THE INVESTMENT ASSOCIATION

FCA Consultation CP20/3: Proposals to Enhance Climate-Related Disclosures by Listed Issuers and Clarification of Existing Disclosure Obligations

Response from the Investment Association

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 40% of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.

The Investment Association's Institutional Voting Information Service (IVIS) is a corporate governance research service which analyses FTSE All Share and FTSE Fledging companies against the IA's investee company guidelines, the UK Corporate Governance Code and best practice.

Executive Summary

The IA welcomes this opportunity to input into the FCA's consultation on enhancing climate-related disclosures.

The risks presented by climate change to business, society and the environment are clear. The need for companies, investors and regulators to act with urgency to address them is undeniable. Climate change, and efforts to mitigate its impact, could result in a significant loss of value in listed companies. This will ultimately impact on ordinary savers, whose pensions and savings are invested in these companies.

TCFD-aligned disclosures are a crucial step forward to managing the impact of climate change; supporting companies to focus on the effects of climate change on their business and communicate how these are being managed to their shareholders and other stakeholders.

Managing assets for both retail and institutional investors, the IA's members are major investors in UK listed companies. They rely on quality disclosures to inform the investment process and the effective stewardship of their investee companies. Quality disclosures, characterised by consistent and comparable information, contribute to accurate asset valuations, which in turn contribute to financial stability. Enhancing climate-related disclosures also enables investors to provide the necessary support and challenge to companies to transition to more sustainable business models.

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The IA supports the stated ambition in the UK's Green Finance Strategy that *all* listed companies should disclose in line with the TCFD recommendations by 2022. In January this year, the IA published its [Shareholder Priorities for 2020], calling for companies to make significant progress towards the TCFD recommendations. IVIS, the IA's corporate governance research service, has monitored company disclosures through the 2020 AGM season against the TCFD's four pillars: governance, risk management, strategy, and metrics and targets. Our research into FTSE 100 disclosures suggests there has been a significant increase in companies disclosing against the TCFD recommendations in 2020.

Building on this progress, we welcome the FCA's proposals to enhance issuers' climate-related disclosures. Our members are clear there is a pressing need for an increase in the quantity and quality of climate-related disclosures from investee companies. The introduction of rules for listed issuers is essential to underpinning market discipline.

There is significant support amongst our members for the FCA to go further than the proposals set out in this consultation by making TCFD-aligned disclosures mandatory for all premium-listed commercial companies. While a number of members are supportive of the current proposal for a 'comply or explain' approach, at least initially, they are clear that this should move to a mandatory basis over a short period. **The IA therefore recommends that the FCA introduces the TCFD disclosure requirement for all commercial companies with a premium listing on a mandatory basis.**

We would also recommend expanding the scope to include commercial companies listed in the standard segment on a comply or explain basis. This meets the ambition set out by the Green Finance Strategy and supports coherent TCFD disclosures across the investment chain. This coherence is essential to ensuring effective investor action on climate change.

Irrespective of whether the FCA takes forward these new rules on a mandatory or comply or explain basis, we would stress the need for clear timelines, beginning with a confirmed review date in 2024. This will give time to assess how well the rules are working and will align the FCA's review period with the DWP's commitment to review the scope of its rules for pension fund TCFD-aligned disclosures. At this review, the FCA should assess the impact of the new rules, avenues for further progress and alignment with regulatory reporting requirements across the investment chain, including for pension funds.

Scope

1. Do you agree that our new rule should apply only to commercial companies with a premium listing, at least initially? If not, what alternative scope would you consider to be appropriate, and why?

HM Government's Green Finance Strategy outlined the UK's ambition that *all listed companies* and large asset owners disclose in line with the TCFD recommendations by 2022. In early 2020, IA members called for all listed FTSE-All Share companies to include a discussion in their annual report of the impact that climate change will have on their business and how the company is managing this impact.

The IA recommends the scope of the new rules is expanded to include all commercial companies with a standard listing on a comply or explain basis.

High quality disclosures across *all* listed companies are a crucial step towards managing the impact of climate change. Investors rely on quality disclosures to inform the investment process and identify where further action is needed to support and challenge companies to transition.

We agree that the rule should apply to commercial companies only initially. Investment companies will be heavily reliant on the disclosures of their investee companies, leading to a lag in their ability to report immediately. For FCA regulated firms, including asset managers, while they are well prepared to report in line with TCFD at the enterprise level in their capacity as issuers, there are a number of methodological challenges to reporting in their capacity as investors and at a portfolio level, which we discuss further in our response to Q3. Similarly, requiring investment companies to provide TCFD-aligned disclosures may not be appropriate or feasible at this stage.

