive than the simple presence of Paris Agreement support or a long-term target, which could be misused for marketing or window dressing. Targets and commitments need to reflect the firm's plans and actions. The Paris Agreement is a government commitment and how that filters down to

individual firms (and corporates) cannot be clear to users without the firm (or corporate) describing that roadmap with key milestones.

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

We agree with the proposals and find them consistent with the proposals for cross referencing to third parties or delegates by asset owners.

Our concerns with cross referencing in general are also relevant here and are captured in the response to Qu.5 under cross referencing to questions 5.

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

We agree with the proposals and find them consistent with the proposals for cross referencing to third party portfolio managers by AFMs.

Cross referencing should, however, not be viewed or exploited to be a dilution of the asset owner's responsibility to the investor for the required disclosure.

Our concerns with cross referencing in general are also relevant here and are captured in the response to Qu.5

That said, we agree with the proposals in sections 4.47 and 4.48, which appear to be consistent with the current TCFD approach and requiring asset owners at a minimum to explain how climate-related considerations have influenced their investment selection and choice of asset managers.

Firms should be transparent as to the arrangement between the parties so that boilerplate text is avoided and consumers can make informed choices i.e., make sure references are adequately contextualised.

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

We broadly agree with the proposed requirements for public product and portfolio-level disclosures.

However, we have some comments around the "on-demand" approach for non-public products / services:

- Currently various levels of data are shared with sophisticated and institutional clients as part of the relationship and this is often not prescriptive. It depends on the nature of the relationship – an unsatisfied client is likely to vote with their feet.

- Where clients need the data to satisfy their own disclosure obligations, they usually know what data they need and can request it and indeed any additional data they'd like.
- We worry that detection of and dealing with breaches could be complicated if not impractical.
- The reporting on underlying holdings should be clarified as it risks being seen as partially contradictory to the approach allowing asset owners / managers to cross-reference other reports.
- Another possible risk is the misuse of this avenue to avoid public disclosure. As an example, some products may be available to a small set of investors or marketed in a limited way and so deemed by the firm to be private.

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

We agree with the concept of a core set of mandatory standardised metrics, to support comparability, consistency, and investor understanding.

Regarding the list of ‘core’ metrics, we agree with the proposed Scope 1 & 2 emissions disclosures.

We have reservations with regard to Scope 3 emissions (and also therefore Total emissions), which remain a well-known challenge unless a global accounting standard in force. We suggest that Scope 3 related metrics be moved to the ‘additional metrics’ section from the ‘core’ section.

In addition to the issue of double counting when it comes to portfolio level (a firm’s Scope 3 can be another firm’s Scope 1), Scope 3 is loosely defined. It would need every corporate in the world to carry out full end of life cycle analysis, user analysis and to which markets their goods are sold to analysis, just to name a few of the complications. Total emissions are linked to the same points on scope 3 limitations. Giving consideration to having reliable data later, rather than unreliable data sooner, the timeline for this may either need to be qualitative rather than quantitative in the first instance or pushed out further to allow the data ecosystem to mature further.

We recognise that the caution we express above concerning the speed of the roll-out of Scope-3 reporting is at odds with new regulations set by the DWP for UK pensions funds and that these schemes will be required to report their scope-3 data. We trust that the FCA and DWP will look to align their requirements in due course pragmatically reflecting the progress that will be made in this area over the coming years.

With regard to the Carbon footprint, there is a potential for confusion between Total emissions and Carbon footprint; **we suggest making this metric title clearer i.e., carbon footprint per million currency invested.**

A key concern we have is that the above indicators directly or indirectly relate to the market value of equity; **we suggest also considering Enterprise Value (net debt plus equity) to normalise emissions across all companies, without the degree of leverage distorting the results for comparability.**

We support the WACI metric, as a good indicator that can also take fixed income into consideration. **However, investors should be cautioned alongside the disclosure as to how the use of revenue in the denominator may skew the results** – for example a low emission company with very low revenue may have higher carbon intensity than a large emitter with very large revenue.

When it comes to timing, these metrics can start when the rules are implemented (other than Scope 3 metrics as commented above). **However, we believe firms should disclose what is assumed and what is audited data and to what extent the audited data has been assured.** The degree of sensitivity of the model to various key assumptions should also be disclosed.

Lastly, these metrics are useful to corporate but challenging for sovereign investment. Additionally, we note sovereign emissions are disclosed at times with a 2-year lag.

As mentioned in our response to Q.2, with a multi asset portfolio or mixed fixed income portfolio, there could be a tendency for double-counting i.e., a corporate's emissions are likely to also contribute to one/several sovereign emissions.

