THE INVESTMENT ASSOCIATION

FCA CP21/17: Enhancing Climate-Related Disclosures by Asset Managers, Life Insurers and FCA-Regulated Pension Providers

Response from the Investment Association

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 40% of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The risks presented by climate change to business, society and the environment are clear. The need for companies, investors and regulators to act with urgency to address them is undeniable. Climate change, and efforts to mitigate its impact, could result in a significant loss of value in investee companies. This will ultimately impact on ordinary savers, whose pensions and savings are invested in these companies. Greater integration of the climate change risks and opportunities in investors' portfolios is therefore critical and will lead to better climate-adjustment outcomes for the investments made on behalf of them.

Economy wide, TCFD-aligned disclosures are a crucial step forward to managing the impact of climate change; supporting companies to focus on the effects of climate change on their business and communicate how these are being managed to their investors; supporting investment managers to communicate to their clients the impact of climate change on their investment portfolios. As such, the investment management industry welcomed the government's published roadmap on making TCFD reporting mandatory across the economy by 2025 and the Investment Association set out in our November 2020 position paper on climate change our commitment to work closely with our members and their pension fund clients to support them to make their own TCFD disclosures.

We therefore welcome the FCA's proposals for climate-related financial disclosures by asset managers and asset owners and support the broad aims and the approach taken in areas such as scope, timing, alignment with pension funds clients' climate-related disclosure obligations, and the flexibility to provide entity-level reports at group-level.

We do, however, have a number of overarching concerns, which if not addressed could result in misleading disclosures to clients and as a result, potential mis-pricing of assets and mis-allocation of capital:

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- There is a need for greater coherence of approaches to TCFD reporting through the investment chain. Asset managers and their clients need high quality, meaningful and comparable disclosures from investee companies in order to make well-informed climate-related investment decisions and fulfil their own climate-related disclosure obligations. However, we remain of the view that there is a mismatch between the mandatory and more granular nature of the proposals on asset managers and asset owners, in comparison to the comply or explain regime for corporate issuers disclosing under the TCFD framework. While we welcome recent work by the FCA and BEIS commitments to address coverage gaps in TCFD reporting across UK companies, further work is needed across the government and regulatory community to address this in a timely manner. We stress the need for clarity on when the FCA's proposals for listed issuers will move to a mandatory basis and the need for BEIS' to strengthen their proposals to ensure the right level of granular climate related information for investors to effectively integrate climate risk into the investment process. Please see our response to CP21/18 and to BEIS's proposals on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs) for further information. This should also include work with securities regulators in other jurisdictions, to increase the coverage of TCFD reporting by companies at a global level. We welcome the commitment set out by the finance ministers of the G7 to this effect.

- In addition to the issue of data gaps arising from the current plans for UK corporate issuers, and overseas investments, data gaps also exist at an asset class level, in relation to those asset classes where the implications of climate-related risks are either not apparent (e.g. derivatives, currency instruments), or where data will unlikely to ever be available (e.g. legacy asset-backed securities). We do not support the use of proxy data and assumptions[1] to fill these gaps: these can be subjective, lacking in comparability and volatile, and as a result unlikely to be decision-useful for investors. It may even result in the mis-pricing of assets and mis-allocation of capital.

- For some managers and clients, the data gaps will affect a significant proportion of their assets under management and the effort that goes into obtaining the required information may not be proportionate in terms of climate outcomes. Considering these challenges, the IA recommends that the FCA follow the 'as far as they are able' approach utilised by the DWP in its' TCFD regime for pension funds in respect of reporting on metrics, targets and scenario analysis. This would be a pragmatic recognition of the situation as it exists today with respect to data gaps and in the short-to-medium-term will provide reassurance to investment managers and their clients that the quantitative disclosures they make would reflect the reality of data availability at any given point in time. In the meantime, the investment management industry is working at pace to improve the availability of information from companies through the stewardship role it plays across the range of asset classes. This work will address data gaps and lead to more complete reporting over time.

