PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

THE FINANCIAL CONDUCT AUTHORITY: ENHANCING CLIMATE-RELATED DISCLOSURES BY ASSET MANAGERS, LIFE INSURERS AND FCA-REGULATED PENSION PROVIDERS (CP21/17)

SEPTEMBER 2021

CONTENTS

EXECUTIVE SUMMARY

- The Financial Conduct Authority's (FCA) proposals are an important step in setting requirements for asset managers, life-insurers and FCA-regulated providers that will shortly be mandated to produce Task Force for Climate Related Financial (TCFD) aligned disclosures.

- The PLSA asks that the FCA's proposals for metrics should be more aligned with the Department for Work and Pensions' (DWP's) Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, which aim to improve both the governance and level of action by trustees in identifying and managing climate risk. An alignment with the DWP regulations will provide greater consistency across the industry on what is being required. This includes providing clarity on the definitions of "relevant assets" and revisiting products in scope to allow for a more coherent approach to TCFD disclosures across the investment chain. This will allow clarity within the industry on expectations and will avoid confusion while also adding comparability. Clarity and comparability will help to contribute efficiency in the market and could help improve investor and consumer awareness.

- We welcome the FCA's forward thinking on the additional metrics, though we believe that this should be done in incremental stages, to allow firms to prepare. We believe these "best efforts" requirements could create further operational challenges to disclosures more broadly, and if mandated, should not be required before 30 June 2024, which is the same deadline applied for scope 3 GHG emissions. This deadline is important, as the FCA recognises that there may be significant data gaps in the short term until further implementation of disclosure requirements.

- The PLSA asks that the FCA recognises the differences between Asset Managers – which have commercial considerations – and in-house investment teams for private sector schemes, as well as those within the LGPS pools. The latter groups (in-house investment teams) should only be held to comply with similar requirements to those for the private or public sector from DWP/TPR guidance and MHCLG, so that they should not have to be compelled to report according to requirements designed with different categories of organisations in mind.

- The consultation indicates that changes to the TCFD requirements will automatically flow through to these proposals. The PLSA believes a further step should be included to ensure the transposition of any rules is appropriate to the UK regulatory framework. Some of the concerns raised by investors - to the TCFD short summer consultation on changes - include significant data collecting and reporting burdens on our members without due consideration of the relative costs and benefits of these proposals.

ABOUT THE PLSA

We are the Pensions and Lifetime Savings Association; we bring together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with 20 million members and £1 trillion in assets, across master trusts and defined benefit, defined contribution, and local government schemes. Our members also include some 400 businesses which provide essential services and advice to UK pensions providers. Our mission is to help everyone to achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings, and to build the confidence and understanding of savers.

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

The PLSA believes that climate change presents a material risk to all firms, regardless of size, and we suggest that the proposed scope of firms could be extended to firms below the £5bn threshold over time. However, we are conscious that smaller firms may face challenges in implementing the requirements in a cost-effective way and will require more time to build their capabilities.

We acknowledge that the proposed scope covers most UK assets under management (AUM) and should therefore support the flow of information useful to the decision-making process across the investment chain. Firms with assets under administration (AUA) are the custodians and not the asset owners and they cannot proactively change the composition of that fund. If we take BNY Mellon as an example, their AUA figure ($45tn) is about 20 times larger than their AUM figure ($2.3tn) and therefore their metrics would be 20 times higher. We would therefore recommend that AUA are not in scope as their inclusion could lead to the wrong things being reported and, in some cases, duplicated and create further cost.

As acknowledged in the consultation, some firms in scope of the proposals will already be subject to overlapping entity-level disclosure requirements, aimed at shareholders, in their capacity as listed issuers. In contrast, the disclosures to be made under these proposals are targeted at clients and consumers. We recommend that the FCA provides guidance to in-scope firms on any differences in the information likely to be useful for client/consumers and on how these disclosures relate to one another. We believe our recommendation will prevent duplicative reporting and maintain consistency between disclosure regimes.

