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Insights

CLIMATE-RELATED DISCLOSURES FOR THE UK ASSET MANAGEMENT INDUSTRY

THE FCA CONSULTS ON TCFD-COMPLIANT MEASURES

25 June 2021

SUMMARY

The FCA has published its much-anticipated consultation (CP21/17) on climate-related financial disclosures and guidance for UK asset managers, UK life insurers and FCA-regulated pension providers. Consistent with the Taskforce on Climate-related Financial Disclosures' (**TCFD**) recommendations and aligned with the mandatory climate-related financial disclosure requirements for listed issuers and large asset owners (and supportive of the DWP's draft regulations that apply to in-scope trustees of occupational pension schemes), the proposals follow the pathway set out in HM Treasury's November 2020 TCFD Interim Report and Roadmap (in line with the expectations in the 2019 Green Finance Strategy). The FCA's proposals aim to increase transparency and competition, encourage capital flows towards firms that better manage climate risks and opportunities, and resource allocation towards transitioning the economy to net zero by 2050.

This briefing sets out some of the key headline points from the consultation. Before we get into the detail, we would make 3 overview comments.

- First, the FCA is eager to ensure coherence with overlapping and complementary requirements in existing UK and international disclosure regimes. This will be of particular interest in relation to any similar disclosures required by UK fund managers operating cross-border in the EU under the EU Sustainable Finance Disclosure Regulation (**SFDR**) and Taxonomy Regulation. However, it appears that there will be an element of additional reporting for firms that fall within scope of both legislative frameworks.
- Secondly, in setting minimum standards that firms must comply with, and on a flexible basis, the FCA is leaving it open for investor clients to agree new contractual terms with firms for the provision of additional information, or in a more prescribed form. UK AIFMs will have to

consider potential requests in this area in the context of their obligations to treat all investors fairly and that any preferential treatment given by an AIFM to one or more investors must not result in an overall material disadvantage to other investors.

- Thirdly, the commitment to mandatory climate-related financial disclosures is important in the context of the UK's leadership following the G7 and ahead of COP26 upcoming summit and our positioning as a competitive and resilient economy. This consultation is published in conjunction with other proposals to extend the application of the TCFD-aligned Listing Rule for premium-listed commercial companies to issuers of standard listed equity shares (and which also seeks views on other topical ESG issues in UK capital markets, including on green and sustainable debt markets and the increasingly prominent role of ESG data and rating providers).

Asset managers and asset owners within scope

Asset managers that are in-scope of CP21/17 include FCA-regulated firms managing investments, providing portfolio management and giving investment advice. The draft new rules capture UK AIFMs (both full-scope and small authorised), discretionary management and investment advisory private equity-type services and UK UCITS ManCos, regardless of where the fund or assets are based. Also within scope are certain life insurers and FCA-regulated pension providers, referred to as 'asset owners'.

Asset owners and asset managers with less than £5bn assets under management or administration on a 3-year rolling average (assessed on an annual basis) are exempt from the requirements. According to the FCA, this would only leave 2% of the UK asset management market unaffected and represent coverage of £12.1trn in UK AuM.

Small registered AIFMs and those overseas firms currently operating with the FCA's Temporary Permissions Regime are not within scope.

Public report #1: the TCFD entity report

Firms will have annually to publish a report in a prominent place on their websites (the **TCFD entity report)** on how as an entity they take climate-related risks and opportunities into account regarding the overall assets managed or administered by them on behalf of their clients and consumers. The TCFD entity report includes a statement, signed by a member of senior management, confirming that the disclosures comply with the ESG Sourcebook (a new draft Sourcebook to be included in the FCA Handbook).

Disclosures are to be in line with the 4 overarching pillars in the TCFD recommendations, recommended disclosures and supplemental guidance for asset managers and asset owners (appended to the consultation) relating to governance, strategy, risk management and metrics and targets. A proportionate and flexible approach is proposed, so that a firm can cross-refer to relevant disclosures where made in another report (eg on a group or consolidated basis, by a delegated manager or under a TCFD-aligned Listing Rule) on the basis that the rationale for doing so is stated and the disclosures and any hyperlinks are clearly signposted. For group or affiliate reports, any material deviation within the group must be explained, and the firm's compliance statement will cover both reports.

Report #2 (to be provided on request only for UK AIFMs and discretionary portfolio managers): the TCFD product report

In addition, firms will have to disclose information annually on their products and portfolios, including a core set of metrics (**TCFD product report**). These disclosures will have to be published in a prominent place on the firm's website (as for the TCFD entity reports) and referenced in client communications. However, for UK AIFMs of unauthorised and unlisted AIFs (as well as portfolio managers and investment advisers within scope), the TCFD product report is not public and needs only be made available annually on request where a client needs the product-level information for its (or its clients') own climate-related financial disclosure obligations. Firms are encouraged, where practicable, to extend this client reporting to others.

Additional disclosures relating to the TCFD pillars are only required where materially different to those made at entity-level and firms consider that more detail would be decision-useful to clients.

To support information flow along the investment chain, it is proposed that firms provide data on their underlying holdings to clients on request, in order to satisfy those client's own climate-related financial reporting obligations.