The FCA should set a clear timeline on when it anticipates investment companies being brought in-scope. As noted in our response to Q3, this should be achieved as soon as is possible and we look forward to working with the FCA to consider how this can best be accomplished.

2. **Do you agree that sovereign-controlled commercial companies with a premium listing should also be in scope? If not, why should these companies not be included?**

We agree that sovereign-controlled commercial companies with a premium listing should be included in the scope of the new rules.

Part of what makes the UK listing regime an attractive market for long-term investors is the confidence that all premium listed companies are accountable to high standards and investor protections. The proposal to enhance climate-related disclosures further enhances these high standards and investor protections and should apply across all premium listed segments.

Asset Managers with a Premium Listing

3. **Do you agree with our approach?**

We agree that in-scope asset managers and insurance companies with asset management businesses should prepare enterprise-level disclosures in their capacity as issuers.

Asset managers that have a listing in the premium segment typically have the capabilities and expertise to prepare enterprise-level disclosures in their capacity as issuers. Many investment managers already disclose in line with TCFD, or are in the process of implementing the recommendations, in their capacity as issuers. The IA is supporting members to develop enhanced entity-level climate-related disclosures in the 2021/22 reporting round.

Providing disclosures in their capacity as regulated firms, especially at the portfolio level, is a more complex demand. At this level, regulated firms will be reliant on the quality, consistency and comparability of investee company disclosures. As TCFD's final report noted, asset managers' climate-related reporting is "likely to evolve as data availability and quality improves". The IA is considering how it can assist its members to improve climate-related disclosures at the portfolio level. We are keen to develop this alongside the FCA and we support the FCA's intention to separately consider how best to enhance climate-related disclosures by regulated firms.

Asset managers will need to make relevant climate disclosures to their clients so that they can make informed choices about their own capital allocation decisions, as well as meeting their own regulatory obligations: large pension funds will shortly be required to make TCFD-aligned disclosures. They will be reliant on their asset managers' disclosures to meet these requirements. Ensuring that disclosure requirements are coherent across the investment chain will be key to creating an efficient market.

As noted in our response to Q2, the FCA should set out a clear timeline for introducing new rules for investment companies and regulated firms.

Consistency with Global Standards

4. Do you agree that our rule should reference the 4 recommendations and 11 supporting recommended disclosures including in the TCFD's June 2017 final report? If not, what alternative approach would you prefer, and why?

We agree that the rule should reference TCFD's final report.

The TCFD recommendations already have significant traction with investors and companies. TCFD-aligned reporting embeds the principles of materiality and strong governance that are crucial to investors. It encourages companies to assess climate change risk and its impact on their business model, strategy, capital allocation and risk management. In undertaking this assessment, investors expect board directors to become fully versed on the impacts of climate change on their business and adapt or strengthen their business model and strategy to ensure long-term viability. These disclosures are essential evidence of how well companies are responding to climate change and are being used to inform the investment process, as well as engagement and voting activities.

We would encourage the FCA to continue to work with the FRC and the investment industry to determine which pillars of TCFD require improvement in the UK context.

For issuer disclosures to be decision-useful, there needs to be greater levels of comparability, especially for the metrics and targets pillar. As per TCFD's 2019 Status Report, 42% of issuers pointed to a lack of standardised metrics for their industry. Investors have voiced similar concerns. Without sector-specific metrics, the comparability of climate-related data, and therefore its utility, is limited. We would therefore encourage the development of sector specific standardised metrics.

To support the development of sector specific standardised metrics, in addition to the proposed rule changes, we recommend that the FCA should, together with the FRC, signal their support for sustainability disclosure frameworks which complement and support TCFD. For instance, investors support greater adoption of SASB, which provides for greater comparability on key climate related metrics as well as a sector-based materiality lens.

5. Do you agree that we should make explicit reference in the Handbook guidance to the TCFD's 'guidance for all sectors' as well as the supplemental guidance for non-financial

groups' accompanying each recommended disclosure? If not, what alternative approach would you prefer and why?

We agree that explicit reference should be made to the TCFD's guidance for all sectors. This will assist issuers in producing consistent disclosures based on common expectations and understandings. As noted in our response to Q4, investors have identified a lack of comparability as a major weakness in current climate change-related disclosures.

