Deloitte.

Deloitte LLP
2 New Street Square
London
EC4A 3BZ

Phone: +44 (0)20 7936 3000
Fax: +44 (0)20 7583 1198
www.deloitte.co.uk

Direct phone: +44 20 7007 0884
vepoole@deloitte.co.uk

10 September 2021

Thorben Heidrich
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

By email: cp21-18@fca.org.uk

Dear Mr Heidrich

CP21/18: Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets

Deloitte LLP (Deloitte UK) is pleased to respond to the FCA's consultation paper 21/18 *Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets* ("the CP").

Climate change is an undiversifiable risk, which requires an immediate and urgent response. We strongly support the UK government's goal of achieving transparency in business reporting on climate-related issues across the UK economy. We agree that there is an important opportunity for the UK to establish a pathway towards mandatory reporting around the world via the 26th UN Climate Change Conference of the Parties (COP26). We therefore welcome the CP and, consistent with our response to the FCA's previous consultation paper CP20/3, support the extension of the requirement to report in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) to standard-listed issuers with some exceptions.

Deloitte Touche Tohmatsu Limited's (DTTL's) Global CEO, Chairman and CFO are signatories to the statement of support for the Task Force on Climate-related Financial Disclosures (TCFD) and DTTL is actively involved in its work through our colleague Catherine Saire, a member of the TCFD. TCFD is market-driven and investor-focused and is recognised as an appropriate framework by the International Organization of Securities Commissions (IOSCO) globally and by the European Securities and Markets Authority (ESMA) in the EU. It is not itself a standard, but it is a positive step towards a comprehensive global system. Progress, including on standards covering climate, is accelerating, as shown by the recent steps taken by IOSCO and the IFRS Foundation, and we fully support and encourage the development of global sustainability standards which will enhance global comparability and consistency. We appreciate that the proposals in this consultation represent an interim measure until such a standard is published and encourage the FCA – and the UK government more widely - to adopt and align with any such standard as soon as practicable and do all that it can to encourage its adoption by jurisdictions around the world to promote consistent and comparable disclosures.

More broadly, corporate reporting is part of a wider system of transparency that enhances confidence in capital markets and promotes efficient allocation of capital to long-term resilient business. This therefore includes enhancing confidence in information provided in Green bond prospectuses, and on the use of proceeds of a bond or ESG data and ratings. These are innovative, fast moving markets in their early stages. However, investors and other capital markets participants increasingly rely on this information in their decision-making, in particular when assessing long-term, risk-adjusted returns. Therefore, it is essential to promote trust, transparency, and confidence in the interests of flows of high-quality information relevant to investor needs. As a result, we welcome moves by the FCA that will drive the transparency, understandability and comparability of information given to investors so they can make informed decisions.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London, EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2021 Deloitte LLP. All rights reserved.

We believe that a foundation of a system of high-quality ESG information is the adoption of global sustainability standards that lead to corporates reporting consistent and comparable ESG information. This helps to create a baseline layer of high-quality, company-reported information which the rest of the eco-system can rely on to support more efficient markets and more effective decision-making. We therefore believe this adds to the case for swift and decisive action to bring about global sustainability standards.

As we set out in our responses below, we also acknowledge that over time, further measures will be important by way of monitoring and oversight of ESG information and providers. However, we think that this should be balanced against the need to continue to encourage innovation and market developments in a fast-changing market and to meet the evolving needs of retail and institutional investors. Innovation encourages competition and choice for consumers of these products. If those customers are well informed, then the market can be an aid in supplying the right products for their needs at the right price. Regulation should not be about eliminating risk from the market, so long as customers are fully aware of the risk they are taking on when making their purchasing decisions. We therefore think that balanced regulation and voluntary guidance can be useful tools at this stage of the development of the market.

Finally, we strongly encourage the FCA to finalise and publish the outcome of this consultation as soon as practicable, ideally in advance of COP26, which takes place from 1 November 2021, to send the right message to the rest of the world about the UK's commitment to embracing climate-related disclosures.

Our responses to the specific questions raised in the CP are in the Appendix to this letter. Please do not hesitate to contact us if you would like to discuss any of the issues raised in our response.