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

We believe the FCA should review its proposed scope of products; our members have suggested that products such as derivatives and legacy asset back securities (ABS) should not be in scope, due to the lack of data. Some of our members have raised concerns about the use of ABS, as there is not an issuer to start asking for data; usually the bank transfers the risks, and it is off their balance sheets. This would require firms to introduce a completely new process to collect this information, which would be operationally challenging and may be costly as well as time consuming. We would recommend the FCA revisits its proposed scope of products and examines whether an inclusion of some of the products mentioned earlier, would materially help ensure climate related risks and opportunities are managed.

In addition to the above, we would recommend that reporting on a product-level basis is restricted to those launched after 2010, and for those which have a minimum AUM of £10m. This would eliminate the need for firms to report on legacy / niche products, which are of limited interest and value, allowing them to focus their efforts on their major products.

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

We would like to stress the importance of collaboration and communication between the FCA, DWP, BEIS and others to ensure coherence between the multiple TCFD regimes and to mitigate the risk of reporting gaps – as well as effort duplication against differing requirements - within the same organisation or across the sector. A lack of coherence could have a bigger impact on the underlying aims of the HMT roadmap.

We support the FCA's phased implementation timetable. This will provide smaller/less resourced firms with additional time to prepare and implement their disclosures. We would also like to ask that the FCA carefully coordinate proposed timings with the implementation timelines of other TCFD initiatives in train with other government bodies; a joined-up approach is crucial to ensure the efficient flow of data for reporting.

For example, the first set of climate-related disclosure requirements for the largest occupational pension schemes and authorised master trusts apply from 1 October 2021 (with TCFD reports to be published within 7 months of the scheme year underway on that date). The deadline for the first TCFD reports to be published by firms in scope of this consultation is 30 June 2023. The ability of pension scheme trustees to meet their TCFD reporting obligations, as set out in the DWP regulations, is dependent on firms' ability to provide that data, with the timelines proposed, this may not be readily available for a considerable period of time

The PLSA also recommends that before the FCA proposals are mandated, there is a commitment to review and assess the costs and benefits that any new requirements may bring before they are introduced. A lack of review of the costs and benefits will have a detrimental impact on the decision making of trustees when making investment decisions. Again, we would stress it is crucial these proposals are aligned with the regulations set out by DWP to allow for greater consistency, which will ultimately help contribute to efficiency in the market and could help improve investor and consumer awareness.

We stress that the FCA recognises the differences between Asset Managers – which have business considerations – and in-house investment teams for private sector schemes, as well as those within the LGPS pools. We recommend the latter groups (in-house investment teams) should only be held to comply with similar requirements to those for the private or public sector from DWP/TPR guidance and MHCLG.

As such, the PLSA would recommend that the timings of the first round of disclosures be moved up to align more closely with when schemes are being asked - and LGPS funds will be asked - to produce their climate-related disclosures. So long as asset managers have sufficient time to produce what is being asked of them, it would be helpful for schemes to have access to this information sooner rather than later.

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

Yes, we expect there to be significant challenges in using proxy data or assumptions to address data gaps. Some of those challenges will include the different range of approaches to creating proxy data, as well as the lack of data for "non-corporate" investments, such as real estate and infrastructure assets.

The PLSA's preference is for high quality data to be made available; however, as we noted in question two, we would recommend the FCA revisit its proposed scope to ensure it would materially ensure climate-related risks and opportunities are managed. The DWP statutory guidance notes this and does not expect trustees to be able to readily calculate emissions for derivatives.

We recommend the FCA adopt the DWP's "as far as they are able" approach and provide a framework, which is aligned with the DWP's statutory guidance.

We welcome the FCA's acknowledgement on the limitation of data, so we would urge the FCA to work with the DWP to consider an agreed methodology for such assumptions, to avoid risks created by making decisions based on inconsistent methodology. While the assumption of proxy data can help inform investment and fund strategies, we would ask that the FCA is clear on expectations, such as provided in the DWP statutory guidance, to avoid any significant impact on the accuracy of reporting results.