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

We do not agree with this proposal. We believe the approach of using two methodologies (one based on TCFD and one based on SFDR) would potentially be confusing for investors as well as adding a layer of complexity for firms.

There are a wide range of metrics and methodologies available and no doubt yet to be developed; rather than try to cover all bases, the new rules should be simple and adopt a single approach.

We suggest that TCFD alignment would tilt towards that as the mandatory approach, with firms that already comply with SFDR being free to disclose on both methodologies if they so desire. As a result, some firms may have to use both methodologies, but all UK firms should not be required to use SFDR.

Q13: Do you agree that, subject to the final TCFD guidance being broadly consistent with that proposed in the current consultation, our proposed rules and guidance should refer to: a. The TCFD Final Report and TCFD Annex in their updated versions, once finalised b. The TCFD's proposed guidance on metrics, targets and transition plans and the proposed technical supplement on measuring portfolio alignment If not, what other approach would you prefer and why?

In general, we agree to using the final TCFD guidance if the ultimate goal is to promote the same framework that TCFD has published.

However, given the resource and data cost associated with implementing this regulation, we suggest that the FCA finalise the regulation only after the TCFD final publication to avoid confusion and additional cost to asset managers.

If the FCA subsequently decides to adopt a different version to the TCFD framework, it may increase complexity for investors and cost for firms, which ultimately the end investors may have to bear.

Climate change requires action now. However, if the regulation creates more noise than actual meaningful investment decision making, risk management and transparency to shareholders, it could be worth delaying slightly for global consistency and getting it right (or more chances of getting it right) the first time.

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

The additional metrics are useful in principle.

However, in practice, some are complex to implement. For example, in order to carry out a full scenario analysis, the exact locations of the assets and operations of the investee companies, including the supply chain needs to be known. Today, this is not the case as corporates do not have that visibility. Many climate scenarios available to the investment communities today come with plenty of assumptions attached, which can impact the conclusions. As an example, one of the data providers evaluates the physical risk of a company based mainly on the location of the HQ.

We suggest focussing additional metrics on the forward-looking emissions outlook for companies, and also aligning this additional disclosure with the firms' targets.

Also, likely to be value added for investors is a firm mapping out the impact of climate change risk, including regulatory risk. We believe that regulatory risks, by way of policy makers implementing new regulations like a carbon border adjustment tax, is likely have a significant impact on the operations of companies translating into an impact on investment portfolios. Please also refer to our response to Qu.11, wherein we have suggested Scope 3 data be moved to additional metrics, at least initially.

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

We agree with the proposal to include a detailed description of deviations relating to Governance, Strategy and Risk Management at the product or portfolio level along with more detailed information as appropriate, to complement a general statement of approach at the firm level.

We are not supportive of detailed scenario analysis as referenced in the response to Qu. 6.

We also draw your attention to the issues flagged in relation to certain less advanced asset classes (from a climate data perspective) and the treatment of derivatives, in our response to Qu.2.

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

We are wary of this requirement given the lack of data and methodological clarity.

It is not clear what the expectation is for scenario analysis as an input into investor decision making, especially given how widely this could vary even within a given organisation's product range.

The additional forward-looking metrics mentioned around climate value at risk and temperature change mostly depend on data providers for accuracy but are somewhat more comparable. Testing scenario analysis for accuracy may not be at all feasible, especially in light of the proposed requirements: we take issue with the comment about concentrated/higher exposures to "more" carbon-intensive sectors, where more is not quantified or otherwise defined. The orderly / disorderly/ hot house classifications are not consistent with other scenario analysis frameworks promulgated by e.g., the UN PRI or particular asset owners. We question whether adding a further set of scenarios is really necessary.

We understand the FCA's desire to include scenario analysis, consistent with the PRI and TCFD, but suggest this could be incorporated as a request in the disclosures and those disclosing can apply their own methodologies as they see fit. This would mitigate the risk of organisations offering potentially flimsy approaches for purely commercial (i.e., potentially greenwashing) purposes.

The FCA could review or commission an independent review of what firms and funds produce and then promote best practice in due course.

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

We agree with the proposal in cases relating to private client information.

However, please refer to our response to Qu.10, as some of the concerns are also applicable to the provision of information on request, such as the risk of misuse of this avenue to avoid public disclosure.

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

We agree with the proposals and find them consistent with the proposals for cross referencing to third parties or delegates by asset owners or delegated investment managers by AFM's.

This naturally assumes that the mirror funds are in fact replicas of the external strategy, which we suggest should be emphasised in the guidance. If there are any variations made by the life insurer, this approach should not be available.

Please also refer to our comments in response to Qu.5. in relation to cross-referencing.