Yours sincerely

Veronica Poole Simon Cleveland

Veronica Poole
UK National Head of Accounting and Corporate Reporting
Deloitte LLP

Simon Cleveland
UK Head of Public Policy and Regulation
Deloitte LLP

Appendix

1. **Do you agree with our proposal to extend the application of our existing TCFD-aligned disclosure requirement (set out in LR 9.8.6R(8)) to issuers of standard listed equity shares, excluding standard listed investment entities and shell companies? If not, what alternative scope would you consider to be appropriate, and why?**

Yes, consistent with our response to CP20/3, we support expansion of the scope to standard-listed issuers without delay. Urgent action is required to meet the Government's target to be net zero by 2050. We conveyed a similar message in our response to the Department for Business, Energy and Industrial Strategy (BEIS) consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships. We urge the FCA and BEIS to work together, involving other government departments as relevant (e.g. HM Treasury, DWP) to create a cohesive set of requirements for UK businesses with the aim of facilitating a smooth transition to the forthcoming global sustainability standards.

Our view is that listed investment entities should also be required to report in line with TCFD recommendations. We see no reason why standard (or, indeed, open-ended and closed-ended premium) listed investment entities should be excluded.

Although we acknowledge that shell companies often have simple balance sheets, we believe that these entities are in a position to make these disclosures given TCFD's proportionate approach. Consistent with TCFD, we believe disclosures about governance and risk management should always be provided to enable users to understand how climate change is considered in investments decisions. For example, a shell company set up to acquire a carbon intensive business and decarbonise it to make a profit could explain its governance and risk management considerations when making decisions relating to the acquisition, along with disclosure of strategy and metrics and targets where material. We therefore believe that shell companies should be included within the extended scope.

Finally, we note that neither the proposals in CP21/17 nor CP21/18 affect the carve-out for investment trusts, VCTs and other forms of closed ended investment fund in LR 15.4.29R. The FCA should consider if this is intentional, as otherwise open-ended investment funds such as OEICs and unit trusts sold to the public will be required to make disclosures, when investment trusts and VCTs are not. As the market for such products is typically similar, it is unclear why this should be the case.

2. **Do you consider that issuers of standard listed GDRs and standard listed issuers of shares other than equity shares should also be subject to our TCFD-aligned disclosure requirements? If not, what alternative approach would you consider to be appropriate, and why?**

Shares other than equity shares are often of a similar nature to debt instruments (for instance, preference shares which do not have voting rights). For this reason, we believe that these entities should be treated in the same way as issuers of standard listed debt securities. Please see our response to question 3.

Standard listed GDRs are certificates representing an underlying security, whether that be an equity share, debt or something else. We believe that these entities should therefore be subject to the same TCFD-aligned disclosure requirements that would apply to the underlying security were it listed.

3. **We welcome views from market participants on whether to apply TCFD-aligned disclosure rules to issuers of standard listed debt (and debt-like) securities, and how best to do this. In particular, we seek input on the following:**
    a) **What climate-related information from issuers of these securities would market participants find decision useful and how far would these information needs be met by TCFD aligned disclosures?**
    b) **Do market participants' information needs differ according to the different types of issuer in LR 17?**
    c) **If you consider that we should apply TCFD-aligned disclosures rules to issuers of standard listed debt (and debt-like) securities, should some issuer types be excluded from the rule to deliver an effective and proportionate approach? If so, which types of issuers should be included/excluded and how can the scope best be defined?**

d) Are there any other matters we should take into consideration – eg, competitiveness, complexity of the application of the rule, burden on issuers in LR 17, or the feasibility to comply with any potential rules?

We are answering parts a)-d) together.

In our view, the information from standard-listed debt issuers that would be useful to market participants will depend on the nature of the entity and, in particular, on the group structure in which it sits. However, as a starting point we believe that TCFD-aligned disclosure rules should be extended to issuers of standard listed debt, with exemptions in certain situations.

Debt issuers can often have substantial operations and the fact they choose to finance via debt rather than equity should not exclude them from the scope of these reporting responsibilities, particularly in the wider context of "greening" the financial sector where lenders may be looking for climate-related and broader ESG information as part of their decision to lend.

