THE INVESTMENT ASSOCIATION

pwc

INSIGHTS AND SUGGESTED ACTIONS ON THE FCA'S TCFD RULES FOR ASSET MANAGERS:

LESSONS FROM YEAR 1 REPORTING AND RECOMMENDATIONS GOING FORWARD

March 2024

ABOUT THE INVESTMENT ASSOCIATION (IA):

The IA champions UK investment management, supporting British savers, investors and businesses. Our 250 members manage £8.8 trillion of assets and the investment management industry supports 126,400 jobs across the UK.

Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks and shares ISAs. The UK is the second largest investment management centre in the world, after the US and manages over a third (37%) of all assets managed in Europe.

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1. FOREWORD

Economy-wide, comprehensive and comparable climate-related disclosures are a crucial step forward in managing the impact of climate change and supporting the net zero transition. As such, the investment industry welcomed the FCA's 2021 Policy Statement containing its final rules on TCFD disclosure by asset managers and the clarity it provided on the FCA's expectations for reporting.

In early 2022, the Investment Association (the "IA") established its TCFD Implementation Forum to support member firms with putting the FCA's rules into practice. The Forum serves as a platform for members to engage in peer-to-peer knowledge sharing, discuss experiences and challenges, and ultimately best practice, as investment managers navigated the intricacies of TCFD implementation.

Having considered how we might further support IA members with the implementation following the deadline for reporting at the end of June 2023, the IA has been delighted to partner with PwC to produce a report reviewing this first round of asset manager disclosures against the FCA rules on TCFD. Our hope is that the report and its recommendations will serve as a helpful resource to firms reporting for June 2024 and beyond.

The report sets out our review of investment managers' entity, product, and on-demand reporting, some of the key challenges faced in implementing the TCFD reporting requirements, as well as a list of 10 key areas for asset managers to consider in their reporting going forward. The IA will also be using this report to inform our ongoing engagement with the FCA around the rules and to evaluate where further guidance from the regulator might be helpful.

We would be delighted to continue the conversation with our members on any questions or comments you might have on the report, so please do not hesitate to get in touch if there are views you would like to share.

Galina Dimitrova

Director – Investment and Capital Markets,
The Investment Association

2. EXECUTIVE SUMMARY

In November 2020, the UK Government published a ***roadmap*** charting a path to achieving its ambition for all sectors of the economy to be reporting in line with the Task Force on Climate-related Financial Disclosures (TCFD) Recommendations by 2025. As part of this, the Financial Conduct Authority (FCA) finalised its ***rules*** in Policy Statement (PS) 21/24 in December 2021, requiring the largest asset managers – those with assets under management (AUM) of > £50bn – to report in line with the TCFD framework by 30 June 2023. These rules go beyond the minimum TCFD requirements – requiring additional disclosures at individual entity and product level and the inclusion of specific metrics.

With the first wave of disclosures now published, and the second wave due to be published by 30 June 2024 (for those asset managers with AUM between £5bn and £50bn), the Investment Association ("IA") and PwC have partnered to review the key themes emerging in the first round of asset manager reporting. As well as undertaking our own analysis of the disclosures, in September 2023 we also spoke to a number of investment management firms, including those that have already reported, and those reporting in 2024 for the first time. This report sets out the key findings from our review, including challenges faced by firms for their 2023 reports, and some ideas that firms can take away when producing their 2024 reports.

KEY FINDINGS

Entity-level reporting

The entity reports we reviewed were produced by a combination of firms. This included firms that had already issued group-wide reports in previous years which they could leverage as well as firms reporting under TCFD for the first time. We found a number of key themes amongst the entity reports:

1. As it is the first year of reporting under the FCA rules, **reports differed in their use of quantitative and qualitative reporting** which may impact how decision-useful they are for investor clients. We understand from our conversations with firms that they expect to enhance their approach to quantitative reporting in the coming years, thus ensuring that reports become more decision-useful.

