CONSULTATION RESPONSE

FCA: CONSULTATION ON ENHANCING CLIMATE-RELATED DISCLOSURES BY ASSET MANAGERS, LIFE INSURERS AND FCA-REGULATED PENSION PROVIDERS

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This response represents the view of the PRI Association and not necessarily the views of its individual members.

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ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $120 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

ABOUT THIS CONSULTATION

The Financial Conduct Authority (FCA) opened this consultation on proposals to introduce rules on climate-related financial disclosure and guidance for asset managers, life insurers, and FCA-regulated pension providers. The key development in this consultation is that the proposal covers both entity and product level disclosures. It is proposed that firms would be required to publish, annually, an entity-level TCFD report on how account for climate-related risks and opportunities while managing or administering investments on behalf of clients and consumers; and that firms would also be required to produce, annually, a baseline set of consistent, comparable disclosures in respect of their products and portfolios, including a core set of metrics.

This follows the publication of the UK government roadmap towards mandatory climate-related disclosures,[1] which aims to implement recommendations made by the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) across the UK economy by 2025 This consultation proposes two phases of implementation. The first phase, proposed to commence in January 2022, would require climate-related disclosures by in-scope asset owners with £25 billion in assets under management (AUM) and asset managers with £50 billion in assets under management by June 2023. The second phase, proposed to commence in January 2023, would require climate-related disclosure by all in-scope firms with over £5 billion in AUM by June 2024. 98% of assets under management in both the UK asset management market and held by UK asset owners are covered by the scope of this proposal.

[1] A roadmap towards mandatory climate-related disclosures, HMT, November 2020

SUMMARY OF PRI'S RESPONSE

The PRI commends the FCA's leadership in issuing this consultation on implementing climate-related disclosure requirements for UK firms. We welcome recommendations proposed in this consultation that closely follow the guidance outlined by TCFD, which also form a basis for the PRI's Reporting Framework. Many recommendations around reporting and disclosure proposed by this consultation are closely aligned to those which we require our signatories to disclose against, which mutually reinforces core aspects of our six principles for responsible investment,[2] specifically the third and sixth, relating to reporting on activities and requiring disclosure by entities in which signatories invest.

The PRI recommends that the FCA consider:

- **Revising the list of core and additional metrics in line with the forthcoming TCFD guidance.** This is expected to include seven cross-industry metrics, the reporting of financed emission using the Partnership for Carbon Financial Accountings (PCAF)[3] methodology as well as measures of portfolio alignment.
- **Making only GHG exposure metrics part of the initial 'core' set of metrics.** Due to data availability and challenges of aggregation at the portfolio level, the FCA could consider including the other six metric categories plus PCAF and portfolio alignment under "additional metrics". This split between "core" and "additional" metrics should be reviewed by the FCA and other UK government departments in 2023.
- **Alongside metric disclosures, issuers should disclose estimates of the underlying data quality.** This could be made in reference to the PCAF data quality score card referenced below.
- **Exploring opportunities for firms with less than £5 billion in AUM to report on climate-related disclosures line with TCFD recommendations at a future date.** Firms above this threshold make up 98% of investment activity in the UK, however smaller firms, not included in scope of these proposals, are not insignificant when it comes to climate-risk. Excluding smaller firms from disclosure rules indefinitely risks fragmentation of data and its usability across the investment chain.
- **Avoiding dual reporting for occupational pension schemes where they have internal in-house fund managers that are FCA-regulated.** Under the current proposals, these firms would be required to report both publicly and on demand. While the FCA clarifies that reports could be combined and cross-referenced, including between FCA-regulated firms and DWP-regulated entities, it is questionable as to on how useful or proportionate this dual reporting would be. As such, considering an exception for occupational pension schemes with in-house fund managers, which will already be subject to DWP regulation, is recommended.

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[2] The PRI's six guiding principles for responsible investment, which we require our signatories to commit to when joining

[3] Partnership for Carbon Accounting Financials (PCAF)

We support many of the proposals in the consultation, including but not limited to:

- **The guidance laid out by the TCFD should be the overarching framework for climate-related disclosure requirements,** not only for firms in scope of this consultation, but for disclosures across all areas of the economy, as per the government roadmap for climate-related disclosures.
- **Disclosure requirements for in-scope firms at both product and entity level.** We commend the FCA on this proposal, which should help to implement comprehensive reporting practises across the investment chain.
- **Firms setting and report on targets on a comply or explain basis.** We agree with the proposal that firms that have made an emission reduction commitment should set near term targets and report on progress and where firms have not set targets, they should explain why not. However, we do recommend that the FCA consider introducing mandatory requirements for targets setting at a future date.