Under Chapter 4 of the Disclosure Guidelines and Transparency Rules (DTR), standard-listed debt issuers other than those exempted by DTR 4.4 must give a fair review of the business including risks, uncertainties, performance, financial and non-financial KPIs. Although we note that debt issuers are currently not widely captured by corporate governance disclosure requirements, many will be subject to the requirement in UK company law to prepare a s172(1) statement setting out how the directors have had regard to certain matters in performing their duty to promote the success of the company, which by its nature addresses some aspects of governance as well as the impact of the company's operations on the environment. In addition, debt issuers which qualify as large by size under UK company law will, unless included in a consolidated report further up the group structure, be required to report on their energy and carbon use under Schedule 7 to the Accounting Regulations.

However, as noted above, we acknowledge that there are some debt issuers for which reporting may not be useful to market participants and propose exemptions for the following:

- Issuers of asset-backed securities (as defined in the PR Regulation Glossary): these issuers tend to not have control over future business strategy, governance arrangements are already established on autopilot and often those charged with governance are not free to make decisions about the impact the business has on the environment. For these entities we consider that disclosures made in line with TCFD are unlikely to be useful.
- Debt issuers meeting the definition of DTR 4.4.1 (i.e. public sector and local authority organisations): these entities would approach climate change through a different lens to companies. Our view is that these entities require a separate, more specialist consideration in respect of TCFD disclosures.
- Subsidiary companies that are included in TCFD-aligned reporting in the consolidated annual report of a UK parent company: as global sustainability standards are issued and adopted, we suggest that the exemption may be broadened to encompass subsidiaries that are included in the consolidated report of a non-UK parent company applying such standards.

In respect of the last, we note that there is growing international pressure for companies to report on climate-related matters and we are supportive of these steps to enhance reporting globally. If an overseas group has disclosed in line with TCFD and effectively complied with the FCA rule, the FCA may consider broadening the subsidiary exemptions to include non-UK parent company consolidated reports. However, we are mindful that the FCA would need to consider the quality of such disclosure regimes and it may take some time to develop an equivalence regime appropriate to capture these entities. As this would be a short-term measure until a global climate standard is finalised, the benefit of such a regime and the speed at which it could be implemented would need to be balanced against the current timeframe for the issuance of a global climate standard. We encourage alignment with the forthcoming global sustainability standards as soon as possible.

4. **Do you agree with our proposal to mirror the structure and wording of LR 9.8.6R(8) and LR 9.8.6BG to LR 9.8.6EG for companies with a UK premium listing? If not, what alternative approach would you consider to be appropriate, and why?**

Yes, we support alignment with the premium listing rule given the importance of consistency. A different structure and wording for companies with a UK standard listing would be complicated for preparers to follow and could increase the risk of incorrect reporting or disclosures that confuse users. Alignment also enables companies with a standard listing to learn from the implementation of the requirement by premium listed companies. The rule allows for a proportionate approach whilst requiring companies to be transparent about how and when they plan to comply with TCFD recommendations.

5. **Do you agree that, subject to the TCFD's final guidance materials being broadly consistent with those proposed, we should incorporate them into our existing and proposed handbook guidance provisions as described (including both the existing guidance relating to LR 9.8.6R(8) and our proposed new guidance relating to LR 14.3.27R): a. the TCFD's proposed updates to the TCFD Final Report and TCFD Annex b. the TCFD's proposed standalone guidance document on metrics, targets and transition planning c. the TCFD's technical supplement on measuring portfolio alignment. If not, what alternative approach would you prefer?**

We agree that in principle the FCA should incorporate the latest guidance from the TCFD once it is finalised. In doing so the FCA should satisfy themselves that the final guidance is appropriate for the purposes of the handbook guidance provisions. We made a number of observations in our response to the TCFD on the *Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans* and the associated *Measuring Portfolio Alignment: Technical Supplement*. For example, in our response we observed that climate-related disclosures on strategy and metrics and targets should always be subject to a materiality assessment and we do not believe that climate-related metrics should be provided irrespective of an assessment of materiality. The FCA may want to take such considerations into account when assessing the TCFD's final guidance for inclusion in the handbook guidance provisions.