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

We welcome the FCA's approach of flexibility to cross-refer to other reports; however, safeguards must be introduced to maintain transparency around specific climate-related risks which in-scope firms may be exposed to. These safeguards should be accompanied by clear explanations of any material deviations between the firm's approach and that of the group/delegated portfolio manager. We would recommend the FCA provide guidance on this to ensure relevant information is easy to access and user-friendly for investors to find so that they are not buried in references.

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

We do agree with the proposed approach in terms of firms having to describe how its governance, strategy, and risk management, including scenario analysis, varies for different products. However, as mentioned previously, we have some concerns about the proposed timeline, as pension schemes will depend on the disclosures made by their asset managers to fulfil their own climate-related obligations. This includes scenario analysis, which schemes will need to undertake at least every three years (including the first year the DWP's Occupational Pension Schemes

(Climate Change Governance and Reporting) Regulations 2021 rules enter into force). We would stress again that this makes the alignment between the FCA and DWP even more important to allow for greater consistency and will strengthen the governance across the board.

The FCA's proposed approach does not indicate how regularly in-scope firms will need to undertake scenario analysis. We acknowledge that proposals for in-scope firms to provide "on demand" climate data to clients will mitigate this issue to some extent. However, we believe the FCA's scenario analysis should be aligned with the DWP's Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, which will be carried out by pension schemes to allow for greater consistency. In addition, we recommend that the FCA provides clarity on the circumstances in which in-scope firms would be expected to review whether new scenario analysis is required (e.g. because of a material increase in the availability of data).

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

Yes, we do agree. We believe it is the responsibility of investors to identify and mitigate material financial risks as part of the investment process, including climate-related risk.

Consultation question 8: Do you agree with our proposals for AFMs that delegate investment management services to third-party portfolio managers? If not, what alternative approach would you prefer and why?

Yes, we do agree with the FCA proposals for AFMs that delegate investment management services to third-party portfolio managers.

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

Yes, we do agree with the proposals for asset owners to cross-refer to group-level, third party or delegate reports; as highlighted in our response to question 5, safeguards should be put in place. These safeguards should include a requirement for firms to be clear with the specific reference, for example, where, how and why they think the other document is helpful.

10: 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 support the FCA's proposals to introduce TCFD disclosure requirements at the product-level and portfolio-level. These disclosures will help to provide clients and consumers with specific, decision-making information on the climate-related risks and opportunities, and how these risks and opportunities are identified and managed.

We agree with the proposed requirements for in-scope firms to provide climate-related data and information on their underlying holdings on request. This should enable other actors across the investment chain to meet their own TCFD-related disclosure obligations.

However, as we highlighted, in our response to question three, we recommend the timeline should be brought forward as pension schemes will need those disclosures on their portfolio or mandates.

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

We welcome the FCA's efforts to align the proposed metrics with the recommended metrics under DWP's statutory TCFD guidance.

Separately, in theory, the principle to calculate metrics in line with the methodologies prescribed under Sustainable Finance Disclosure Regulation (SFDR) would enable greater standardisation of, and comparability between, UK and EU financial products.

However, we are concerned that the proposed methodologies for calculating several metrics set out in this consultation do not align with the recommended methodologies proposed by DWP, which are not linked to SFDR. The level of effort needed to produce two different sets of metrics is high and costly and could create confusion over which figures are the "right ones".

As mentioned in the answer to question three, while we understand the urgent need to act on climate-related disclosures, the PLSA urges all the government bodies and regulators working on climate change related initiatives to be joined up in timelines, methodologies, and objectives, so that the industry can gather and use common data.

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

The usefulness of the proposed metrics will depend on the extent to which the methodologies that underpin them are comparable with those used by other organisations across the investment chain, including pension schemes. We are concerned the formulas set out in column A do not align with the recommended methodologies set out in the DWP's statutory TCFD guidance. For example, under the proposed carbon footprint metric, the formula in column A advantages issuer market capitalisation, whereas DWP recommends the use of Enterprise Value Including Cash (EVIC). We suggest that the FCA reviews these formulas to align directly with the approach taken by DWP to allow for greater consistency.

