

31 January 2019

Shamamah Deen
Strategy Implementation Division
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

By email: dp18-08@fca.org.uk

Dear Ms Deen

Climate Change and Green Finance

Deloitte LLP (Deloitte UK) is pleased to respond to the FCA's discussion paper (DP) *Climate Change and Green Finance*. The DP is timely, particularly given the urgency (and extent of related financial risks) implied by the Intergovernmental Panel on Climate Change's Special Report of October 2018 on the impacts of global warming of 1.5°C above pre-industrial levels. We note that there have been other regulatory developments in this space with the Prudential Regulation Authority (PRA)'s Consultation on 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change' and the International Organization of Securities Commissions' (IOSCO's) recent statement on disclosure of environmental, social and governance (ESG) matters. In our view, the FCA's response is commensurate with the scale and urgency of the challenge and risk to our financial system, and in line with other regulatory/ supervisory bodies.

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 Deloitte was actively involved in its work through our colleague Eric Dugelay, a member of the TCFD. Deloitte UK is also engaged with programmes such as the City of London's Green Finance Initiative Working Groups and is seeking to contribute expertise to the development of market practice in this area. In our view and experience, climate-related risks are a current material financial risk to the financial services sector which need to be on the CFO agenda. The recent consultation published by the Financial Reporting Council on a new Stewardship Code also highlights the importance of ESG factors from a stewardship perspective. It is therefore essential for firms to integrate consideration of these risks into their existing operations. In order to make meaningful entity-specific disclosures that are of practical use to investors and other market participants, firms need to be able to assess the impact of the relevant risks on their business models and strategy, integrate oversight of these risks into their existing risk management and governance arrangements, and conduct scenario analysis. Disclosures need to cover both the climate-related financial risks faced and also the actions that firms are taking to manage them.

Our responses to the specific questions raised in the DP are in the Appendix to this letter. In summary, we support the actions proposed by the FCA to encourage enhanced disclosure relating to this business-critical issue. In particular, we note that the FCA intends to consult on guidance to issuers about how the current regulatory regime might be interpreted to apply to climate change-related risks. Given the demand for such guidance and the need for it to be available as part of the 2019 year end reporting cycle, we encourage the FCA to consult on this and any other planned guidance as soon as practicable.

In developing a framework for reporting, we believe the Recommendations of the TCFD represent a good starting point. The framework is market-driven and investor-focused and has been designed to require disclosure of material information on climate-related financial risks and their effects in mainstream financial filings. It is recognised as an appropriate disclosure framework by IOSCO globally and by the European Securities and Markets Authority (ESMA) in the EU.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London, EC4A 3BZ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NWE 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 NWE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2019 Deloitte LLP. All rights reserved.

We recommend that the FCA develop further guidance and educational resources regarding a clear, standardised definition of 'green finance' and consider how best to give customers and investors confidence that such products are genuinely 'green'.

Finally, we note the intention to establish a Climate Financial Risk Forum (para 6.3 of the DP). Given our role as a provider of assurance to financial services firms, we would very much welcome the opportunity to participate in this Forum.

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

UK National Head of Accounting and Corporate Reporting
Deloitte LLP



Mike Barber

Partner
Deloitte LLP

Appendix

Disclosures in capital markets

1. What, if any, difficulties do issuers face in determining materiality? We are also interested in exploring how investors consider materiality in this context.

There seems to be a general consensus across regulators that climate risk is material to most sectors. For example, the Sustainability Accounting Standards Board (SASB) Technical Bulletin on climate risk found that climate change is likely to have a material financial impact on companies in 72 out of 79 industries (93% of the capital markets). However, that impact will affect different industries in different ways and over different time horizons. The TCFD, rightly, requires the linking of non-financial and financial considerations. The challenge in determining materiality in this context is in integrating financial materiality with non-financial, sustainability and environmental materiality processes. This is because relevant frameworks often use different definitions for materiality as the frameworks may be aimed at differing user groups. Perhaps even more of a challenge to good disclosure is data and methodology. See our comments to Q2 below.