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[1] We note also that requiring the use of proxy data and assumptions will increase the reliance of asset managers and asset owners on unregulated ESG data and ratings providers, an issue which is increasingly attracting the attention of regulators globally.

In addition, there are a number of specific points where we believe the proposals would benefit from further refinement:

- In-scope firms: we recommend that OPS firms be carved out of the FCA's TCFD proposals, on the grounds that their parent pension schemes – their sole client – are covered by the DWP TCFD regime. We do not see any benefit in OPS firms being effectively subject to two TCFD regimes. A similar issue will arise in future with respect to Local Government Pension Scheme (LGPS) pools and their LGPS fund clients, who will in due course be subject to their own TCFD reporting obligations.

- Provision of climate-related metrics of underlying portfolio holdings: licensing agreements with data providers generally prevent firms from sharing climate-related metrics at the security level with third parties. A requirement to disclose such information at the portfolio/asset class level would be more compatible with current market practice.

- Calculation of metrics on a TCFD and SFDR basis: We do not see the need for calculations to be made on a dual basis and believe that this would be particularly confusing for investors, as well as increasing the reporting burden for firms. Therefore, we recommend the FCA use only one set of formulae, in line with TCFD.

- Finally, we have concerns around the provision of detailed metrics to retail investors. There needs to be greater understanding of how retail customers are likely to engage with this information in their investment decision-making.

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 agree with the proposed scope of **asset management firms** outlined, with the exception of one category of firm which we discuss below. The activities captured – portfolio and fund management, broadly defined– are appropriate.

However, we believe that OPS firms should be exempted from the FCA's proposals in respect of asset management firms. OPS firms are the in-house investment management arms of occupational pension schemes and have their own FCA-regulated firm category, as a result of which, they owe clear regulatory obligations to their sole clients, the parent pension fund. With regards to TCFD reporting, the parent pension schemes will be subject to the DWP's regulations and will be reliant on their in-house OPS firm to provide them with the information needed to meet these obligations. It is the DWP regulations that will therefore be most relevant for OPS firms. With no external clients there is no benefit to OPS firms making their own TCFD disclosures under the FCA's rules. Including them in the FCA's TCFD regime will lead to duplication of reporting and a timetable that is out of sync with the DWP's requirements, which take effect for the first wave of in-scope pension schemes from1 October this year.

We therefore recommend exempting OPS firms from the scope of the FCA's proposals. The simplest way to do this would be to rely on the definitions of an OPS firm and OPS activity in the FCA Handbook and simply exclude these categories from the list of in-scope firms and business respectively.

In a similar vein we note that a number of Local Government Pension Scheme (LGPS) pool companies are AIFMs and thus captured by the FCA's proposals. The pool companies are similar to OPS firms in that they have only one type of client – in this case LGPS funds – who will in future be subject to their own TCFD reporting obligations, on which MHCLG will consult in due course [2]. Since the pool companies have only one client type, we recommend that the FCA ensures that its' proposals fully align with MHCLG's plans for TCFD reporting by the LGPS.

With regard to the £5 billion size threshold we are supportive of the proposal to exclude asset managers below this threshold from the obligation, although as we note in our responses to question 3 below, asset managers that manage money for UK pension scheme clients will face commercial pressures to help their clients with TCFD reporting, regardless of whether they themselves are in-scope of the FCA regime. It is therefore likely that some firms below the £5 billion threshold will nonetheless be reporting in line with the TCFD framework.

A broader observation that we have on the scope of the proposals relates to the size of the UK market covered from the perspective of the end retail investor. The FCA states in paragraph 3.17 of the CP that the proposed threshold *"would capture 98% of both the UK asset management market and held by UK asset owners"*. We think the actual level of coverage in the retail investment market is likely to be somewhat lower. This is because

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[2] See paragraph 1.17 of the Government's TCFD Roadmap.

much retail investment is intermediated via distributors, that are largely out of scope of the proposed obligations (other than where they provide a TCFD-product). As a result, even though the funds being distributed may be publishing TCFD data, distributors dealing with the end investors will not be obliged to pass any data on to them. Given the core focus of the FCA's proposals is to ensure that UK institutional clients, particularly pension schemes, have the information they need to make their own climate-related disclosures, this may be less of an immediate concern. However, it does suggest that further measures may be necessary to ensure broader retail market coverage of climate-related financial disclosures.