6. **Do you agree that we should include additional guidance which references the wider set of materials that have been published both within and alongside the TCFD's final report, as useful sources of guidance and interpretation when complying with our proposed rule?**

Agree – see responses to Q4 and Q5.

We note that practical guidance that complements the TCFD's final report is already available for non-financial firms (e.g. from the Climate Disclosure Standards Board) and financial firms (e.g. from the Climate Financial Risk Forum). We expect that the work of the Climate Financial Risk Forum will help develop consensus on which methodologies, data and metrics are most useful for quantitative reporting.

Proportionality: Ability to Explain

7. **Do you agree that we should introduce the new rule on a 'comply or explain'? If not, what alternative approach would you prefer, and why?**

IA members had mixed views on the basis on which the new rules should be introduced. On balance, there was significant support for making TCFD-aligned disclosures mandatory for all commercial companies with a premium listing, although a number of IA members would support 'comply or explain' – at least for an initial period. The IA therefore recommends the FCA introduce a mandatory requirement for all commercial companies with a premium listing. We would expect the rule to apply to standard listed commercial companies on a comply or explain basis in the first instance. We have outlined the arguments we have heard for both options below.

Mandatory Disclosures

The urgency of the challenge presented by climate change, coupled with the speed at which companies are improving their disclosures, means that it is now both appropriate and feasible to require commercial companies with a premium listing to provide TCFD-aligned disclosures on a mandatory basis.

Commercial companies with a premium listing are well placed to make TCFD-aligned disclosures on a mandatory basis. Analysis by IVIS, the IA's corporate governance research service, suggests that the number of FTSE 100 companies committing to TCFD-aligned disclosures has more than doubled in the last year. The majority of these companies now report or commit to report in line by 2022 and have reported against at least one of the four pillars of TCFD. For those that have not disclosed against the TCFD recommendations in the past, the recommendations are sufficiently flexible to accommodate companies at different stages of the journey.

New rules mandating climate change disclosures for listed issuers represent an opportunity for the UK to reaffirm its role as a world leader in tackling climate change. Investors were encouraged by the Green Finance Strategy's commitment to "cement UK leadership" in this area. Other countries are making significant progress, with [New Zealand] being the first country to make TCFD-aligned disclosures mandatory for around 200 entities by 2023, including all equity issuers listed on the New Zealand Stock Exchange.

Mandatory disclosures from commercial companies with a premium listing is an important step for enhancing climate disclosures across the investment chain. Following Government amendments to the [Pension Schemes Bill] which allow for mandated climate change disclosures, the Department for Work and Pensions is consulting on requiring TCFD-aligned disclosures for larger pension schemes. These pension schemes will be reliant on their investment managers' disclosures, who in turn will be reliant on the disclosures made by the companies, both private and public, that they invest in. Different requirements at different levels of the investment chain inhibit the ability of actors across the chain to meet their regulatory requirements. Consistent regulations support investors to incorporate climate risk more effectively into their investment process and to report on these risks to their client so that information flows support asset owners to make effective capital allocation decisions.

Comply or Explain

Investors recognise that companies are on a journey to implementing the TCFD recommendations. Comply or explain would afford issuers the necessary flexibility in this initial period. Investors' own expectations, outlined in the IA's Shareholder Priorities for 2020, have been set in the knowledge that disclosures remain in their infancy and capabilities are still developing.

We welcome the consultation's note that non-disclosure would only occur on an "exceptional basis". If comply or explain is adopted, the FCA should re-enforce the expectation that all companies disclose against the TCFD recommendations, with companies explaining why certain pillars may not be appropriate to their business. Investors will continue to make this expectation clear in their engagements.

Given the importance of these disclosures, investors will expect any explanations to be well-reasoned, clearly linked to business strategy and to outline the specific actions taken to mitigate risks that would otherwise be disclosed using the TCFD framework, or provide a timeline for when they expect to make TCFD-aligned disclosures. It may be the case that commercial companies with a standard listing are able to meet the first three pillars of TCFD (governance, strategy, risk management) but struggle with metrics and targets. We nonetheless want as wide array of companies as possible to be considering climate-related risks and how these impact their governance and strategy.

Scope

We recommend that commercial companies with a standard listing be brought into scope on a comply or explain basis.