A recent statement by IOSCO emphasised the importance for issuers of considering the inclusion of ESG matters when disclosing information that is material to investors' decisions. In particular, it stated that ESG matters, though sometimes characterised as non-financial, may have a material short-term and long-term impact on the business operations of the issuers as well as on risks and returns for investors and their investment and voting decisions. In line with this, it may be helpful to encourage companies to consider risks in the context of different timeframes – for instance, separate consideration of short-medium and medium-long term risks – rather than aggregating the two into one materiality assessment. For those required to disclose their principal risks e.g. in a strategic report, some may assess climate risk to be a more emerging or longer term material risk, so it may not appear in their principal risks disclosure. Distinguishing between shorter and longer term risks would be in line with the spirit of the Code's ask to distinguish between a) those risks relevant in assessing a company's viability and b) those relevant for a discussion of its longer-term prospects.

In considering how to present climate-related financial information it is important to ensure that the information given is proportionate to the entity's particular circumstances and material to stakeholders in the context of the report in which the information is included. It is therefore essential that management has a good understanding of the characteristics of the primary users of the report in question and of the types of decisions they will make on the basis of the information given.

Throughout an annual report, for instance, investors typically expect content to be of consistent quality and subject to the same materiality lens throughout, i.e. an investor (or financial) lens. The same materiality principles applied to the financial statements should be used to determine materiality in narrative disclosures, including those related to climate change. This is the approach taken by the TCFD, the SASB and the International Integrated Reporting Council.

In our publication [Thinking Allowed: Materiality](#), we proposed a general materiality 'judgement framework' which can be summarised as follows:

- Understand who your primary users are and the types of decisions for which they will use the financial report.
- Identify the information that is likely to be relevant to those users and, from this information set, work out what is material to them.
- Present the information in a meaningful way that emphasises those matters that are likely to be of most interest to the primary users.
- Step back and review the complete financial report.

Assessing climate-related information involves identifying what information is likely to be relevant to the primary users. In particular, climate-related financial information is likely to be material if it has been discussed by the Board and/or the Audit Committee during the period. Companies with a global footprint will need to make such assessments in the context of global stakeholders and the requirements that apply across jurisdictions.

2. We are interested in understanding whether greater comparability of disclosures would help investors in their decision-making more generally. If so, what framework would be most useful?

Given the time-critical nature of this issue, we believe that it would be more efficient and effective for the FCA to draw on the TCFD's Recommendations rather than developing another framework. The TCFD's Recommendations are already broadly accepted by many market regulators, investors and asset managers. Their use promotes international consistency and comparability, although comparability could be enhanced further by legislating for or otherwise enacting at least some of the key recommendations. We would not want those companies which have already signed up to the TCFD to abandon it.

Adoption of the TCFD Recommendations can be approached in different ways which would do relatively little to enable comparability. Enacting some of the more specific guidance aimed at supporting the implementation of the TCFD Recommendations could be a greater driver towards comparability. Alignment of metrics to support the implementation of the TCFD's Recommendations is already happening. SASB and the Climate Disclosure Standards Board (CDSB) set out in their document 'Climate Risks: From principles to practice' how their offerings, focused on a financially based concept of materiality, present a TCFD-ready approach to climate-related disclosure. Furthermore, the Corporate Reporting Dialogue's (CRD) 'Better Alignment Project', aimed at driving better alignment in the corporate reporting landscape, is currently working with the SASB, Global Reporting Initiative (GRI), CDP (Carbon Disclosure Project) and the CDSB to map their frameworks against the TCFD Recommendations. Their report, expected later this year, will show the linkages of the TCFD Recommendations to the respective reporting frameworks, identify how non-financial metrics relate to financial outcomes and explain how the TCFD Recommendations should be integrated in mainstream reports. The European Commission's Technical Expert Group (TEG) on Sustainable Finance, in its 'Report on Climate-related Disclosures', also sets out how the Recommendations of the TCFD could be mapped to the requirements of the Non-Financial Reporting Directive.