2. **Reporting on transition planning was varied – although firms expect to evolve their approach in future years**. We expect that disclosures on transition plans will be enhanced in the coming years, particularly once the Transition Plan Taskforce (TPT) sector-specific guidance is finalised. However, the FCA might expect, as per its guidance in the ESG Sourcebook, to see a greater link between individual net zero targets and a firm's transition plan to meet that target.

3. **Firms could improve usability for consumers and investors in their reports**. This could be achieved in future by, for example, ensuring the report can be easily located in a prominent location on their website.

4. Whilst **most firms included a signed compliance statement to confirm the report complied with the FCA rules, some did not**. This can be easily fixed in year two by including a statement with more refined wording – for example, some firms included a statement, but it did not confirm compliance with chapter 2 of the FCA's ESG sourcebook.

KEY FINDINGS

Product-level and on-demand reporting

Similarly, we found some consistent themes from our review of a range of product reports:

1. **A lack of specific guidance from the FCA in key areas leads to a variation in approaches for product-level reporting**. For example, as the Sourcebook doesn't provide a definition of 'carbon intensive' sectors or what constitutes 'high' or 'concentrated' exposure, firms have defined these terms differently. This creates a risk that two near-identical products could have different levels of disclosure – one disclosing qualitative analysis only versus disclosing both qualitative and quantitative analysis.

2. **Scenario modelling could be further enhanced**. For example, we saw a number of product reports set out an increased fund valuation in a hothouse world scenario. This might be correct, but our working assumption is that most funds would lose value in this outcome[1]. Therefore, more work should be put into scenario modelling and testing inputs to ensure the outputs are reliable and consistent.

3. **Due to data gaps, firms were not able to disclose all relevant product-level metrics.** Notwithstanding the transitional provisions, our review found many firms were unable to disclose Scope 3 emissions or weighted average carbon intensity. Climate value-at-risk, which is required to be disclosed 'as far as reasonably practicable' was often not disclosed due to poor data availability. Whilst firms often provided a rationale for these disclosures not being included (e.g. due to poor data availability), not all firms included this explanation. We believe that all firms should be outlining the steps they will take to improve the completeness and the quality of their disclosures in the future where there is not full coverage of the FCA's required metrics.

4. **Reports could be more user-friendly for consumers**. A number of complex terms were used in the reports without definition. We found good examples of reports that defined key terminology and provided graphics and comparative points, making them much more decision-useful to consumers and investors.

[1] https://www.finance-watch.org/wp-content/uploads/2023/10/report-finance-in-a-hot-house-world.pdf

3. TOP TEN AREAS FOR FUTURE FOCUS

Based on our analysis, research and member interviews, we believe there are ten key areas asset managers should focus on to optimise their TCFD reporting.

01 **Disclosure of narrative strategy** – Consider how you will ensure that your FCA TCFD reports are consistent with your wider sustainability reporting. Have a coherent message and view of climate change that will be clear to your investors.

02 **Data coverage** – Determine the minimum data coverage you will require to report against. Decide how you will explain this in your report and disclose what steps you will implement to increase your data coverage across asset classes and emissions. If you do not set a minimum data coverage threshold, be clear to readers what your data coverage is.

03 **Data timing** – Determine if your existing technology and reporting processes allow you to take a data cut at the right time to report by 30 June annually. If not, establish whether you will use a different reporting date (e.g. using data as of 30 September rather than 31 December) and whether you can change your approach to make this simpler.

04 **Disclosing additional metrics** – Consider how confident you are in disclosing additional metrics such as Climate Value at Risk (CVaR) and implied temperature rise for each product. Also consider implementing a documented policy for determining what metrics might be "decision-useful" and so should be included in your product reports.

05 **Compliance statement** – Decide which member of senior management will sign-off your entity report. Consider how you will get them comfortable that the entity report is compliant with the FCA's rules (for example, you could undertake an internal or external gap analysis approach).

06 **Consumer testing and usability** – Think about conducting testing with your customer base to test whether they understand your reporting. If you don't undertake consumer testing, consider how you will ensure information is understood and not misconstrued against your other fund disclosures and investment strategy.