An initial tiered approach, with premium listed commercial companies required to make TCFD-aligned disclosures on a mandatory basis and standard listed commercial companies required to make TCFD-aligned disclosures on a comply or explain would allow best practice to emerge in the premium segment and be replicated across smaller companies, while also providing standard listed companies the time needed to build the requisite capabilities to make disclosures on a mandatory basis at an appropriate time. We would subsequently expect TCFD-aligned disclosures to be made mandatory for standard listed issuers after a clearly defined initial period.

The FCA should provide a clear timeline for a review of the effectiveness of these rules. It would be sensible if this review process took place after two reporting cycles. We note that the DWP has proposed a review of its TCFD requirements for pension funds in 2024 and we would encourage the FCA to align its review with this in order to provide greater regulatory coherence across the investment chain.

Materiality Assessment for Governance and Risk Management Disclosures

8. Do you agree that the recommended disclosures under the 'governance' and 'risk management' recommendations should not be subject to a materiality assessment? If not, what alternative approach would you prefer, and why?

We agree that disclosures under the 'governance' and 'risk management' recommendations should not be subject to a materiality assessment. As set out in the IA's Shareholder Priorities for 2020, investors expect all companies to have governance processes in place and to:

- Proactively identify which climate related risks they are exposed to, including physical, transition and liability risks and disclose how they manage these risks.
- Recognise that the pervasive and complex nature of these risks mean that it is not always immediately apparent which direct or indirect impacts are financially material.
- Undertake a systematic assessment which considers impacts on their products and services, operating model, assets and financial position, supply chain, as well as on their key stakeholders, employees and customer base.
- Establish robust systems and controls to manage these risks including clearly defined responsibilities for monitoring and oversight by the board and management.

This will ensure that companies have the appropriate systems in place so that, should climate change become a material concern, this can be quickly identified and mitigated.

9. Do you agree that issuers should ordinarily be able to make the recommended disclosures under the governance and risk management recommendations?

We agree. During the year under review, IVIS monitored climate change-related disclosures by FTSE All Share companies. This was informed by the four pillars of TCFD: governance, risk management, strategy, and metrics and targets. Our analysis of FTSE 100 companies that held an AGM between 1 January 2020 and 30 September 2020 found that 69% of those companies are describing their governance of climate related risks and opportunities and 70% described the actual or potential impacts of climate related risks and how these are assessed and managed.

While we would reasonably expect this number to lag outside of the FTSE 100, this is strong evidence that these disclosures can be incorporated into existing disclosures on governance and risk management. Investors have been clear that they expect companies to have governance processes in place and proactively identify climate related risks.

10. Do you agree that explicit guidance is needed to clarify that it would be acceptable for an issuer to explain non-disclosure of these recommended disclosures only on an exceptional basis?

We agree. As noted in our response to Q7, investors expect all companies to be disclosing in line with the TCFD recommendations. Where non-disclosure is deemed appropriate, investors will expect any explanations to be well-reasoned, clearly linked to the business strategy of the company and outline the specific actions taken to mitigate risks that would otherwise be disclosed using the TCFD framework.

Location of Disclosures, Assurance and Statement of Compliance

11. Do you agree that the statement of compliance and the proposed disclosures should be made within an issuer's annual financial report? If not, what alternative approach would you prefer and why?

We agree. Issuers' annual financial reports are a key source of information for investors. The information provided therein is critical to supporting long-term sustainable value, enabling investors to make more efficient capital allocation decisions and to conduct quality oversight and engagement through their stewardship activities. While the annual financial report is predominantly for shareholders, these disclosures also provide important information for a wide range of stakeholders and should be as accessible as possible.

We recognise the practicalities of linking to fuller statements outside of the annual financial report. This allows companies to make comprehensive and meaningful disclosures without bloating the annual financial report – however, these should be clearly linked to in the report and accounts, as per our response to Q12.

12. Do you agree that an issuer should be required to include within the statement of compliance a description of where in its annual financial report (or other relevant document) its TCFD-aligned disclosures can be found? If not, what alternative approach would you prefer and why?

We agree – see our response to Q11.

In our review of company disclosures, we found that a number of companies had taken this approach, with a clear TCFD index at the front or back of the report. Climate risk management should be considered as a critical part of the companies thinking at every level rather than as a stand-alone issue. This approach allows companies to disclose in a manner that reflects this.

13. Do you agree that the FCA should not require third-party assurance of issuers' climate-related disclosures at this time? More generally, we welcome views on the role of assurance for climate-related disclosures.

Investors rely on the quality and robustness of the information provided by companies when making investment decisions. As non-financial information increasingly informs investment decision making, it is essential that investors have confidence in the quality and accuracy of this information. Assurance goes some way to providing this confidence.