Greater comparability of disclosures can certainly be useful for investors, but caution is needed to avoid stifling innovation in this space. Standardisation can lead to a 'boiler-plate', box-ticking approach which is undesirable. This view is consistent with the insight on investor information needs in respect of ESG disclosures as set out in the World Business Council for Sustainable Development's (WBCSD's) draft 'The ESG disclosure judgement handbook'. This found that investors face challenges when comparing information and therefore performance of companies. Investors are keen that companies use frameworks to evaluate how to best satisfy their reporting objectives, improve the quality and comparability of ESG information and respond to user needs – rather than using them as a tick box exercise.

It is also important to bear in mind that comparability by itself is not sufficient; disclosures need to provide sufficient depth and specificity around the issues. Indeed, comparability will become increasingly important as disclosures are enhanced. As discussed further below, the establishment of a learning hub similar to that of the UK Financial Reporting Council (FRC)'s Financial Reporting Lab may help both in identifying investor information needs and supporting innovation in reporting.

Finally it is worth noting that scenario analysis presents a particular challenge to comparability as companies may approach this in different ways and apply differing parameters and assumptions. Comparability in this respect may be enhanced by ensuring that companies clearly and transparently disclose those assumptions made in performing such analyses within the context of a specified framework. It may help to establish a common set of variables which should be included in the set of assumptions disclosed. The TCFD Technical Supplement 'The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities' includes

guidance on scenarios, data sources and suggested parameters for carrying out scenario analyses. A similar industry-specific framework could help to improve comparability. The FCA could develop (or publicise those already developed - we are aware that there are already established industry groups which are looking at developing tools) example scenarios, or guidance around expectations for modelling considerations for different products (such as mortgage provisions) so that such firms can use them as a guide for their own scenario development. Small and medium-sized firms in particular may benefit from such resources.

3. Would exploring a 'comply or explain' approach, or other avenues to encourage more consistent disclosures, be an effective way of facilitating more effective markets?

As noted in 5.15 of the DP, some disclosure regarding climate risk is required currently by certain entities, such as companies required by law to disclose their principal risks in a strategic report. We urge the FCA to consult on their guidance to issuers, in terms of how the current regulatory regime might be interpreted to apply to climate change-related risks, as soon as possible both in terms of external disclosures (i.e. annual report and accounts) and customer and beneficiary specific reporting. The TEG on Sustainable Finance in its 'Report on Climate-related Disclosures' set out how the Recommendations of the TCFD could be mapped to the requirements of the Non-Financial Reporting Directive. We appreciate that many of the entities that fall under the remit of the FCA are not subject to company law (e.g. unit trusts, OEICs) and as such this gap should be filled.

The risk with use of a 'comply or explain' approach is that it may have the unintended consequence of promoting a 'tick-box' approach. Indeed, this risk has been called out by the FRC in its introduction to the 2018 UK Corporate Governance Code. However, a benefit is that it is an understood concept in the UK, where a high-level description of how the principles of corporate governance have been applied accompanies the statement of compliance with the more detailed provisions of the Code. Such description, when of sufficient quality, is useful and provides readers with more colour to inform their decision-taking than the compliance statement alone. In our view, companies should be encouraged to comply with the recommendations of the chosen framework (e.g. TCFD and a measurement framework such as that suggested in Q2 above), unless a recommendation is not considered material. In this scenario they should explain why this is the case.

In the first couple of years, it may also be helpful to allow companies to explain why they have not yet been able to comply with the framework or specific parts thereof and set out what they are doing to facilitate compliance going forward. This would be consistent with the introduction of the legal requirement for quoted companies to disclose greenhouse gas emissions in the directors' report, which includes a general impracticability exemption, provided that the company explains what information is excluded and why. After this period the requirement should be fully mandated. The urgency of addressing this matter would not, in our view, allow for a transition period longer than two years.

The FCA should also consider the proposal by the TEG on Sustainable Finance in its January 2019 report that disclosures could be differentiated into three levels: Type 1 disclosures, which companies should give as an absolute minimum; Type 2 disclosures, which companies should consider making, based on their assessment of materiality; and Type 3 disclosures, which companies may consider including, such as innovative disclosures that provide more enhanced information. Types 1 and 2 would be "comply or explain", with type 3 optional, allowing those who wish to innovate in their disclosures to go further.