13: Do you agree that, subject to the final TCFD guidance being broadly consistent with that proposed in the current consultation, our proposed rules and guidance should refer to: The TCFD Final Report and TCFD Annex in their updated versions, once finalised; The TCFD's proposed guidance on metrics, targets and transition

plans and the proposed technical supplement on measuring portfolio alignment. If not, what other approach would you prefer and why?

We agree it is appropriate for the FCA to refer to the updated TCFD Final Report, TCFD Annex, and proposed guidance if they align with the proposed rules put forward in this consultation. The PLSA believes a further step should be included to ensure the transposition of any rules is appropriate to the UK regulatory framework. However, it is important to stress that the FCA proposals should prioritise the need to maintain consistency with the DWP proposals and other regulatory initiatives within the UK TCFD roadmap, to avoid both confusion over what is required, and to avoid inconsistencies in methodologies that could create additional, unnecessary work. As highlighted in question 3, investors have some concerns about the TCFD short summer consultation on changes including - significant data collecting and reporting burdens on our members without due consideration of the relative costs and benefits of these proposals.

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

We support the FCA's efforts to promote the use of forward-looking metrics. We note the FCA recognises that methodologies and best practice for calculating these metrics continues to evolve. On that basis, we would recommend these additional metrics are introduced in a phased approach to allow for sufficient data to be available and require disclosures from no later than 30 June 2024, in line with the FCA's proposals for Scope 3 GHG emissions. This deadline is important as the FCA recognises that there may be significant data gaps in the short term until further implementation of disclosure requirements. It is important again to stress the FCA proposals should maintain consistency with other regulatory initiatives and given the lack of data available in these areas, this would make it difficult for our pension schemes.

Some of our members have highlighted that the additional metrics would be very difficult for consumers to digest. Without detailed knowledge, it may be difficult for potential customers to understand what is in their financial interest. A risk rating style approach, for example a score card, might aid customer understanding and engagement, and lead to pro-active action by investors, whereas confusion will likely lead to inaction and / or poor decision-making.

Any such metrics should be easily understood to retail investors and be consistent across all firms and products to allow easy comparisons to be made.

15: 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 are broadly supportive of the FCA's proposed approach, including the proposals for firms to undertake scenario analysis at product/portfolio-level, which will enable pension scheme trustees to meet their own scenario analysis requirements under the DWP TCFD rules.

We are supportive of the FCA's efforts to ensure consistency between the scenario analysis requirements for in-scope firms and the requirements for pension schemes under the DWP rules.

The proposed approach strikes a balance between supporting the information needs of trustees, while also remaining proportionate for firms. As data in this area continue to evolve, more firms will be able to move from qualitative analysis to more sophisticated quantitative analysis over time.

We support the requirement of firms with concentrated exposures to carbon-intensive assets to undertake quantitative analysis as soon as practicable. We understand the rationale for the FCA's decision to avoid being overly prescriptive in defining thresholds for "concentrated" or "higher" exposures to carbon-intensive sectors. However, we recommend it would be helpful to provide guidance that enables asset owners and asset managers to determine what sectors/holdings should be considered carbon intensive.

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

Pension schemes will need to account for the cost and feasibility of producing such outputs when making asset allocations, this could result in a distraction on their fiduciary responsibilities and prevent trustees from good decision-making.

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

We agree with the suggested approach as we believe this information, will be of most use for pension schemes when reviewing individual funds. This information would also help trustees when looking at the climate-related risk of their own schemes.

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

Yes, we do agree.

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

Yes, we do agree - for DC schemes/sections using a single manager for their default arrangements - that having the investment manager report on the default fund (rather than the trustees having to aggregate the individual components) will be very useful.

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

NA

DISCLAIMER

Material provided in this publication is meant as general information on matters of interest. This publication is not meant to give accounting, financial, consulting, investment, legal, or any other professional advice.
You should not take action based on this guide and you should speak to a professional adviser if you need such information or advice.
The publisher (The Pensions and Lifetime Savings Association) or sponsoring company cannot accept responsibility for any errors in this publication, or accept responsibility for any losses suffered by anyone who acts or fails to act as a result of any information given in this publication.