Whichever approach is taken to references to TCFD materials, it is clear that LR 14.3.27R and LR 9.8.6R(8) should be aligned.

6. **Do you agree that we should update the Technical Note 801.1 to reflect the proposed new rule and associated guidance in this CP?**

Yes, we agree that Technical Note 801.1 should be updated.

7. **Do you agree with our encouraging listed companies to consider the SASB metrics for their sector when making their disclosures against the TCFD's recommended disclosures, as appropriate? If not, please explain.**

Investors and other users of reports find industry-specific activity metrics important. We note that the IFRS Foundation has confirmed it will use the prototype climate-related financial disclosure standard ('the prototype') as a potential basis for global standards and that the prototype references SASB metrics. In addition, we note that the FRC encourages the use of SASB metrics. Given this, we agree with encouraging listed companies to consider the SASB metrics when preparing TCFD disclosures.

8. **Do you agree with our approach to maintain a 'comply or explain' compliance basis until such time as a common international reporting standard has been published and adopted in the UK? If not, what alternative approach would you prefer, and why?**

Yes, we agree. As noted above, we support alignment with the premium listing rule. We acknowledge that since the finalisation of the rules for the premium-listed companies, progress towards a global climate standard is moving at pace. However, as an interim measure, we would prefer that any new requirements should be on a consistent basis with those already implemented. Once a global standard is finalised and adopted, we consider that disclosures should be mandated. The "comply or explain" basis allows companies time to develop the capabilities to meet these requirements.

Deloitte.

9. Do you agree with our approach not to require third party audit and assurance for issuers' climate-related disclosures at this time? If not, what additional requirements would you consider to be appropriate?

The role of assurance in corporate reporting is growing and it is clear that investors and other stakeholders increasingly want to see additional assurance. The direction of travel is towards assurance as a requirement – for example, the EU's proposed Corporate Sustainability Disclosure Directive would mandate assurance of sustainability information. We determine that the right way to consider this question is in parallel with the BEIS consultation "Restoring trust in audit and corporate governance", in particular section 3.2 on the audit and assurance policy, which asks whether topics such as ESG ought to be subject to either mandatory assurance or an audit and assurance policy. In the interim, in-scope entities may wish to consider whether to commission assurance over climate-related financial disclosures in line with their audit and assurance policy and enhance their governance and risk management disclosures to explain the process the directors have gone through (including any internal and/or external assurance) to build deserved confidence in their reporting.

10. Do you agree that our new rule should take effect for accounting periods beginning on or after 1 January 2022? If you consider that we should set a different timeframe, please explain why.

Yes, we agree and encourage early adoption of the rules where possible. We believe that the climate crisis must be given priority and the urgency of the need for companies to address the effect of climate change in their annual reports cannot be overstated. The effective date still gives time for companies to adapt. Urgent action is required to stand any chance of meeting the UK Government's 2050 net zero target and reducing emissions by 78% by 2035 compared to 1990 levels.

In our response to the BEIS consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and limited liability partnerships we strongly encouraged BEIS to finalise and publish legislation arising from the consultation to take effect as soon as practicable. The idea that legislation and the FCA policy statement in respect of this consultation could be published in advance of COP26, which takes place from 1 November 2021, holds great appeal, demonstrating to the world that the UK is serious about climate change reporting by companies. It would also be in line with the timings set out in the government Roadmap towards mandatory climate-related disclosures.

11. Do you agree with the conclusions and analysis set out in our cost benefit analysis (Annex 2)?

Yes, we agree. The proposals represent a critical step towards the UK Government's 2022 objectives set out in its Green Finance Strategy. The ability for standard issuers to make TCFD-aligned disclosures on a "comply or explain" basis allows companies to apply the rules on a basis that is proportionate to their nature, entity type and size.

12. If future changes were considered in relation to the UK prospectus regime, we would welcome views on also taking the opportunity to introduce specific requirements in relation to UoP bond frameworks and their sustainability characteristics?

This is a new market that is rapidly becoming mainstream. So far, limited regulation has meant that companies have been able to innovate quickly and bring new solutions to market. As a result of limited guidance on these matters, there has not always been transparency around the nature of these products and therefore it is hard for investors to make informed decisions. This gap in understanding is of concern as we believe this may be an indication that investors do not have "all necessary information", which is the core test required by Article 6 of the Prospectus Regulation (which is currently being consulted on by Her Majesty's Treasury (HMT)).