Public reporting requirements

1. Do you think that a requirement for firms to report on climate risks would be a valuable measure?

Yes, it is vital that firms (both firms themselves and financial products of firms) report on their exposure to the risks of climate change and on the financial effects of climate change risks, where material, and both directly and indirectly (e.g. as part of their supply chain).

Climate-related risks make up the majority of the top rated risks in the World Economic Forum's (WEF's) 2019 Global Risk Report (both in terms of likelihood and impact). The report emphasises that climate change is a risk multiplier and can have significant ripple effects across a number of global issues including extreme weather events, large-scale involuntary migration, food crises, social instability, etc. The Economist Intelligence Unit in its report 'The Cost of Inaction: Recognising the Value at Risk from Climate Change' estimates that between now and 2100 the potential financial losses arising from climate change could run from \$4.2 trillion to \$43 trillion, versus a total global stock of manageable assets worth \$143 trillion. Furthermore, a report released by the Global Commission on the Economy and Climate finds that bold climate action could deliver at least US\$26 trillion in economic benefits through to 2030, compared with business-as-usual.

There have been numerous calls from stakeholders including investor groups, policymakers and regulators for action to be taken to ensure financial institutions are taking account of the financial risks of climate change. For example, the Institutional Investors Group on Climate Change (IIGCC), a forum for investors with current membership of 169 representing over €21 trillion assets, has a mission to mobilise capital for the low carbon future by amplifying the investor voice and collaborating with business, policymakers and investors. As climate change is a major systemic risk, understanding how entities are responding to this risk is critical to investors in determining who the market winners and losers will be, so investor communication must address this adequately.

As stated above, we advise the FCA to consult on its guidance to issuers as a matter of urgency in terms of how the current regulatory regime might be interpreted to apply to climate change-related risks. In addition, we encourage the FCA to undertake and publish guidance in this area as market practice develops, to assist smaller and medium-sized firms to comply.

2. Do you have any suggestions for what information could be included in a climate risks report?

We believe that any information on climate change risks aimed at the investor or customer audience should be included prominently within the main body of the report in question (i.e. within the annual report or prospectus, depending on the audience), rather than as a separate climate risks report (although an additional climate risks report containing more detailed data and analysis might also be produced if required). It is important that investors/customers are able to assess climate risks in the context of other relevant risks and at the same level of materiality. This enables them to assess comprehensively all risks facing the fund or product in question, including the linkage between climate and other types of risk. For example, there may be several risks including climate risk which might trigger a firm to change its business model – it would be useful for investors to see these together.

With regard to the information to be included, we recommend basing this initially on the Recommendations of the TCFD, supported by relevant metrics as discussed above.

3. Do you have any views on which regulated firms should be required to compile a climate risks report?

Disclosure should be proportionate to the entity in question and material to investors/customers. The extent of disclosure should depend on the extent to which the entity is subject to specific risks and opportunities from climate change. In making the assessment of which firms should be required to compile information on climate risks, which is a complex regulatory challenge, we recommend the FCA considers the following matters:

- The FCA has explained its view that listed companies should already be giving this disclosure. We welcome the suggestion in paragraph 5.15 of the DP and recommend that this happens quickly, enabling finalised guidance to be made available to issuers planning their 2019 year end reporting. We suggest that any guidance focuses not only on the duty to prepare a management report in DTR

- 4.1.8R, but also considers the reports of other issuers of debt securities (LR 17) and the disclosure of risks in a prospectus under the Prospectus Directive Regulation and in listing particulars.
- When considering the requirements for entities other than listed companies, the size of the entity in financial terms (the approach taken by BEIS as regards GHG disclosure in companies' directors' reports) should not dictate whether or not it provides climate risk disclosure. For example, a small fund manager could manage a fund which is significantly exposed to climate risk. Understanding the effect of climate risk on a fund that they manage could be important as it may drive a change in the manager's own business model.
 - For those managing funds on behalf of others (pension funds, asset managers etc.) or advising on such matters (e.g. investment advisors), debate is needed as to whether risks should be reported at the fund manager level, the fund level or both. Reporting in, for instance, the fund manager's report would reduce duplication; however, retail investors are only likely to read the reports and prospectuses of the specific funds. The FCA should consider both UCITS funds and AIFs in this regard. Again, it may be possible to achieve this by means of guidance to assist in interpretation of current rules, but we note that the handbook text in this area is more closely linked to direct financial risk than to the financial impact of climate risk.