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

We agree with the proposals for asset owners and support broad alignment with the DWP on popular arrangements i.e., default strategies with at least 10% of overall amounts in defaults, or with £100 million or more in assets under management and administration in the default, should be in scope for product-level disclosures.

This is particularly relevant for pre-selected portfolios or where clients have not made an active investment choice.

However, as noted in our response to Q1, we would caution against excluding asset owners which may be below the AUM threshold and would recommend consideration of the implementation options detailed in our scope and timelines commentary.

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

For most firms, the view of costs associated with mandatory climate-related disclosures will ultimately come down to whether the firms' investment beliefs consider climate to be a systemic risk that should be measured and managed like any other investment risk – implying this is an unavoidable cost that should in any case be incurred - or, is it considered an incremental activity at incremental cost.

We suggest that the benefits of such reporting could be emphasised by the FCA as part of the introduction of the regulation, which in time should well outweigh the costs. For example:

- Reporting on climate-related disclosures helps to maintain credibility and reputation among clients and investors.
- Adopting the TCFD reporting approach helps to implement a structured process for integrating climate risks into strategic investment decision making.
- Production of the report helps to develop climate-related expertise and upskill staff.

We have not been in a position to independently validate or challenge the CBA. We are instead providing some perspectives below on key contributors to disclosure cost.

Data

We have significant concerns about firms' ability to reliably source the amount of data required by the proposed regulations and ensure its suitability. Resources are particularly constrained in smaller firms which further limits their capacity to obtain and report meaningful data. However, we appreciate that climate related reporting has to start somewhere, that climate reporting data should improve and become more widely available with time, and that larger firms are likely to support data enhancement and accuracy, which in turn will support smaller firms.

Third party consultants

Many firms are likely to rely on third party consultants to support production of their report on climate-related disclosures, either because relevant knowledge does not exist in-house or such

resource may be allocated elsewhere. Consultants may provide staff training (before the reports are produced in-house) or produce all mandated climate-related disclosure reports. Naturally the use of consultants will have an accompanying cost although applying a phased approach to implementation will allow smaller entities time to familiarise themselves with what is required as larger firms start to report. As firms become more familiar with the data, more of the reports will be capable of being produced in-house and in larger firms' costs are therefore likely to fall over time.

We caution against the FCA directly or indirectly implying via its proposals that firms should necessarily engage consultants or hire many new staff that are ostensibly ESG experts without always having the requisite experience or insight. Rather, genuine upskilling and training of existing staff should also be encouraged as part of this initiative.

Option to mirror the DWP approach

Assuming smaller firms are in scope of these requirements (per recommendations contained in Q1), the FCA could mirror the approach for smaller firms taken by the DWP. This allows Trustees to produce the TCFD report "as far as they are able". It states: "Trustees must carry out scenario analysis, obtain data, calculate and use metrics and measure performance against trustee-set targets 'as far as they are able'. This means taking all such steps as are reasonable and proportionate in the particular circumstances taking into account the costs, or likely costs, which will be incurred by scheme and the time required to be spent by the trustees or people acting on their behalf."

CFA Society United Kingdom

APPENDIX III: Recent CFA UK response letters on TCFD and ESG reporting by Firms and Corporates

Response to BEIS on audit and corporate governance reform
[June 2021]
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-uk-response-to-beis---restoring-trust---final.pdf

Response to BEIS on requiring mandatory TCFD Disclosures by public companies, private companies and limited liability partnerships
[May 2021]
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/beis-mandatory-tcfd.pdf

Second Response to the DWP on Taking Action on Climate Change
[March 2021]
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/follow-up-letter-to-department-for-work-and-pensions.pdf

Response to the FCA Position Statement (PS20/17) on proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations
[February 2021]
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/ccdr-follow-up-letter-to-fca---february-2021.pdf

Response to the FRC's Discussion Paper on the Future of Financial Reporting
[February 2021]
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/future-of-corporate-reporting.pdf

Response to the DWP on Taking Action on Climate Change: improving governance and reporting by occupational pension schemes
[October 2020]
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/dwp-cc-full-letter-october-2020.pdf

Response to CFA Institute's Consultation Paper on the development of CFA Institute's ESG Disclosure Standards for investment products
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-uk-response-form-consultation-paper-on-esg-disclosure-standards.pdf

Response to the FCA (CP20/3) on proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations
[October 2020]
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/ccdr-final-letter-to-fca.pdf

Response to the BSI (PAS7341) 'Responsible and Sustainable Investment'
(February 2020)
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-uk-letter-to-bsi-on-pas-7341-28-february-2020.pdf