For **asset owners,** we agree with the proposed scope of firms captured. It is particularly important that providers of DC pension products (both insured and non-insured) are captured, since the long time-horizon of these products may mean that they are particularly exposed to the risks and opportunities arising from climate change. Moreover, while these firms may not always manufacture their own investment components, relying instead on those manufactured by external asset managers, they still carry out investment activity through asset allocation and fund and/or manager selection decisions that are taken in the construction of the pre-set investment portfolios that sit inside these products[3]. Climate change considerations have the potential to affect these decisions and it is therefore entirely appropriate that these firms are in scope of TCFD reporting. We agree with the £5 billion size threshold for determining which asset owners are in scope.

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

We agree with the proposed product scope to include authorised funds, unauthorised AIFs, and portfolio management services; however, the consultation does not sufficiently recognise the breadth of asset classes that might be reported upon and the relevance of climate-related factors and data availability to those asset classes. The requisite underlying data will be most complete and transparent for equity and corporate fixed income instruments from large public issuers and in that regard, we welcome the proposals in CP21/18 to bring listed debt issuers into scope for TCFD reporting. For other asset classes and issuers, the underlying data may not be relevant or available. As such, we believe there should be greater flexibility around what asset managers should be required to report in relation to the quantitative elements of the proposals, in particular metrics and targets.

In particular, firms should have the ability to apply judgement on whether to report metrics or not, and if not, to provide an explanation. Alongside this, the FCA should include a provision allowing asset managers to report the percentage of a portfolio for which data is not available for each asset class. This would bring the FCA's proposals further into line with the DWP's regulations for occupational pension schemes since it effectively mimics the requirement in the latter to produce metrics and targets only as far as pension trustees are able, while providing transparency over where there are gaps and what is being done to address them. This is a pragmatic way to address the issue of data gaps and relevance of climate-related metrics and we have supported this approach being taken by the DWP. We strongly urge the FCA to do the same.

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[3] The same argument applies to the provision of insurance-based investment products, which we agree should also be in scope of TCFD reporting.

Examples of asset classes or issuers where metrics are either not relevant or are unlikely to be obtained include:

- Collateralised Loan Obligations (CLOs). These instruments have neither data or estimates available, nor is there is currently any climate-related disclosure requirement for loan issuers, which makes product-level disclosures impossible.

- Legacy asset backed securities (ABS). Unless the information was provided at deal launch, it is not practically possible to gather data as there is no corporate entity to provide this information.

- Currency instruments. We do not believe that climate related metrics are relevant or applicable for currency instruments.

- Derivatives. Many derivative instruments are not linked to a corporate issuer and thus would not have relevant carbon metrics. In instances where a derivative references a corporate entity (e.g. credit default swaps or equity derivatives), holders of derivatives do not have any direct ownership or influence on the company and its GHG emissions. In addition, where derivatives are used for short term trades or hedging, the climate risk component may be less relevant and the technical burden may be disproportionately high, given trades are often added and then taken off quickly.

For these asset classes we recommend the FCA give consideration to declaring them out of scope for the reporting of metrics. This will simplify the reporting process for firms and allow them to focus on asset classes where data exists and is decision-useful for investors.

Examples of asset classes where there are currently data gaps include:

- Traditional (i.e. non-green) government and supranational bonds. While the core metrics are theoretically possible to produce for government and supranational bonds, there are real issues with double counting and scope of what categories of the entities' emissions must be agreed. There is also the scope for real methodological inconsistencies with the additional metrics.

- Private debt and loan securities. Data on private debt and loan securities is extremely limited. We also note that while vendors are working towards addressing this gap, their metrics may rely heavily on assumptions and proxies where information is not publicly available.