Auditors are already required to assess whether there is any inconsistency between the narrative disclosures provided by the company and the company's accounts. However, companies are not required to state whether the level of assurance has extended beyond this requirement. As a result, it can be difficult for investors to determine what information has received third-party assurance.

We recommend that the FCA require issuers to state whether or not their climate-related disclosures were subject to third-party assurance and, if so, the level of assurance that was provided.

Investors are requesting that non-financial information has a level of third-party assurance. In our response to Sir Donald Brydon's review of the quality and effectiveness of audit, the IA called for the audit to cover the wider metrics investors consider important and that influence investors' decisions, such as APMs and KPIs. These metrics are increasingly including climate-related measures. Where KPIs include climate related metrics and targets, we would expect third-party assurance. At a minimum, assurance should cover whether non-financial information, including climate-related, has been defined with the basis of calculation clearly disclosed, an explanation given as to why information has been presented and is useful, and whether this has been presented consistently over time.

The promotion of common frameworks for reporting, like TCFD, sets the foundation for which non-financial information can be assured. As the comparability and consistency of reporting increases, we would expect greater levels of assurance. The FCA and other regulators should continue to keep this requirement under review as practices develop.

The Duties of Sponsors

14. Do you have any feedback on the interactions between our proposed rule and the role of sponsors in assisting premium listed issuers?

No further comment.

Application of Established Concepts and Principles

15. Do you have any other feedback related to the interaction between our proposed rule and existing legislative and regulatory requirements and industry standards and practice?

We welcome the FCA's existing efforts to collaborate with other regulators on TCFD-disclosures. Indeed, this will need to be taken even further to determine how the new rules interact with other regulations in order to ensure greater transparency of climate risk across the full range of financial instruments and to ensure a coherent approach to climate-related disclosures across the investment chain.

As noted in our response to Q7, it is vital that the interaction between requirements up and down the investment chain is coherent. Quality, comparable and consistent disclosures are needed at every level: asset owner, investment manager and issuer. At present, there is a risk that each level of the investment chain will have different regulatory expectations.

We also note that over the last two decades, we have seen a significant shift in capital allocation from equities to fixed income, private markets, real estate and infrastructure. While we appreciate that responsibility for enhancing climate related disclosures for non-listed entities falls outside the FCA's remit, we would encourage the FCA to continue to collaborate with other regulators to enhance climate related disclosures across both public and private markets.

Managing Challenges, Risks and Unintended Consequences

16. Do you consider that our proposals adequately address the challenges, risks and unintended consequences described above? If not, what additional measures would you suggest?

We consider the proposals to be adequate but would re-iterate the importance of setting out a clear timeline for next steps, especially as it relates to expanding the scope of the regulations and strengthening the comply or explain basis.

We would also stress the need to consider how this rule will impact the investment chain as a whole, as noted in our response to Q3.

Finally, we would note that climate change-related disclosures are relatively new and best practice will continue to develop at pace. We would stress the need for collaboration between industry, regulators and government to ensure that the rules remain fit for purpose and future-proofed.

Timing of Implementation

17. Do you agree that our new rule should take effect for accounting period beginning on or after 1 January 2021? If you consider that we should set a different time frame, please explain why?

The IA supports swift implementation of the new rule and would therefore support the rule coming into effect for accounting periods beginning on or after 1 January 2021. We appreciate that the COVID-19 pandemic has impacted the resources available to companies. However, its impact only highlights the critical need to engage with systemic risks early and effectively.

The expectation to report against the TCFD recommendations has already been trailed extensively. In 2019, HM Government's Green Finance Strategy included an expectation that "all listed companies and large asset owners [would] disclose in line with the TCFD recommendations by 2022". Similarly, the IA distributed its Shareholder Priorities to companies in the FTSE All-Share in early 2020, calling for "significant progress" towards the TCFD recommendations. We found that the number of companies committed to reporting against TCFD in the FTSE 100 had more than doubled between 2019 and 2020.

The IA considers that companies should therefore be well positioned to comply with these rules.

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

Agree.

Technical Note

19. Do you agree with the guidance provided in the draft Technical Note set out in Appendix 2? Are there any changes that you would suggest? If so, please describe.

We agree with the draft Technical Note. As per our response to Q1 and stressing the importance of other asset classes, we welcome the note that, "issuers should assess climate-related risks and opportunities and other ESG considerations carefully in informing their disclosures, both in respect of equity and non-equity securities".