It is our view that investors are at risk of placing undue confidence in the products they are being offered because they are not fully informed about and do not fully understand the product, or the assurance/verification surrounding the product. We therefore believe that it is in the public interest to introduce requirements for use of proceeds (UoP) bond frameworks and their sustainability characteristics with the aim of improving consistency of disclosure and transparency for investors.

We would welcome the development of more definitive requirements (in the regulation that would be relevant to the issuer, whether that is the UK Prospectus Regime, Listing Rules or market rules) relating to UoP documentation in order to encourage clarity for investors and other stakeholders as to the issuer's intentions. A consistent taxonomy to describe how 'green' a product is may be helpful. Furthermore, we would welcome clarity on the role of second party opinion (SPO) providers in relation to the prospectus and what reliance can be placed upon them.

Similarly, issuers are at risk of not keeping to the commitments they are making in the prospectus/listing particulars. If this happens, there is an argument that these products have been mis-sold. The onus should be on issuers to make all reasonable endeavours to meet the commitments they make in the prospectus. Issuers should be expected to evidence that they have done this. Guidance for issuers in this area would again be welcome. Equally, should the issuer fail to make all reasonable endeavours or be able to evidence this, there should be guidance on the recourse available to investors.

We note that the required disclosures for retail investors may be different from those of institutional investors. Prospectuses should be user focused so that the information presented is at a level that the user can understand and engage with. This may mean the inclusion of glossaries of terms and explanations in suitably simple, jargon-free language, to allow retail investors to properly understand the information presented.

Should the recommendation by Sir Donald Brydon, subsequently endorsed by the Department of Business, Energy & Industrial Strategy (BEIS) White Paper come into effect, the FCA may also wish to consider encouraging companies to include their approach to assurance over UoP bonds and their sustainability characteristics in their Audit and Assurance Policy (AAP).

13. Should the FCA explore supporting the UoP bond market by recognising existing standards (eg, ICMA Principles), potentially through our recognition of industry codes criteria and process?

Disclosure of plans for the use of the funds for sustainability projects in the investment circular is to be encouraged as it helps to improve transparency of information for investors. Equally important is requiring issuers to report on the use of Green Bond Proceeds as this will have the disciplining effect of directors knowing they will be held to account. We also consider that aligning to a single framework is a sensible approach. The question of which framework to align to is more difficult.

The International Capital Markets Association (ICMA) principles are, by definition, principles. They are less prescriptive and do not give clear measures of what is green and what is not. Alignment around these principles may therefore have limited impact on improving clarity and comparability of information for investors.

By contrast, the Climate Bonds Initiative prescribes more definitive measures that need to be met. The challenge here is that prescriptive disclosure requirements tend to be met with a compliance only attitude by those that must adhere to them. This may limit the usefulness of the disclosures made.

The European Green bond standard offers a further model.

There are many advantages to having consistent standards on an international level, not least the reduction in administrative burden for issuers looking to multiple markets and the greater ease with which investors can make comparisons of products across borders. There are challenges here too. A global standard would be better than an EU standard for consistency but creating such requirements will be challenging across the globe's diverse economies and politics.

A balance is therefore needed. Ideally the market would help drive best practice as those UoP bond providers with good quality information should be better able to attract investors at a lower cost than those providing poor information and are therefore riskier. There should be a minimum standard that all are expected to comply with; plus scope for entities to disclose more voluntarily if they wish. Standards tend to be slow to change and update. In a market moving as quickly as this, guidance over best practice and voluntary measures allow disclosure to keep pace with the market and investor needs and help drive consistency and comparability.

We believe a better approach is for the FCA and/or HMT to set a green bond framework underpinned by a solid taxonomy. The taxonomy allows comparability of products under a common language which should help combat 'greenwashing'. A framework would be written in a more precise style that would make monitoring and enforcement easier than enforcing a set of principles. A clear framework also lends itself to being considered 'suitable criteria' should the company wish to obtain assurance over the information.