- Newly issued asset backed securities. While data is increasingly available, gaps remain, and in some cases, it will not be relevant. Investment managers are supporting industry initiatives to provide this data; however, cooperation from issuers of ABS is also needed.

- Smaller companies remain out of scope of climate-related disclosure requirements and are less likely to voluntarily provide the requisite data.

- Investment managers invest globally on behalf of their clients. Not all jurisdictions have climate-related disclosure requirements for companies issuing securities in their markets. Until there is a high degree of global standardisation and adoption of climate-related disclosure requirements, data gaps will persist.

In addition, multi-asset products will have a mixture of asset classes, some of which will have good climate-related data and others not. For these products our proposal for more judgement over what is reported would better reflect the state of data availability. A multi-asset product could therefore report at the asset class level, providing data for asset classes where available and for those where it is not, an explanation of why the reporting is absent. A percentage breakdown of the product's holdings covered by the available data would be a useful piece of contextual information. Such asset class level reporting would also better reflect the fact that metrics aren't always comparable across asset classes. For example, carbon intensity for corporates is very different than for sovereigns and they cannot simply be aggregated into a single value.

As the investment management industry works to improve the availability of information from companies through the stewardship role it plays across the range of asset classes, data quality and completeness will improve over the coming years, reducing the issues described here.

As a point of clarification, IA member firms would find it helpful if the FCA could clarify whether funds that have been in operation for less than 12 months are in scope of product-level reporting requirements.

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

We agree with the FCA's approach to implementing TCFD reporting obligations on a phased basis in accordance with the timeline proposed. However, we note that as a result of the DWP's regulations on TCFD reporting by occupational pension schemes coming into force from October 1st this year, asset managers will effectively already be in scope of TCFD reporting ahead of the FCA's rules coming into force.

This is because while the DWP obligations are on occupational pension schemes, the dependency on asset managers for much of the required information effectively turns them into requirements that also bind on asset managers. It becomes a commercial imperative to assist clients in meeting their own obligations. Many asset managers will therefore be working to produce TCFD disclosures for pension scheme clients on a best-efforts basis and the IA will be working to assist its' members in this regard.

Ideally, the DWP timetable would have aligned with the FCA's proposals to ensure that there was consistency of timing across the investment chain, but we accept that this is no longer possible. In light of that, the FCA's approach is a reasonable one, particularly if our recommendation about the approach to reporting on metrics, targets and scenario analysis on a basis similar to the DWP's 'as far as they are able' approach is adopted.

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.

The Investment Association does not support firms having to report on the basis of 'best efforts' using assumptions and proxy data. Mandated reporting should only apply where data is available, relevant, and methodology is clear.

Requiring firms to report on the basis of proxy data and assumptions is problematic for our members:

- Firstly, even assumptions need data to support them.
- The data and results are likely to be subjective and not comparable.
- It is possible to use assumptions which can make the climate-related characteristics of a portfolio overly-favourable and therefore possibly misleading to investors.
- We also question the value that the FCA attribute to this: i.e. investors being able to compare the same product with the same investment firm over time. In practice, if proxy data and assumptions are used it is highly likely that the methodology and assumptions will evolve and change over time, meaning that investors won't be able to compare easily. This can be exacerbated by changes in the availability of data coverage, which may lead to highly volatile reporting on an annual basis.
- This may also lead to an over-reliance on data providers in the future. We note that such firms are currently not regulated by the FCA and the issue of whether they should be is of increasing concern to regulators globally.

Instead, we think it would be better to apply the time and resource from the industry to help resolving the data gap issues quickly. We believe the FCA could encourage working groups to be established with the industry and policymakers to ensure this takes place as desired by policymakers. The IA additionally asks that the FCA produce greater clarity around their definition of 'best efforts'.

While data quality improves, the adoption by the FCA of a similar approach to the DWP of requiring the reporting of quantitative metrics and targets only as far as is able, and explaining where information is unavailable, will better serve investors, since it will provide them with actual information rather than proxy data.

