AMIC
The buy side voice of ICMA
Asset Management & Investors Council

ICMA
International Capital Market Association

CP 21/17: Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers

https://www.fca.org.uk/publication/consultation/cp21-17.pdf

CP deadline 10 September

ICMA's AMIC welcomes FCA CP 21/17 on climate related disclosures by asset managers, life insurers, and FCA-regulated pensions providers.

Our members are global asset allocators working with international client bases. It is critical for them that regulators work towards a coordinated approach that works for investors across jurisdictions.

AMIC therefore welcomes the fact the FCA proposals are being based on the TCFD recommendations , which form part of a globally recognised standard.

Our main concern, which is also the most difficult SFDR implementation challenge, is that the implementation timing requires the buyside to disclose on metrics which are not yet required from issuers.

From an investor's perspective, the sequencing proposed by the FCA is far from ideal as it is both costly and approximate.

There are currently important discrepancies between assessments performed by ESG data providers, precisely due to the absence of mandatory, standardised, and audited reporting for issuers. This heterogeneity of information forces asset managers to work with several ESG data providers in order to work out the credible average performance of an issuer against the most basic KPIs (such as carbon emissions).

Furthermore, we think it is important to highlight that for some asset classes/products, like sovereign bonds, calculating the core KPIs such as GHG emissions will be subject to methodological choices, biases and therefore approximations.

Overall, we believe that the proposal and implementation phases as they stand will necessarily result in an ongoing data coverage issue and significant reliance on proxies and estimates with disclosures that won't always be comparable and sometimes difficult to explain to the end-investors.

Requiring UK listed issuers to disclose against the core metrics first would be conceptually the right order to follow but in practice it would only partially help asset managers given that they also invest across the globe and in non listed assets (private debt/equity).

Our key message in our response is thus that the sequencing of the disclosure requirements should be first on the issuer side at international level (upcoming IFRS standard), followed by the buyside, and that in the meantime the proposed approach is applied on a "as far as they are able" approach, as adopted by the DWP and The Pensions Regulator, with accepted use of proxies and estimated data.

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.

Yes, although we note that the geographical scope (i.e. UK entities and UK domiciled products) would mean that non UK authorised managers marketing their funds in the UK would not be subject to the same disclosure requirements which would lead to products sold in the UK treated differently and

resulting in different levels of disclosure transparency between UK and not UK entity products offered in the UK.

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 believe some products should be out of scope and that there should be flexibility around reporting for in-scope products where appropriate (e.g. data gaps).Our members have identified several asset classes which we consider should be out of scope given that they have metrics which either cannot be obtained or metrics which are not relevant. These asset classes include:

- Legacy asset backed securities: This asset class has data gaps as well as no possibility to gather data at some point in the future given that there is no corporate data from which firms can engage with to request data from. There is no practical way to gather data for this asset class unless the data was provided at deal launch.
- Currency instruments: Climate-related metrics are not relevant or applicable for this asset class.
- Derivatives: There are considerable challenges in employing climate-related metrics with respect to this asset class. There is no issuer linked to derivatives instruments to determine the metrics. Even if derivatives instruments were linked to a corporate, holders of derivatives do not have any direct ownership or influence on the company and its GHG emissions.

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

We agree with phased implementation and timing of the disclosure requirements, but the success of delivering those metrics depends on the investee companies providing this data ahead of asset managers disclosing on those KPIs.

Requiring UK listed issuers to disclose against the core metrics first would be conceptually the right order to follow but in practice it would only partially help asset managers given that they also invest across the globe and in non listed assets (private debt/equity).

Our key message in our response is thus that the sequencing of the disclosure requirements should be first on the issuer side at international level, followed by the buyside, and that in the meantime the proposed approach is applied on a “as far as they are able” approach with accepted use of proxies and estimated data.

Setting a mandatory list of KPIs applicable to the buy-side will not considerably enhance product comparability unless all issuers are subject to similar disclosure obligations.

We suggest the “as far as they are able” approach in reference to the approach which has been adopted by DWP and The Pensions Regulator (TPR) on TCFD reporting for pension funds. Our members consider that this approach is an appropriate balance between encouraging reporting whilst ensuring that the effort and cost deployed to try to fill the data gap issues are not disproportionate. This approach would help the FCA’s commitment to align with the DWP rules and avoid the UK regulators adopting two different approaches for the same reporting. We do not think it is sensible to adopt two separate approaches given that there will be entities which will be caught under both regulations.

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.

Given that there is currently no requirement on listed companies to disclose against the proposed metrics, asset managers will have overall to significantly rely on proxies and assumptions. This will be true for all investments with specific asset classes subject to more challenges than others. For instance, for green bonds, we usually know the carbon emissions avoided thanks to the use-of-proceeds and not the actual carbon emission of the project. For example, in the case of buildings,

their ongoing energy consumption makes up for the majority share of buildings overall carbon emissions profile. Calculating emissions can be complicated due to multiple electricity generating sources but it can be estimated.

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?