Phased but accelerated implementation

The new rules are expected to apply on a phased basis as follows:

- From 1 January 2022 (with a first publication deadline of 30 June 2023) to UK asset managers with more than £50bn AuM and asset owners with £25bn or more AuM or administration in relation to in-scope business.
- From 1 January 2023 (with a first publication deadline of 30 June 2024) for the remaining asset managers and assets owners with over £5bn AuM.

Firms will be able to select the initial 12 month reporting period for their first TCFD entity report, provided it falls within the window set out above ie no earlier than 1 January 2022/2023 and published before 30 June 2023/2024 (and if any changes are made to reporting periods for subsequent reports, that there are no gaps in reporting).

TCFD product reports have to be calculated within the same 12 month reporting period and published by 30 June on a firm's website (and referenced in the client communication which follows most closely after the 30 June reporting deadline). For 'on demand' disclosures to individual or institutional clients, the requested information must be provided once in any 12 month period, from 1 July 2023/2024.

TCFD entity report: some more details

The consultation acknowledges that disclosures made under the TCFD pillars may either be broad, covering a wide range of investment strategies, asset classes or products, or more tailored. The FCA suggests that firms explain any material differences in their approach to the TCFD governance, strategy or risk management pillars for specific investment strategies, asset classes or products. Disclosures that are cross-referenced should be easily accessible from the report and written for a less sophisticated audience.

For climate-related scenario analysis, firms should disclose their approach, how they apply the analysis in their investment and risk decision-making process and give quantitative examples to demonstrate their approach.

For metrics and targets, firms should explain in cases where they are not yet aligned with the Government's net zero commitment. Details of climate-related targets, including KPIs to measure progress, must be reported on. To reflect the diverse range of assets a firm may hold, disclosures on an aggregated AuM basis can be complemented with specific asset class, investment strategy or product information.

TCFD product report: some more details

The FCA sets out its proposed core metrics (a subset of those listed in the TCFD recommendations) in the consultation, and flags any differences with the SFDR calculation methodologies. For divergences between the two regimes, the FCA proposes that firms report using the formulas under both regimes – to promote consistency and comparability of firms with a global reach. Metrics should be contextualised (including explaining any gaps in underlying data and how these have been addressed, along with any limitations in approach) to ensure that all disclosures are fair, clear and not misleading, and accompanied by a historical time series for comparison from the second year of reporting.

Firms are to use 'best efforts' to supplement core metrics with certain less-established, mostly forward-looking additional metrics.

Firms that manage a listed unauthorised AIF must include their product or portfolio level disclosures in their TCFD entity report.

The TCFD product report only needs to set out details of any overarching approach to governance, strategy and risk management where it is materially different to that in the TCFD entity report. The consultation sets out a proposed approach to scenario analysis for additional disclosures for portfolios with concentrated or high exposures to more carbon-intensive sectors (to include a quantitative analysis of an ‘orderly transition’, ‘disorderly transition’ to net zero emissions and ‘hothouse world’ scenario). When applying the proposals to life insurer and FCA-regulated pension providers as asset owners, product-level metrics should be applied at the level of the individual fund or pre-set investment portfolio, to provide a picture of the metrics across the portfolio/wrapper as a whole.

Third party or delegate reports

In-scope firms that are authorised fund managers (AFMs) but which delegate to a third party portfolio manager remain responsible for the TCFD entity report and compliance statement but can cross-refer to disclosures made by their delegate. The AFM has to explain the reason for selecting the delegate, including specifically addressing how climate-related matters have been taken into account in selection and service/product reliance. The approach is similar on delegation in relation to the TCFD product reports.

In addition, asset owners can cross-refer to TCFD entity reports at group level or of a third party delegate to the extent relevant to the firm and its TCFD in-scope business - for example, to an external asset manager’s report that manages its underlying funds on its behalf. The asset owner retains overall responsibility and has to explain how climate-related considerations have influenced its decision to appoint the third party manager.

SFDR interaction

These FCA proposals are based on a similar approach to that of the SFDR: the principal obligations relate to disclosures at manager/entity-level and those that are product specific. This is good news, as the industry is likely to welcome harmonisation and alignment between different disclosure requirements, where possible. Also, the fact that under the FCA rules a firm can cross-refer to relevant disclosures made in other reports is helpful in terms of efficiency and consistency.

However, the FCA proposals emphasise that where firms are permitted to cross-reference their climate-related financial disclosures, they refer to TCFD-compliant reports (and not SFDR or other models). This would mean that UK firms that are also subject to the SFDR rules (for example, marketing cross-border in the EU under Article 42 of AIFMD or that are subject to the SFDR contractually as a delegate of an EU AIFM) would have to comply with the UK and EU rules in parallel. The FCA states that in the consultation that it has taken international-related requirements into account, including the SFDR, and that it will continue to consider the interactions between the UK and EU rules as it further develops its policy. But in the meantime it appears that divergence in terms of the granular reporting detail is a distinct possibility.

Feedback on the consultation is requested by 10 September 2021, with a view to a policy statement being made later this year and coming into effect from 1 January 2022 (as described above).

Our briefing on Proposed climate-related disclosures for standard listed companies.

See also our background note on TCFD and its UK remit: an aide memoire.

RELATED CAPABILITIES

- Corporate Real Estate and Funds

MEET THE TEAM

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