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

The IA strongly supports the proposed approach to allow a firm to provide a group-level TCFD entity report. Many global firms have developed firmwide capabilities around sustainable investing, risk management and governance. A group-level report will allow firms to prepare a single set of TCFD-aligned disclosures reflective of their global business.

We also agree with following the TCFD's eleven recommendations as the basis for the FCA's proposed entity-level disclosure rules, as referring in the rules to the TCFD recommendations will allow future updates to the latter to be reflected in firms' TCFD entity reports.

We agree with the ability to rely on entity-level reports made:

- By other members of a corporate group where appropriate: this would appear a proportionate way to avoid duplication of reporting.
- In the case where a firm is captured by the FCA's TCFD reporting requirements on listed firms: again, this would avoid duplication of reporting.
- Where investment decisions have been delegated to another manager. It makes sense for the entity making the investment decisions to set out how climate-related factors influence those decisions. This is particularly relevant for asset owners relying on third party asset management products as components within their own products.

Our only additional comment is that we think it should be possible for a single compliance statement to be prepared by entities within the same group. It would be inefficient for each entity referring to a group TCFD report to have to prepare its' own compliance statement. A simpler approach would be for each relevant entity's senior management to sign the TCFD compliance statement.

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 agree with the proposed approach yet note that scenario analysis may not be appropriate, or possible, for some asset classes.

Scenario analysis is still subject to many assumptions and limitations and suffers from lack of comparability and therefore it must be acknowledged that the one size fits all approach will not work for all asset classes.

Similar to the DWP 'as far as they are able' approach to scenario analysis, we would suggest that the FCA provides firms with the flexibility to apply judgment over whether it's appropriate or possible to produce this.

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?

The UK investment management industry has already made significant commitments to climate-related targets. As of July 2021, UK investment firms with more than £5.6trn assets under management (AUM) have signed up to the Net Zero Asset Managers initiative and committed to investing aligned with net zero emissions by 2050 or sooner. This represents more than 66% of IA members by AUM. This means that the industry (both at home and globally) has comfortably exceeded the Race to Zero Breakthrough target set by the COP26 President-designate Alok Sharma in January 2021 to commit 20% of AUM to the net zero target. Globally, 43% of AUM has been committed to the Net Zero Asset Managers initiative, demonstrating that UK-based investment managers are ahead of their international peers in this regard.

The IA believes that climate-related targets can be important in helping achieve certain goals, and firms should be encouraged to set them where it is appropriate and in line with client preferences.

However, in doing so firms, clients and regulators must consider certain factors:

- Climate-related targets may not be relevant for certain kinds of business where the impacts of climate change are not relevant e.g. Liability Driven Investment (LDI) mandates, where heavy use is made of derivatives (see our response to question two)

- The role of investment managers as fiduciaries acting on behalf of clients. Firms, particularly those with large institutional businesses, often receive highly customised mandates from clients and find it challenging to commit to a target if it is not driven by client request.

- Poorly-designed climate-related targets can have unintended consequences, by incentivising sub-optimal behaviour. For example, a simple emissions-based target could be met by selling investments that have high-carbon emitting characteristics. This will improve the carbon score of the portfolio but will not lead to any meaningful change in the real economy, which should be the goal of climate-related investment decision-making. It is therefore important that the design and effects of targets are given careful thought before adoption.

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?

The IA agrees with the proposal to require the AFM to produce an entity level TCFD report since the AFM is responsible for running the fund. However, in doing so, it is entirely reasonable for the AFM to rely on TCFD disclosures made by any investment manager to which management of the fund's investments is delegated, since it is the latter that will be deciding how climate-related matters are taken into account when investing the fund's assets.

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?

The Investment Association agrees for two reasons:

- Most of the time asset owners will delegate investment decisions at the security level to external managers – so it makes sense to rely on the reports of these delegates.

- Since asset owners make decisions on manager selection and asset/fund allocation in their products they should be required to set out in their entity level reports how climate-related factors affect these decisions.

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 generally support the requirements regarding TCFD-aligned product or portfolio-level disclosures. These reports will provide investors with climate-related information regarding assets to which they have economic exposure.