07 **Definition of "concentrated or high exposure to carbon intensive sectors"** – Decide how you are defining 'concentrated or 'high' exposure and 'carbon intensive sectors'. Determine whether this is consistent with your internal view of a carbon intensive industry and that of your peers as well as what an investor might expect. Consider how you will provide this disclosure in your reports whilst explaining how this might not be representative of your strategy.

08 **Differentiating your approach** – Assess if your approach to governance, strategy and risk management is consistent across all your funds. Give thought to whether investors expect to see a differentiated approach for certain funds (such as sustainable or ESG funds).

09 **Resourcing challenges** – Consider how you will resource completing your report, both in year one and as it becomes a BAU activity. For example, will you implement a specific TCFD programme team, or make it part of existing Sustainability, Compliance or Finance teams?

10 **Future of your report** – As rules are likely to quickly evolve, it is crucial to review how you will future-proof your reporting processes to align with requirements including the FCA's Sustainability Disclosure Requirements (SDR), the International Sustainability Standards Board (ISSB) and the TPT.

4. INTRODUCTION

In 2020, the UK became the first G7 country to commit to mandatory TCFD-aligned reporting requirements across the economy. To implement this commitment, the UK Government published a ***roadmap*** towards requiring TCFD reporting by various market participants by 2025. Since then, the UK Government and regulators have made significant progress towards achieving that ambition, with TCFD-aligned disclosure requirements having been introduced for listed companies, large private companies and limited liability partnerships (LLPs), occupational pension schemes, and asset managers, life insurers and FCA-regulated pension providers.

The FCA finalised its ***rules*** for asset managers, life insurers and FCA-regulated pension providers in December 2021 in Policy Statement 21/24 (PS21/24). The rules, which were introduced through the new ESG Sourcebook in the FCA Handbook, require climate-related disclosures broadly aligned to the ***TCFD Recommendations***. Alongside the rules, the FCA also issued guidance that references the ***TCFD Guidance on Metrics, Targets and Transition Plans*** to help firms determine whether their disclosures are consistent with the rules.

The FCA decided on a phased implementation for its rules, prioritising the largest firms in the first instance. The first wave of reporting required asset managers with over £50 billion in AUM and asset owners with assets over £25 billion to report by 30 June 2023 (based on 2022 data). The second wave of reporting will require asset managers with more than £5 billion AUM to report by 30 June 2024 (based on 2023 data). The rules apply at entity level, meaning some groups will have multiple firms in scope and reporting under the TCFD rules. These firms must then report on an annual basis. In addition, the rules specifically define AUM based on funds operated by a UK entity and investment management and advice provided by a UK entity to a client. This captures a range of asset management firm types, including private equity advisers in the UK and UK fund operators with non-UK funds.

Based on its own research, the FCA estimated that its rules would capture 34 asset management and 12 asset owner firms in the first phase of implementation, and 140 asset management and 34 asset owner firms in the second. This represents £12.1 trillion in assets, capturing 98% of the UK asset management and asset owner market[2].

The IA and PwC ("we") performed a joint review of the reports published by firms in June 2023. This report sets out the key findings from our review, exploring the lessons that can be learned for reporting in 2024 – whether you will be reporting for the first or second time.

Our report is structured into a number of sections. To begin, we briefly outline the objectives for the report and the methodology that we adopted when performing the review. We then outline the main themes we identified across entity and product-level reporting, respectively, and identify key learnings for June 2024 reporting and beyond. Finally, we look at how we expect mandatory TCFD reporting in the UK to evolve and what the asset management industry will need to be mindful of as they further develop their approaches to sustainability reporting.