14. We would also welcome views on more ambitious measures the FCA could consider, for example to require that the central elements of UoP bonds be reflected in contractual agreements and set out in the prospectus.

The rapid growth in green bonds can be, in part, attributed to the freedom the market has had to develop new products to satisfy customer demand. Care should be taken to make sure that innovation is not unduly curtailed by the introduction of frameworks and regulation.

Even so, we believe that there is a greater public interest need to protect investors from potentially undesirable behaviour by the providers of UoP bonds. In most cases this is due to a lack of understanding or an under-developed control environment by the issuer, though there is the possibility of intentionally dishonest behaviour too. Steps to ensure that in relation to UoP or sustainability-linked bonds' prospectus, 'all necessary information' is included (which as per the definition should take into account the nature and circumstances of the issuer and the type of security being issued) should be encouraged.

15. We would welcome views on the potential harm set out above and what, if any, actions the FCA or the Treasury should consider.

For users to be able to fully trust the work of the SPO provider/verifier it is important that these companies are independent of the bond issuer. They should also have suitable technical knowledge of the products being provided, the KPIs being assessed and the assurance methodology used – in the same way that ISAE3000 defines quality control and independence requirements.

Also, there are no common standards or professional qualifications so benchmarking technical competence is challenging. SPO providers/verifiers should be expected to be transparent about the relevant training and experience of their staff that are performing work in this area.

Our experience of non-accountant providers is that, whilst some do solid, robust work, others do work that is lighter touch. Some of their engagements are perhaps more comparable to 'agreed upon procedures' or a 'review and recommend' rather than an assurance engagement. However, due to a lack of transparency on what work has (and has not) been done, and a lack of understanding by investors, these 'reviews' are sometimes thought to be providing a level of assurance greater than an ISAE 3000 assurance engagement.

We believe that any 'assurance' provided over these bonds should be performed to a recognised assurance standard, which provides a robust approach to assurance. In addition, the providers of such assurance should comply with International Standard on Quality Management 1 (ISQM1) issued by the International Auditing and Assurance Standards Board (IAASB), which deals with a firm's responsibilities to design, implement and operate a system of quality management for engagements including ISAE 3000 assurance, and (where applicable) ISQM 2 which deals with engagement level quality control review. Compliance with these standards provides preparers and users with the confidence that the assurance execution standards have been applied in a consistent, high quality fashion.

We also believe that it is important for there to be a robust framework for the independence of assurance providers. For firms of accountants operating in this space, long-standing and tough codes of ethics/ethical standards apply to address perceived conflicts of interest, which preclude (in particular) the assurance provider providing assurance over something that they have recently provided advice on. A robust independence framework is necessary and should be no weaker than that of the International Ethics Standard Board for Accountants (IESBA).

A careful balance is therefore needed between ensuring a high-quality product for the users and retaining competition and choice in the market.

Including these bonds in the Audit and Assurance Policy may be a solution. Stakeholders can then make a choice over whether the assurance being provided is appropriate for their needs. This will need to be supported by an education programme so that investors know the difference between limited and reasonable assurance under ISAE 3000, the level of assurance provided by offerings from non-accountant providers who have chosen not to adopt ISAE 3000, and agreed upon procedures.

We welcome regulatory oversight that may improve matters in these respects. We encourage the FCA to consider the BEIS White Papers' proposals for extending the role of the Audit, Reporting and Governance Authority (ARGA) to cover an extended audit profession. There may be synergies by working together to regulate SPO providers/verifiers. Having to comply with two sets of regulation would add undue cost and red tape to the market.

16. Should the FCA, alongside the Treasury, consider the development and creation of a UK bond standard, starting with green bonds?

A well designed and implemented UK bond standard is to be welcomed. Such a standard should be consistent with UK green standards, currently under development, and global standards in this area. There is a risk of fragmentation of standards if they are not built consistently at a global level. This will make it harder for investors to compare products. Inconsistent standards will also push up the cost of administering these bonds and risk the competitiveness of the UK bond market. The standard should reflect the differing needs of retail and institutional investors.

Deloitte.

The UK Government has made commitments to net zero by 2050 and stated a desire to turn the UK into a green finance hub. The EU is already making tangible progress in developing rules and regulation in this area; and the Biden administration in the US has promised significant steps forward in this area too. The action of the FCA should be considered as part of the wider, strategic programme by the Government to move the UK to a green economy.