Additionally, we support the proposed requirement to provide discretionary clients with TCFD portfolio reports once a year upon their request, to satisfy their own climate-related financial reporting obligations. This is superior to making the reports available on a website which often does not suit clients' need for confidentiality or the bespoke nature of the service often provided to institutional clients. We also agree with the proposed annual frequency and appreciate that the proposal clarifies that client portfolio reports may not be requested before 1 July 2023.

However, we do not support the recommendation to provide clients with climate-related data on underlying holdings of their portfolios, assuming that what is meant here are the required metrics associated with those securities. While we are committed to high standards of client transparency and do not have a principles-based objection to this proposal, in many situations licensing agreements with data providers do not permit granular data to be shared with third parties, in this case a firm's clients. We would recommend this information to be provided at an aggregate product or portfolio level instead, since licensing agreements do allow for data to be shared at that level. That said, we note the proposed rule in ESG 2.3.8R and consider that it provides sufficient flexibility to take account of the impact of licensing agreements that restrict firms' ability to pass on the relevant holdings-level data to clients. Nonetheless, in the interests of ensuring that clients' expectations are clear, it may be helpful in the final rules to include guidance that states climate-related metrics need only be provided at the asset class/portfolio level.

Note that for some products, e.g. multi-asset products, they can have a mixture of asset classes and it would be better to report at an asset class level for these, noting the proportion of the portfolio for which data is not available. This is because the formulas for different asset classes can be different (e.g. different denominators) and so they cannot easily be aggregated.

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?

Yes, the IA agrees with the proposed core metrics especially as they align with the DWP requirements on pension funds, which is a crucial factor. Further clarification on the length of time that the historical comparisons cover would be helpful. We note that up to five years of historical data would be consistent with SFDR.

Notwithstanding our support for the core list of metrics proposed, it should be noted that the same challenges in respect of data gaps (especially challenges in obtaining scope 3 emissions data, as well as variations in data availability by asset class) that we have

previously highlighted apply here. The IA would reiterate that the challenge with calculating these metrics for fixed income assets is particularly difficult, as a large proportion of fixed income assets will have little to no data to report on these metrics. We have proposed in our answer to question two that the FCA should have a provision in its' rules allowing asset managers to report the percentage of a portfolio for which data is not available, for each asset class. This would be a useful piece of contextual information for investor, when considering the metrics associated with a product or portfolio.

These challenges are not a reason to avoid mandating metrics, but when doing so there must be a recognition that it will take time for the quality of these metrics to improve. It is also critical that underlying company data is available to close these data gaps. For all these reasons we highlight again the need for a more flexible approach to reporting, as described in our answer to question two.

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 see the need for both calculations to be made and believe that this would be particularly confusing for retail investors and increase the reporting burden.

Therefore, we recommend the FCA use only one set of formula. We suggest that the SFDR basis calculation requirement should be removed. Given that many non-EU jurisdictions refer to the TCFD framework and not the SFDR calculations, as well as the fact that these rules are about UK and not EU asset managers, we would suggest that the FCA aligns with the TCFD formulas. Additionally, the changes put forward in the June 2021 consultation on updates to TCFD recommendations is likely to align TCFD reporting more closely to SFDR reporting in terms of scope 3 inclusion, therefore double reporting may not be necessary

To minimise these issues going forward, the IA fully supports regulators and authorities working together to ensure that standards are aligned at a global level. Specifically, they may want to consider denominators that are relevant by asset class e.g. market capitalisation is not a useful metric for calculating carbon footprints of fixed income portfolios.

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?

Yes, in principle we support alignment with upcoming changes to TCFD rules.

However, we believe that timing and scope needs to be modified accordingly:

- It would not be possible to meet the Jan 2022 deadline with the new TCFD recommendations which are still not published and not expected to be published till Q4 2021.

- If scope 3 GHG is included in the TCFD recommendations, it will take a considerable amount of time before that can be implemented. The market will need time to adapt and for corporates to start providing that information, and then for it to be readily available from data providers so that it can be implemented as a metric for reporting. In Europe scope 3 GHG emissions do not come into effect until Jan 2023, and we think that is the earliest date when scope 3 GHG should be included for any mandatory TCFD reporting.