Yes, some firms already provide a TCFD report in their annual reports based on the 2017 TCFD recommendations. The flexibility to cross-refer to other reports is welcomed especially for large group where the TCFD report is currently being issued by the holding company and not necessarily the UK entity.

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?

Yes although we have several concerns around scenario analysis.

Conducting temperature scenario analysis at a portfolio level requires having access to verified data from issuers, which is currently missing. Beyond the issue of access to data, we want to highlight the fact that the implementation of climate scenario analysis by investors is still in its infancy from a methodological perspective and the science behind is complex. Investors need to choose a warming scenario and all the various attached assumptions i.e. the energy supply and demand mix, GDP growth and a discount rate. Many different methods of scenario analysis are being suggested and promoted, each with different assumptions and data sets. Several approaches are also proposed to estimate carbon budgets compatible with a scenario of 1.5°C. The allocation of a carbon budget between countries, regions, sectors and issuers is also another challenging step from a methodological point of view. We do note however the recent publication of the NGFS climate scenarios for central banks and supervisors which may considerably contribute over time to progress on methodological issues.

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 are of the view that all firms should ultimately be setting climate-related targets on a voluntary basis but we do not see any added value in firms disclosing why they haven't if they are not yet set.

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?

Yes we support the proposed approach but would also recommend that there is guidance to ensure that disclosures are not "copy-pasted". AFMs should understand the content and context of third-party portfolio managers reporting before using it in order to maintain a high level of care and rigour with their own reporting.

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?

Yes we support these proposals but would recommend that asset owners provide a minimum level of judgment, assessment and oversight before re-publishing pre-existing disclosures.

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?

Yes, including portfolio/product level disclosure ensures full transparency in the full investment chain and firms are already providing this information on clients' requests.

Our members however do not agree with the proposals on the provision of granular data on the underlying holdings as license agreements with data vendors would not allow this. License agreements with third party data providers restrict asset managers from sharing company-level data. This would mean that data for each individual holding could not be shared with a client without breaching contractual agreements with data vendors.

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 list of proposed core metrics but end investors should be warned that product disclosures are done on a "as far as they are able " approach and that the use of estimates and proxies are authorised.

Some firms have started reporting GHG emissions in their TCFD reports and have noted that they do not have sufficient CO2 data coverage to support GHG emissions data reporting for 100% of their funds. Particularly with respect to scope 3 emissions, firms are reporting where possible but the lack of standardised methodologies and data gaps for certain asset classes make it very difficult to measure this category comprehensively.

This data gap issue has a knock-on impact on other core and additional metrics (given that they also rely on Scope 1, 2 and 3 emissions for their accurate calculation). Until this data gap is resolved we think it's premature to impose disclosing against additional forward looking metrics such as the Climate VaR.

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 would welcome global alignment on proposed methodologies and are concerned that having two measurement approaches per KPI will confuse retail investors and will be difficult to incorporate into a coherent and user friendly disclosure report. We would support sticking to one methodology so that we can avoid the situation of having to justify several and different figures for the same metric to retail investors. Cross-jurisdictional alignment for disclosure standards is critical, we favour the TCFD methodology as it is the globally recognised standard, being referenced by most jurisdictions apart from the EU, and would thus welcome this proposal to limit the disclosure of the core metrics to the TCFD methodology only.

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

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

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

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

We think it's premature for the proposed rules and guidance to refer to the TCFD Final Report as this updated TCFD framework has not been finalised yet. The TCFD framework is an important baseline for climate change reporting but the market is not yet able to implement the proposals as coverage is low and there are a lot of data gaps. The updated versions will be welcomed future aspirations, but in the immediate future the proposed rules should refer to the current existing TCFD framework as the market is still working towards complying with the current requirements.

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

No we do not agree with the proposed approach. We would welcome the proposal of the core metrics on a "as far as they are able" approach, given this data will already be based on many assumptions. The industry should aspire towards those additional metrics but it shouldn't be mandatory) given that we do not yet have access to audited and reliable underlying data to compute these forward looking KPIs.

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 direction of travel but there is no common standard around methodology for this yet.

As outlined in Q6, we have several concerns around scenario analysis.

Conducting temperature scenario analysis at a portfolio level requires having access to verified data from issuers, which is currently missing. Beyond the issue of access to data, we want to highlight the fact that the implementation of climate scenario analysis by investors is still in its infancy from a methodological perspective and the science behind is complex. Investors need to choose a warming scenario and all the various attached assumptions i.e. the energy supply and demand mix, GDP growth and a discount rate. Many different methods of scenario analysis are being suggested and promoted, each with different assumptions and data sets. Several approaches are also proposed to estimate carbon budgets compatible with a scenario of 1.5°C. The allocation of a carbon budget between countries, regions, sectors and issuers is also another challenging step from a methodological point of view. We do note however the recent publication of the NGFS climate scenarios for central banks and supervisors which may considerably contribute over time to progress on methodological issues.

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?

Given that scenario analysis remains subject to many assumptions and limitations, we do not consider that it can yet provide a reliable output upon which users could base decisions.

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 this approach and asset managers already provide this information to clients on request.

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?

No comment

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

No comment

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.

No comment