17. Do you agree with how we have characterised the challenges and potential harms arising from the role played by ESG data and rating providers? If not, please explain what other challenges or harms might arise?

Yes, we agree with the challenges arising from the role played by ESG data and rating providers. Fundamentally the users of the ESG ratings need to have confidence in those ratings. They therefore need to know how the rating was determined, including:

- The skills, training and independence of the entity/person making the assessment;
- What the rating means, so investors have a clear understanding of what the rating is telling them;
- The methodology used to determine the rating;
- How the data was gathered to make the assessment; and
- The steps made to understand and assess the controls around the data such that the data can be considered reliable (complete and accurate).

Additionally, users need to be able to compare ratings between agencies with minimal effort. There is an important role for sustainability standards in promoting consistent and comparable reported information. However, we do not seek a homogenous approach. Standards must have flexibility to reflect the differing needs of retail and institutional investors and allow for changes in their objectives and interests.

As noted in paragraph 4.44 of the CP, there is variety in the data points used by different organisations in creating their ratings. Also, much of this information is gathered from public sources or self-assessment questionnaires. This gives cause for concern about the quality of the data being used, and the ability to reliably compare one score with another, from the same, or a different, provider.

This issue is not helped by a lack of transparency from providers over the areas noted above, which makes the ratings difficult to compare and understand. We welcome steps to improve this transparency and allow users to make more informed decisions.

Users of ESG ratings also need to understand the meaning of a rating and the implications of placing reliance on that rating when making investment decisions. We believe that a lack of understanding by the general public of the difference between: reasonable and limited assurance; agreed upon procedures; and the broad and undefined 'reviews', has led to the public placing more reliance on these ratings than may be appropriate.

18. Would further guidance for firms on their use of ESG ratings – and potentially other third-party ESG data – be useful, potentially clarifying expectations on outsourcing arrangements, due diligence, disclosure and the use of ratings in benchmarks and indices? Are there other aspects such guidance should include?

Guidance and examples are very helpful in setting expectations in the areas noted. There should be a minimum quality standard that all firms are expected to comply without limiting firms' ability to go further in the controls they establish and any voluntary disclosures they make. The risk of being too prescriptive is it encourages a compliance mindset. Ideally the market should push entities to give high quality, meaningful data because this allows them to attract the best investors.

As such, guidance should encourage transparency over the use of ESG ratings and ESG data in the decisions they make, and how the firms satisfy themselves that the data they use is reliable, rather than attempting to control the use of ratings in the operations of a business.

19. We would welcome views on whether there is a case either to encourage ESG data and rating providers to adopt a voluntary Best Practice Code, or for the FCA to engage with the Treasury to encourage bringing ESG data and rating providers' activities inside the FCA's regulatory perimeter.

We refer you to our responses to questions 13, 16 and 17.

Deloitte.

Yes, there is a case for both. As we note in 13.2 and 18.1 regulation should set a baseline that all are expected to comply with to give basic protection to investors. However, there should still be room for further voluntary disclosure to allow best practice to evolve quickly.

The FCA may want to consider similar encouragement for SPOs.

We note that in the remit letter from the Chancellor dated 23 March 2021 Rishi Sunak calls for the FCA to aid in delivering a financial system that supports and enables a net-zero economy by "mobilising private finance towards sustainable and resilient growth and is resilient to the physical and transition risks that climate change presents". The FCA has clear remit to strengthen the market for ESG investing by mitigating the issues noted in the consultation document that can detract from customers making ESG investments. Only if investors have deserved confidence in these ESG investment products, and the risks and rewards of investing are well understood, will private finance move into this area in a sustainable way.