Weighted Average Carbon Intensity (WACI)
When using revenues as per TCFD 2017 weighted average carbon intensity, public and private companies are more easily comparable. Some of our members feel the private companies' assessment of 'financed emissions' or category 15 scope 3, shouldn't be aggregated with the publicly listed companies EVIC-based emission calculations. This renders PCAF approach unusable for hybrid portfolio or firm-level aggregation.

We appreciate that PCAF's approach adds value by providing a measure of climate impact that aligns more clearly the financed emissions and the depleting carbon budget, as companies' absolute emissions do not get diluted by high profitability/revenue. We feel WACI measures (using revenue) and PCAF measures can be both useful. We just caveat that while WACI measures can be used in hybrid portfolios (i.e. public and private market instruments), Enterprise value-linked ones are not and therefore are unlikely to be useful at firm-level aggregation. We note that PCAF expects data availability to improve through EU Benchmark regulation, thus we are concerned that this data improvement will require a global effort in order to be decision-useful for global investors. In conclusion, while the objective of the standard is to standardize and harmonize GHG accounting across financial institutions, we feel that it falls short of recognising the complexity of many investment strategies, particularly in credit markets.

Additionally, the FSB has not indicated when they will release the final version of the proposals, making it challenging for firms to have sufficient 'lead time' to comply.

We welcome greater clarity on how the FCA will continue to adapt its rules in response to developments in the TCFD framework in the future. It is important that the FSB has an open and transparent governance process for evolving the TCFD recommendations, following developments in market practice, with significant input from investors as the key users of financial reporting. There also needs to be clarity from the FSB on how the TCFD framework will interact with the standards developed by the IFRS Foundation's ISSB.

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

Subject to the inclusion of a DWP-style ‘as far as they are able’ provision, the IA agrees with the FCA’s approach to additional metrics and welcomes the ambition of forward-looking metrics being developed. Given the evolving methodologies for these metrics we think it sensible to avoid placing too much emphasis on their production at this stage and firms should be able to do so on an ‘as far as they are able’ basis, in line with the approach taken to additional metrics by the DWP proposals for pension funds. Additionally, there needs to be greater clarity on how helpful these metrics will be to the retail investor: they are complex and given their somewhat experimental nature it is not clear how their disclosure will help retail investors understand the climate-related characteristics of their portfolios. In the first instance we see the metrics and targets as being more useful for institutional clients in their investment decision-making, as well as being necessary for meeting their own climate-related disclosure obligations. Institutional investors are also more likely than retail investors to have access to advice and expertise in interpreting and using additional metrics.

The IA has some concerns around how useful Climate value at risk is from a fixed income perspective as it is not positioned to take maturities and seniority of debt into account. There is a recognition that there needs to be greater clarity on the specific meaning and intent of this metric and how the retail investor should read this metric.

The IA would welcome guidance from the FCA on best practices specifically on how top-down analysis can be used in managing portfolios as the current guidance seems to be only on how to run the analysis, not how to use it. Further clarity on how the FCA sees these analyses adding value would additionally be welcomed.

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?

In general, yes, but it must be recognised that scenario analysis may not be appropriate, or possible, for some asset classes. While we strive for commonality in metrics and scenario analysis, it must also be acknowledged that the one size fits all approach will not work for all asset classes.

We are also concerned that the proposed requirements for scenario analysis are not clear. The scenarios are aligned with the NGFS (and BoE climate stress test) scenarios, but parameters such as speed of transition and sensitivity analysis are not defined. This may result in a wide range of data that is disclosed to investors, with little comparability across similar funds.

Therefore, we would recommend that firms have flexibility to apply judgment over whether it’s appropriate or possible to produce this, combined with an explanation as to why, if this is not produced.

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?