DETAILED RESPONSE TO QUESTIONS

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

The PRI welcome the proposed scope of firms included in this consultation, as well as the FCA's acknowledgement of the key actors and stakeholders. We also welcome the proposal to initially prioritise requiring disclosure by large firms in the early stage of implementation, effective in 2022 for firms with AUM over £50 billion and in 2023 for firms with AUM over £5 billion. Larger firms are likely to have more resources to dedicate towards the reporting and analysis required of this consultation and will be more resilient to face challenges that may arise while standards of reporting in line with TCFD recommendations become adopted.

We recommend the FCA examine opportunities for smaller firms to report on climate-related disclosures in line with TCFD recommendations. We note that smaller firms are not exempt from climate-related risk in their investment strategy and ownership decisions and, of the PRI's 732 UK-based signatories, 327 have £5 billion or less in AUM and already report on a number of ESG and climate-related metrics. Under the PRI's 2021 Reporting Framework all signatories are required to report on mandatory climate indicators such as transition risk (indicated in AUM coverage) and scenario analysis (indicated by strategy type). Our requirements on climate change reporting are anchored on the 11 TCFD recommendations. The PRI Data Portal collates signatories' reporting data and allows users to explore and compare climate-related data, along with data on sustainability outcomes, governance and stewardship issues.[4] Many of these smaller signatories invest in environmentally and socially impactful businesses and projects and provide early-stage funding for organisations who offer innovative solutions and technologies that are imperative in addressing climate challenges and reaching emissions targets. The FCA may consider plans to extend disclosure

[4] The PRI Data Portal is a database that allows users to explore signatories' reporting data

requirements to smaller firms with under £5 billion in assets at a future date, aligned with what has recently been proposed by the DWP.

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

Yes. The PRI welcome the proposal that disclosure will be required for larger firms first and agree with the proposed phased approach.

We note that the TCFD has recently consulted on proposed new guidance on climate-related metrics, targets, and transition plans. In our response to this consultation[5], the PRI recommended allowing for a one-year grace implementation period which could reduce the cost and challenge of implementing the new guidance as well as provide time for investors and other preparers to build the necessary internal capacity. The PRI make the recommendation to all regulators to regularly review guidance provided by the TCFD on climate-related disclosure to ensure that updated guidance can be implemented to best suit the needs of all stakeholders across the investment chain and to ensure adherence to climate targets within necessary timeframes.

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. The PRI's 2021 Reporting Framework requires all signatories to report on measures around governance, strategy and risk management as part of core requirements as proposed by this consultation. Similarly, the proposals on scenario analysis are aligned with those required under the PRI's 2021 Reporting Framework, under the Investment and Stewardship Policy (ISP) module.[6] The PRI welcomes comparability and uniformity in reporting metrics and requirements for usability of reporting data for all stakeholders across the investment chain which the proposals in this consultation support.

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?

Yes. The PRI agree with the 'comply or explain' approach to firms setting climate-related targets outlined by this consultation.

Firms should be encouraged to set climate-related targets, but where targets have not been set, firms should explain why. In line with proposals in this consultation and the TCFD recommendations, where a climate-related target has been set, the firm must describe the target, including the key performance indicators it uses to measure progress, and report on these in the TCFD entity report. Setting climate-related targets, especially emissions targets, is important to ensure accountability for achieving climate-related ambitions within all sectors of the economy, as well as sufficient alignment to the

[5] PRI's response to TCFD's consultation on metrics, targets, transition plans and portfolio alignment, July 2021

[6] See annex for further on the PRI Reporting Framework 2021, Investment and Stewardship Policy

legally-binding sixth carbon budget that outlines a 78% reduction in emissions by 2035.[7] However, we acknowledge that the underlying methodology for net zero target setting is currently insufficient and there are fundamental challenges in investors to creating 1.5 degree aligned portfolio in a 4 degree aligned economy. Furthermore, we also recognise that there is an absence of suitable methodology and data availability that makes setting targets difficult for some asset classes - including sovereign bonds, private equity and derivatives. Therefore, encouraging climate target setting is important, but we do not believe that it should be mandated at this time. We recommend that the FCA consider means to introduce mandatory climate-related target setting at a point in the future.

The consultation paper highlights various initiatives that support investors in climate-related target setting:

- For asset owners, the PRI supports the approach set out by the **UN-convened Net Zero Asset Owner Alliance (AOA)**[8] target setting protocol which recommends a -16% to -29% emission reduction by 2025 against base year 2019. Members who join the Alliance and issue targets after 2020 may reduce emissions by 5%-pts. per annum in their 2025 sub-portfolio targets.
- **The Net Zero Asset Managers Initiative**[9] is an international group of 128 asset manager signatories who collectively represent $43 trillion in assets under management. Among other ambitions, the Initiative encourages members to set interim emissions targets for 2030.
- **The Science Based Targets initiative (SBTi)[10]** is a partnership between the Carbon Disclosure Project, the UN Global Compact, the World Resources Institute and the World Wide Fund for Nature (WWF). It has, thus far, mostly focused on non-financial corporates, helping companies set emissions targets that are in line with holding global warming to well below 2°C above pre-industrial levels.

