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10 September 2021

Louisa Chender
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

By email: cp21-17@fca.org.uk

Dear Ms Chender

CP21/17: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers

Deloitte LLP (Deloitte UK) is pleased to respond to the FCA's consultation paper 21/17 *Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers* ("the CP").

Climate change is a systemic and existential 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 UK's G7 Presidency and 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 and linked current consultation paper CP21/18, support the extension of the requirement to report consistently with the Recommendations and Recommended Disclosures of the Task Force on Climate-related Financial Disclosures (TCFD). We see this as an opportunity for the FCA to take the lead on improving data flow and capital allocation in the investment chain, and to align with other reporting and disclosure requirements. Done right, the regulatory package will improve the transparency of firms' commitments at both a corporate and product level, as well as the veracity of any claims made.

Deloitte Touche Tohmatsu Limited's (DTTL's) Global CEO, Chairman and CFO are signatories to the statement of support for the TCFD and DTTL is actively involved in its work through 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. TCFD is not itself a reporting standard per se but 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 to do all that it can to encourage adoption by jurisdictions around the world, in order to promote consistent and comparable disclosures.

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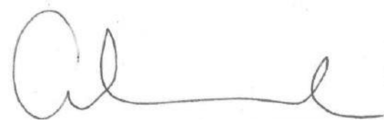
Furthermore, we strongly encourage the FCA to finalise and publish the outcome of this consultation as soon as practicable, ideally in advance of COP26, to give organisations clarity on the regulatory expectations ahead of the proposed implementation date of 1st January 2022.

Our responses to the specific questions raised in the CP are set out 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
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Appendix

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

We consider this threshold to be low given the increasing polarisation of wealth and the fact that many smaller asset managers are nearing this level. There is also a difference between an AIFM managing retail assets (when £5b may be appropriate as a threshold) versus an AIFM that only manages funds held by sophisticated investors such as a Private Equity Fund – when £5b may be considered too low. Because the threshold includes smaller firms, it is our view that the current proposal brings too many entities into scope too quickly and there may be challenges with so many firms trying to implement the framework at the same time. There may be benefits for asset managers in having more tiers included in the roll out between £50bn and £5bn or a more staggered approach in the roll out. This would require larger asset managers and owners, with more resources, to implement the framework before the smaller firms do so and have the benefit of facilitating a smoother process for the smaller firms to implement the framework as they can learn from implementation at the larger level. Implementing it this way will ensure there is not too much pressure on the market. Another benefit of a tier system would also give regulators the opportunity to see which parts of the regulatory package are effective and make improvements before this is rolled out to the wider market.

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 agree with our proposed scope of products? If not, what types of products should, or should not, be in scope and why?**

Yes, we agree.

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

As mentioned in our response to Q1, we advise the introduction of more phases or interim steps to stagger implementation further. The larger firms have greater capacity to implement the framework effectively, enabling smaller firms to learn from their implementation at a later date. Under this approach it may also be possible to reassess the £5b threshold closer to the point of implementation to determine if the threshold should in fact be increased or otherwise altered.

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

We see the main challenges in using proxy data and assumptions as ensuring the data are clear, transparent, and able to be justified as sufficient for use. Using proxy data and assumptions also raises the issue whether gaps are due to an asset owner or manager not having the access or capability to produce the required data or whether a firm is unable to source the required data and it is genuinely unavailable.

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

We support cross-referencing to avoid duplication but would caution that excessive or non-specific cross-references may adversely affect the end user's ability to understand the full picture, particularly if the entity report has numerous cross-references to different sets of reporting. A single cross-reference to a group-wide

report would be clear and unambiguous. An aggregated view with a summary footnote explaining what the cross-reference is referring to (i.e. governance, risk management etc) may be useful.

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

As with other entities subject to TCFD reporting - and consistent with our responses to CP20/3 and CP21/18 - we believe that governance and risk management disclosures should not be subject to a materiality assessment. As regards scenario analysis, we agree with the proposed approach but note that smaller firms may struggle to produce consistent, comparable data. Paragraphs 4.21-4.22 refer to the ability of an in-scope asset owner or manager to refer to a report prepared by a listed group that they are part of. Those rules allow for a 'comply or explain' approach, unlike these asset manager and owner rules. It will be important for the rules to be clear whether cross-referring to a Listing Rules report that has 'explained' is sufficient, or whether the 'explained' information must instead be given at the entity level.

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

Yes, we agree with the proposed comply or explain approach.

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

We agree; the AFM should also have sufficient oversight of the third-party portfolio manager's investment management processes and controls to ensure appropriate levels of engagement; support the AFM's decision in continuing or ceasing a third-party relationship; and give them AFM comfort that climate-related matters are being sufficiently dealt with. Sufficient oversight improves confidence in the climate related disclosures, allowing the AFM and the investors transparency of a portfolio and its impact.

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

Excessive use of cross-referencing may adversely affect the end user's ability to understand the full picture. An aggregated view with a summary footnote explaining what the cross-reference is referring to (i.e. governance, risk management etc) may be useful. We consider that reliance on, or the referencing of, third party/delegate reporting should be permitted, if the firm has explained how it has monitored and managed the risks associated with using third party data. For example, it should be clear whether the reporting firm has received the appropriate consent and whether there are monitoring and oversight processes in place to review and challenge the veracity of the data.