There is a fundamental question that the IA urges the FCA to consider on the value of the proposed product level scenario analyses. We would highlight the risk of investment decisions being made on the basis of unreliable information, which may result in poor outcomes for end investors and would argue that this requirement is premature in nature.

VaR analysis is likely to be the most likely measure to be used for decision making purposes. However, it is important to note that this makes more sense for some asset classes than others.

VaR is a very subjective measure and is likely to lead to completely different results for the same securities depending on inputs and assumptions made in models.

In general, scenario analysis works better for equities than corporate bonds. A portfolio of corporate bonds likely has multiple maturities, which in some cases will make scenario analysis inappropriate. The actual portfolio held now could look nothing like the one held by the time horizon of the scenario comes to pass and scenario analysis beyond the maturity of the bond has no value for decision making purposes. There must be much more focus on fundamental security analysis and climate risk considerations in relative value assessment and issue selection, than on the top-down scenario analysis proposed.

Further, without guidance on how top-down analysis can best be used, many investors may run such analysis more as a "check-the-box" effort. This may even come at the expense of more thoughtful (potentially bottom up) analysis if the top-down exercise leads to a false sense of security and/or consumes significant time and resources.

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?

Yes, the IA agrees because this reflects the bespoke nature of the service of discretionary portfolio management. The precise nature of reporting should be agreed between manager and client in line with the latter's needs.

On timing the same point about misalignment with DWP rules applies. But firms will work on a best-efforts basis.

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?

Yes, the IA agrees. Where the insurer exactly matches the strategy of the asset manager, they should be able to rely on the disclosures of the latter – it would seem disproportionate to require them to make their own disclosures in full. Where there is some difference in investment strategy as a result of any discretion exercised by the insurer, it is appropriate for them to make their own disclosures, setting out the climate-related characteristics of their own portfolios.

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?

Yes, we agree with the proposal for disclosure at the level of the pre-set investment strategy. This reflects the way these products are structured (with strategies constructed using funds/portfolios as building blocks). What should matter most to the investor in these strategies are the characteristics at the overall strategy level rather than the individual building blocks – although of course the information is relevant at the component level too, since climate-related characteristics would be important to understand when making decisions about which funds to include in the wider portfolio.

In DC pension schemes, the use of 'lifestyling' investment strategies is common across the DC industry and means that asset allocation varies across member age cohorts over time. As a result, the climate-related exposure of a portfolio could vary significantly across different cohorts of members depending upon their asset allocation at any point in time. Given this variation in asset allocation across age cohorts, it is important to consider any major differences in the environmental characteristics of the strategy by age. The FCA's proposal to calculate metrics and targets based only on the most representative age profile, while still identifying risks and opportunities which affect particular cohorts more strongly and providing at least qualitative narrative around this, seems proportionate. However, the FCA could consider going further and requiring the appropriate disclosures for all cohorts where there is significant variation in asset allocation, rather than simply the most representative one.

There are two areas that we think the FCA should give further consideration in respect of the scope of the proposals in relation to insurers' default strategies:

- Where employers in contract-based schemes utilise adviser-led default strategies, we believe these should also be excluded as the insurer has no control over the strategy, governance, risk management and composition of these defaults other than standard due diligence to protect customers. This would limit the information that can be provided in any TCFD reporting. The FCA could consider this as part of the planned extension of its regulatory perimeter to include investment consultants, following the outcome of the CMA's 2017-19 review of the UK investment consulting and fiduciary management market.

- We propose that default arrangements that are no longer actively marketed are excluded from the scope of TCFD product reporting. We would instead welcome further consumer research by the FCA to better understand how customers are engaged with their investments with respect to the transition to a net-zero world. These arrangements will also still be captured in TCFD entity level reporting and Life Insurers must still engage with identifying solutions to the challenges to support their transition to net-zero.

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 asset classes where there are data gaps, having to try to pull together these metrics can be disproportionate in cost to its benefit. We believe the resources and time is better spent in working with regulators and industry, through working groups, aimed at developing industry standards. We also ask that the FCA be mindful of the costs associated with the necessary data from vendors to produce these reports as these costs can be material.