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. The PRI welcomes this proposal requiring disclosure at product or portfolio level. For asset owners, product-level disclosure will be considerably more useful than entity level reporting, as it will better enable them to compare the exposure to climate-related issues of different funds. In turn this will facilitate greater achievability of firms' climate-related goals.

[7] Press release: UK enshrines new target in law to slash emissions by 78% by 2035, April 2021

[8] UN-convened Net Zero Asset Owner Alliance

[9] Net Zero Asset Managers Initiative

[10] The Science Based Targets Initiative

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?

The PRI recommends amending this list so that it is in line with the forthcoming new Taskforce guidance on cross industry metrics, which is due to published in October this year. At the time of writing, the set of cross industry metrics is expected to include those listed below.

Summary Table: Cross-Industry, Climate-Related Metric Categories

Metric Category	Example Unit of Measure[32]	Example Implementation
GHG Emissions: Absolute Scope 1, Scope 2, and Scope 3;[33] emissions intensity	MT of CO_2e	– Absolute Scope 1, Scope 2, and Scope 3 GHG emissions – Financed emissions by asset class – Weighted average carbon intensity – GHG emissions per MWh of electricity produced – Gross global Scope 1 GHG emissions covered under emissions-limiting regulations
Transition Risks: Amount and extent of assets or business activities vulnerable to transition risks*	Amount or percentage	– Volume of real estate collaterals highly exposed to transition risk – Concentration of credit exposure to carbon-related assets – Percent of revenue from coal mining – Percent of revenue passenger kilometers not covered by Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA)
Physical Risks: Amount and extent of assets or business activities vulnerable to physical risks*	Amount or percentage	– Number and value of mortgage loans in 100-year flood zones – Wastewater treatment capacity located in 100–year flood zones – Revenue associated with water withdrawn and consumed in regions of high or extremely high baseline water stress – Proportion of property, infrastructure, or other alternative asset portfolios in an area subject to flooding, heat stress, or water stress – Proportion of real assets exposed to 1:100 or 1:200 climate-related hazards
Climate-Related Opportunities: Proportion of revenue, assets, or other business activities aligned with climate-related opportunities	Amount or percentage	– Net premiums written related to energy efficiency and low carbon technology – Number of (1) zero emission vehicles (ZEV), (2) hybrid vehicles, and (3) plug-in hybrid vehicles sold – Green revenues – Green bonds – Proportion of homes delivered certified to a third-party, multi-attribute green building standard
Capital Deployment: Amount of capital expenditure, financing, or investment deployed toward climate-related risks and opportunities	Reporting currency	– Percentage of annual revenue invested in R&D of low-carbon products/services – Investment in climate adaptation measures (e.g., soil health, irrigation, technology)
Internal Carbon Prices: Price on each ton of GHG emissions used internally by an organization	Price in reporting currency, per MT of CO_2e	– Internal carbon price – Shadow carbon price, by geography
Remuneration: Proportion of executive management remuneration linked to climate considerations**	Percentage, weighting, description, or amount in reporting currency	– Portion of employee's annual discretionary bonus linked to investments in ESG-related products – Weighting of climate goals on long-term incentive scorecards for Executive Directors – Weighting of performance against operational emissions' targets for remuneration scorecard

Due to the challenges with data availability and portfolio aggregation, the FCA could consider initially including only the first category “GHG emissions" in the core section and leave the others as “additional" metrics. The aggregation of vulnerable assets to physical climate risk, for example, is particularly challenging at the portfolio level, as such allowing flexibility to focus on asset classes, such as real assets, where data is comparatively more readily available is recommended.

As noted above, the availability and quality of data can vary considerably across markets, sectors and asset classes. As imperfect data should not be a limiting factor in implementing climate-related disclosures, we recommend simultaneous disclosure of an estimate of the underlying data quality. This could be made in reference to PCAF's data quality score card shown below.

PCAF general data quality score card[11]

Certain
(5-10% error margin in estimations)

Score 1	Audited GHG emissions data or actual primary energy data
Score 2	Non-audited GHG emissions data, or other primary data
Score 3	Averaged data that is peer/(sub)-sectorspecific
Score 4	Proxy data on the basis of region or country
Score 5	Estimated data with very limited support

Uncertain
(40-50% error margin in estimations)

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.

Yes. Referring to the forthcoming Taskforce guidance on the calculation of metrics is recommended. The core GHG exposure metrics are unchanged, however the inclusion of the other six metrics categories, as well as PCAF and portfolio alignment metrics go beyond the formula list in appendix 3.