10. **Do you agree with our proposed requirements for product or portfolio-level disclosures, including the provision of data on underlying holdings and climate-related data to clients on demand? If not, what alternative approach would you prefer and why?**

Yes, we agree. With regards to the supply chain, if a manager doesn't give product level info, then the owners using the manager's services will be denied a clear line of sight into climate-related matters, which could cut across other regimes too e.g. the Department of Work and Pensions one. There would also be an impact on the public interest because investing in individual corporate shares is increasingly uncommon, and those choosing to do so are likely sophisticated enough to have their own investment strategy which may or may not have regard to climate change. Owner investors are typically a lot more common and less able to do their own detailed research. It is our view that the FCA provides guidance for how tracker funds can provide the required data.

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

Yes, we agree with the proposed core metrics which are widely and consistently used. We acknowledge challenges in obtaining reliable Scope 3 data and consider that it would be premature to mandate some of these at this stage given the immaturity of data; more guidance would likely be needed to ensure consistency and comparability.

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

We agree that both formulas should be included on a side-by-side basis for comparison.

13. Do you agree that, subject to the final TCFD guidance being broadly consistent with that proposed in the current consultation, our proposed rules and guidance should refer to: 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, we agree. As per our response to Q5, we support cross-referencing to avoid duplication, but would caution that excessive or non-specific cross-references may adversely affect the end user's ability to understand the full picture, particularly if the entity report has numerous cross-references to different sets of reporting. A single cross-reference to a group-wide report would be clear and unambiguous. An aggregated view with a summary footnote explaining what the cross-reference is referring to (i.e. governance, risk management etc) may be useful.

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. 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.

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

We agree that the additional metrics and targets should be reported on where these are consistent with firms' strategy and operations. However, we acknowledge the immaturity of data in this area and therefore the likelihood that data will increase in quality and consistency over time.

15. Do you agree with our approach to governance, strategy and risk management, including scenario analysis at product or portfolio-level? If not, what alternative approach would you prefer and why?

We agree with the scenario analysis being performed at product or portfolio-level to aid the end users' understanding. This approach will also support trustees to produce information in line with Department of Work and Pensions draft regulations.

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

Our understanding is that the most common quantitative scenario analysis output would be financial value at risk. Value at Risk (VaR) is a statistical technique used to measure the amount of potential loss that could happen in an investment portfolio over a specified period of time. To financial analysts and to large asset owners, there are any number of other statistical representations that could be used. However, at product or portfolio level, especially for products such as OEICs and AUTs offered to retail investors, they will need a metric that they can understand and relate to. Sometimes this needs to be as simple as converting to profit or turnover adjustment to be useful for decision making. Another output format might be data that can be plugged into pre-existing models such as financial or risk, therefore utilising existing software, processes and expertise. Guidance might usefully draw this out, i.e. that for products aimed at retail investors, simple methods should be used; for products restricted to wholesale investors, more sophisticated methods may be used. As per our response to Q19, consideration should be given to alignment with the approach adopted by the Pensions Regulator and the recommendations made by the Department for Work and Pensions for those occupational schemes.

In our experience, the cost of producing climate scenario analysis outputs is high and feasibility is low (certainly to any reasonable level of confidence). Modelling the physical impact of climate change is challenging as the climate is fundamentally chaotic and unpredictable. By narrowing down the parameters and geographical area, outputs can become more specific, but access to scientifically endorsed models may prove challenging. This is because the quality and uncertainty of the models is challenging for particular perils and geographies. Insurers must justify why they use the models they do – this should be reflected here.

Regarding transition risks (for example regulatory, consumer preference, reputational), quantitative analysis is even more difficult as reliable and transferrable data sets are not available. We believe that the quantitative scenario analysis is best conducted following a thorough qualitative risk assessment process with key stakeholders to understand what is material to that product or portfolio. Narrowing down the focus is the best way to keep costs low and feasibility relatively high.

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

We agree that this information should be provided to enable users to produce their own climate-related disclosures. We agree that flexibility may be needed, given the differences in how climate change has been reflected in the asset manager's mandate. However, asset managers should not be allowed simply to default to proxies and assumptions without themselves using reasonable endeavours to obtain the necessary information from the entities that they have invested in.

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

We agree with the suggestions, but note that the products that life insurers offer can vary so it may require some nuance reflecting that:

- where a life insurer is offering an investment product, such as a unit linked fund, this is an appropriate approach – the client would be able to understand the individual assets that make up that investment product; and
- where a life insurer is offering a life insurance product which does not have a specific investment portfolio as part of the product, the life insurer should be able to provide a high-level overview of the balance sheet approach the entity providing the life insurance product is taking towards managing climate risk. This should be approach based and higher-level compared to what is expected from an asset manager.

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

Consideration should be given to alignment with the approach adopted by the Pensions Regulator and the recommendations made by the Department for Work and Pensions for those occupational schemes.

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

While this question is directed at asset owners and managers, we would note that firms might wish to consider the benefits of, and required budgetary requirements for, the engagement of independent assurance providers so as to independently verify the consistency and veracity of publicly available information in line with their strategic objectives. The direction of travel is increasingly towards mandatory assurance of ESG/sustainability information in corporate reporting, and the increasing desire for verification of reported information that can include external assurance.