To the extent relevant, the PRA and FCA should, in any case, adopt common definitions.

Additional questions

1. How can authorities, including the FCA, most effectively work with industry to meet investor demand for green investment opportunities and encourage those raising capital and investing in it to pursue sustainable outcomes?

Given the urgency of this issue we strongly advise the FCA to engage with other regulators and supervisors including the PRA, the Pensions Regulator (tPR), the Bank of England and the FRC (or its successor, with reference to the Kingman Review), for instance through the existing Network for Greening the Financial System, to develop and promote internationally consistent supervisory approaches and advance thinking on this issue, including using existing standards and frameworks wherever possible.

The FCA could also consider providing input to preparer pilots by offering its regulatory expectations (e.g. the UNEP FI TCFD implementation pilot) and work with trade bodies such as the UK Investment Association (IA), which has recently published a consultation on sustainable and responsible investment for asset managers.

In light of the PRA's own consultation paper on enhancing banks' and insurers' approaches to managing the financial risks from climate change, it will be important to maintain a joined-up approach within the UK, in which context we welcome the establishment of a joint Climate Financial Risk Forum. As noted in our cover letter, we would welcome the opportunity to participate in this Forum.

2. Do you agree with the extent of the FCA's proposed interventions on climate change-related financial disclosures? Is there a specific need for us to intervene further in the interests of market integrity or consumer interests?

We agree with the proposed interventions, but suggest that the FCA may wish to consider further measures in relation to consumer protection and conduct by firms in relation to product development in the green finance market, ensuring that investors in green finance products are able to invest with confidence in such products and avoid 'greenwashing'. In particular we suggest that the FCA Handbook could be updated to require funds to report on ongoing climate-related performance against key measures, including updated assumptions over time and potentially extending to future developments.

In relation to proposals to produce guidance for providers of pension schemes, we recommend engagement with tPR to ensure a joined up approach.

As set out in our cover letter, we encourage the FCA to consult on and finalise its proposed interventions in a timely manner to enable firms to implement the necessary requirements as quickly as possible.

3. In light of the EU work on taxonomy, what are your views on the form common standards and metrics for measuring and reporting against green financial services products should take?

The European Commission, via the TEG, is proposing to set out minimum criteria for a product to be considered a 'green finance' product. Where the FCA stipulates any specific requirements for such products, we recommend that the FCA align its definition to that agreed by the TEG. It may also be helpful to allow for and facilitate different 'shades of green', acknowledging that some products may be greener than others.

4. How could regulators and industry best work together as part of the Climate Financial Risk Forum?

We recommend that the FCA considers adopting a similar model to that used by the FRC in its Financial Reporting Lab project. The Lab environment promotes innovation in reporting by enabling companies to test new reporting formats with investors, and investors to indicate areas of importance and interest to them. The success of this model is evidenced by the European Financial Reporting Advisory Group's decision to establish the European Corporate Reporting Lab along similar lines. SASB also developed their standards using a similar approach.

5. What are your biggest concerns and commercial priorities regarding climate change?

Given the findings outlined in the Intergovernmental Panel on Climate Change's Special Report of October 2018 on the impacts of global warming of 1.5°C above pre-industrial levels, we encourage the FCA, other regulators and government to act swiftly and with a sense of urgency to encourage improved disclosure and regulation. As noted above, we recommend the FCA adopts the TCFD Recommendations as a basis for reporting, as they are immediately available and already in use.

6. What are the biggest barriers to the growth of green financial services in the UK?

We believe there is scope for greater education and improved information to help investors understand what 'green' means and why they might choose to invest in a green product other than for ethical reasons. This is particularly relevant in the case of pension schemes, where investments may be made over decades, and to which climate change poses a very clear risk. There may also be scope for increased assurance over green financial services to facilitate investor confidence and minimise 'greenwashing', and standardised labelling of green financial products to improve transparency and comparability.

As explained in our answer to Q3 above, allowing for different 'shades of green' may help the growth by allowing regulated firms and funds to move in stages rather than having to make a major shift in one year.