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;

Yes. The incorporation of the Taskforce's new guidance is recommended. This will improve the analysis and quantification of climate-related issues by financial institutions. However, as noted above, due to data availability and methodological issues it may be challenging for financial institutions to aggregate and disclose across all asset classes. As such, disclosure should be focused

[11] Source: PCAF, The Global Carbon Standard for the Financial Industry

on where data is comparatively available. As practices and the underlying methodologies improve the maturity of these metrics should be reviewed by the FCA and other UK government departments.

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, the PRI agrees that the disclosure of transition plans should be part of the FCA's regulatory proposals. All 11 disclosure recommendations made by TCFD in the Final Report and Annex, as well as the aforementioned supplementary and additional guidance published in June 2021, should serve as the overarching framework for climate-relate disclosure, not only for firms in scope of this consultation, but for disclosures in across all areas of the economy, as per the government roadmap for climate-related disclosures. Further to this, recommendations for climate-related disclosures set out by the TCFD should serve as the principal framework for financial actors and businesses internationally. This will help to ensure comparable and harmonious global capital markets disclosure and reporting, as well as greater transparency around climate-related issues across the investment chain.

The PRI note that, in order for all firms in scope of this consultation to comprehensively identify, assess and manage climate risk, they must have sufficient corporate data for the companies in which their assets are invested in. Following a consultation issued by the Department for Business, Energy & Industrial Strategy (BEIS) earlier in the year on proposals to require mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPS[12], the PRI responded,[13] outlining our recommendation that BEIS strengthen their proposals for greater consistency with other UK climate reporting regulation, such as that which has recently been introduced by the DWP. This will be vital in providing firms with the necessary level of transparency to conduct due diligence and align portfolios with climate goals and report on them sufficiently.

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

The PRI recommends that proposals should be updated in line with Taskforce's forthcoming new guidance on metrics, targets and transition plans. The PRI recommend the FCA provide additional clarity on metrics and the appropriate use case of each of these metrics. A review of the UK Climate Financial Risk Forum's[14] (CFRF) forthcoming report on data and metrics is also recommended.

Not all of the additional options presently have the same use case. Implied Temperature Rise (ITR), for example, is a powerful communication tool, particularly for non-specialised users. Yet, as is documented in the TCFD's forward-looking metric consultation guidance and in research by other

[12] BEIS Consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs), March 2021

[13] PRI's response to BEIS Consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs), May 2021

[14] Climate Financial Risk Forum

bodies, such as The Alignment Cookbook[15], the absence of the transparency of inputs and a common methodology between providers, at present, limits its ability to track progress towards climate goals. As such, it is premature for ITR to be used to inform target setting, portfolio allocation and optimisation. Moreover, once adopted there is a risk it could become part an implicit target, due the pressure of annual disclosure and the desire to demonstrate "improved" performance.

The use of a metrics dashboard, as proposed in the forthcoming CFRF data metrics report, as opposed to over-reliance on a single metric, is recommended.

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?

Yes. The PRI supports these proposals which are well calibrated to those outlined by DWP and would provide useful information about the strategic resilience of the fund to a range of climate scenarios.

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?

The seven cross industry metrics, together with the new guidance on portfolio alignment, offers a useful conceptual framework for forward looking disclosure. However, the outputs are likely to depend somewhat on the choice of service provider by the issuer. The forthcoming CFRF report on climate scenario analysis will provide additional guidance metrics and disclosure.

ANNEX

The PRI's 2021 Reporting Framework requires signatories to report on the following indicators under the ISP module:

- **Governance:** There are two core governance indicators in this module. These aim to address how the board (or the equivalent function) and management exercises oversight over climate-related risks and opportunities (ISP 28, ISP 29). There are also a number of indicators around confidence-building measures, including those around third-party external assurance providers, ESG or RI certifications and details on how and whether ESG auditing is conducted.
- **Strategy:** Four strategy indicators assess how signatories identify and classify climate-related risks and opportunities within investment time horizon(s) (ISP 30, ISP 30.1, ISP 31, ISP 32).
- **Scenario Analysis:** There are two indicators for scenario analysis that come under the strategy section of the framework. Signatories are asked to indicate if scenario analysis is used in their risk management strategy, and if so, what range of scenarios are utilised. There

[15] The Alignment Cookbook (2020) A Technical Review of Methodologies Assessing a Portfolio's Alignment with Low-Carbon Trajectories or Temperature Goal, Green and Sustainable Finance

is also a voluntary descriptive question on how climate scenario analysis is used to test the resilience of the signatory’s investment strategy and inform investments in specific asset classes (ISP 33, ISP 33.1).

- **Risk management:** Four indicators assess types of approach to risk management, including identifying which processes are used to manage and track risk and how this informs investment decisions (ISP 34, ISP 35, ISP 36).

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