20. If there is a case for closer regulatory oversight of ESG data and rating providers, we welcome views on:

a. Whether transparency, governance and management of conflicts of interest are the right aspects of ESG data and rating providers' operations and activities to prioritise in regulatory oversight, and if not, what other aspects should be considered

b. Whether and how regulatory priorities should differ between ESG rating providers and other ESG data providers

c. The similarities and differences between the policy issues that arise for ESG rating providers and those that arise for CRAs, and how far these similarities and differences might inform the appropriate policy response

Transparency, governance, and management of conflicts of interest are key areas for the FCA to address. We note that ESG data and rating providers are in general not part of a professional body and therefore do not have a formalised code of ethics. Both of these would help in improving transparency, governance, and the management of conflicts of interest. The FCA may wish to work with others such as the FRC, ICAEW and ICAS to help establish a suitable professional body and ethical framework for these providers. For example, the application of a framework as set out in the Financial Reporting Council's Code of Ethics could provide clarity and formalise independence requirements for public interest assurance engagements.

If looked at from a transparency point of view, with the focus being to allow investors to make informed decisions, the regulatory priorities for ESG ratings providers and ESG data providers are very similar. The issues raised in our response to earlier questions in this section of the consultation remain relevant to both areas.

There are many lessons to learn from the experience with Credit Rating Agencies, particularly when it comes to the transparency of methodologies used, user understanding of ratings, and independence considerations. Many of the solutions applied to the credit ratings industry should be considered for applicability to the ESG ratings and ESG data providers industry. However, they are not the same, and there are still challenges in the credit rating industry which must be considered:

- One difference in the two markets is that the number of credit rating agencies is small while the number of ESG ratings and ESG data providers is much larger. The larger number has the advantage of competition and choice for consumers of these products. If those customers are well informed, then the market can be an aid in supplying the right products for their needs at the right price. Regulation should not be about eliminating risk from the market, as long as customers are fully aware of the risk they are taking on when making their purchasing decisions.
- We note that ESG firms are being acquired by larger players in the market. This may have the advantage that it leads to more standardised products that are easier to assess by customers. These larger entities may also be better placed to shoulder the cost of regulation the FCA may place on the sector.
- Customer education cannot be achieved through regulation alone. Whilst those in the financial services sector may understand credit ratings, the person in the street, probably knows little more than a higher rating being better than a lower one.

Deloitte.

21. What other ESG topics do you consider that we should be prioritising to support our strategic objective? Please explain.

The FCA's strategic objective is to "ensure that all relevant markets work well". Defining 'work well' is important in the context of ESG and the remit from the Government to "mobilising private finance towards sustainable and resilient growth and is resilient to the physical and transition risks that climate change presents".

From an economics perspective a well working market is an efficient one where supply and demand are such that an equilibrium is achieved where the market delivers the socially desirable amount of a product to consumers.

Steps to improve information in the market, as we have encouraged in our response to the questions above, would help to meet the FCA's objective of a market that 'works well'. However, this may not be enough to achieve the remit from the Government.

Given the scale and immediacy of the climate crisis, the FCA must therefore consider whether further intervention is needed, for example:

- Should more be done to encourage the mobilisation of private finance towards sustainable and resilient growth that is resilient to the physical and transition risks that climate change presents?
- Does the Government's remit imply that action should be taken to discourage finance from moving to projects that do not meet these attributes?

These questions broaden the ESG response that the FCA must take from considering whether and how to regulate the activities of participants in the UoP bond market, SPO providers and verifiers, and ESG rating providers and ESG data providers to considering whether the market is operating as desired more generally and whether investors are getting the information they need to make informed decisions across the whole of corporate reporting.

The rise in demand for ESG metrics shows that investors are interested in the performance of a company not only in profit terms, but also in how it delivers its purpose through its business model across a range of key performance metrics. To meet investor demands there needs to be a wholesale change in corporate reporting. We are encouraged to see the FCA's CP21/21: Primary Markets Effectiveness Review, DP21/2: Diversity and inclusion in the financial sector – working together to drive change, and the HMT UK Prospectus Regime Review which consider these broader areas.

The FCA should consider working closely with many Government bodies to look at a broad range of ESG related products and services, as well as those outside the ESG space that may have a detrimental impact on the remit set by the Government. Examples include:

- Sustainability linked transactions. To date we have not observed any disputes regarding sustainability-linked performance targets, but due to weaknesses in measurement and technical knowledge we think disputes are likely.
- Potential greenwashing in reporting by regulated entities more generally.
- Failure to disclose in prospectuses of non-ESG investments the potential to negatively impact ESG metrics.