[2] https://www.fca.org.uk/publication/policy/ps21-24.pdf

5. REVIEW METHODOLOGY

We reviewed 27 entity-level and 241 product-level (including on-demand) TCFD reports from 9 firms. This gave us a representative sample of the different types of entity-level and product-level reports produced for 2023. The firms included within this review were among the largest UK asset managers, all managing at least £50 billion AUM from at least one UK regulated entity. The product reports and investment strategies of these firms covered all asset classes, investment styles, fund types and geographic focus areas. In addition, we spoke to a small number of firms that were reporting in 2024 for the first time to understand more about their implementation plan.

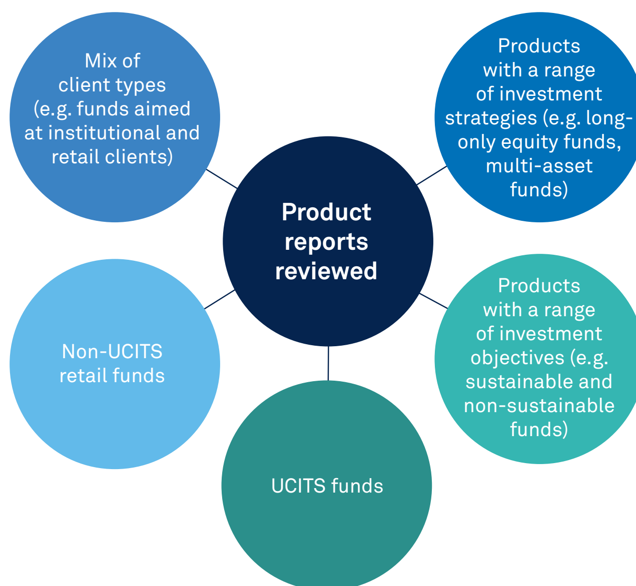
FIGURE 1:

Asset Manager	Number of funds reviewed
AM1	25
AM2	20
AM3	25
AM4	20
AM5	24
AM6	56
AM7	43
AM8	1
AM9	27
Total	**241**

Within the types of firm and products we reviewed we wanted a mix from across the market, as seen in figures 2 and 3 below:

FIGURE 2: FIRM REPORTS

FIGURE 3: PRODUCT REPORTS



We considered a wide range of fund and entity types to ensure that our review, and subsequent findings, were not skewed based on the type of entity or funds we reviewed.

To complete our analysis, we also interviewed 12 IA members. These interviews focused on the process the firms had followed to publish their reports and the challenges they faced in implementing these processes. As part of this work we also discussed what worked well and the implementation programme followed by those firms. Finally, we also spoke with firms that will be reporting in 2024 for the first time in order to understand more information about their implementation programme for compliance, and how this might be different to firms that have already reported.

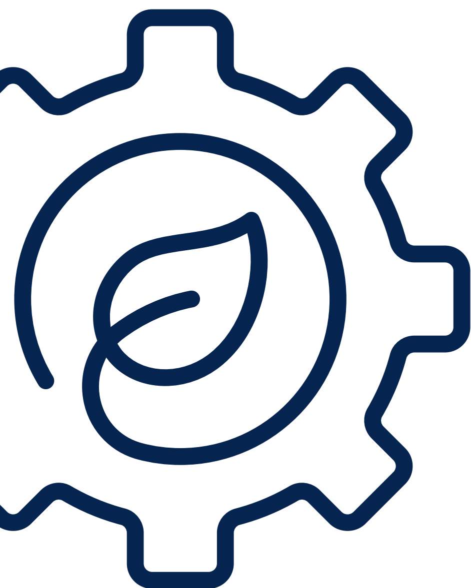
We considered all of these inputs in forming our conclusions in this report.

6. ENTITY-LEVEL REPORTING

PS21/24 introduced a set of requirements for asset managers to report climate-related information at an entity level. These entity level reports must be aligned to the TCFD Recommendations and may also want to consider the ***supplemental asset manager guidance*** contained within the TCFD Annex. The FCA's rules require firms to specifically consider the climate-related risks and opportunities that occur through the investments made by the firm on behalf of their clients.

In-scope firms are required to report on an annual basis. Whilst it is possible under the rules to rely on group reporting, firms must highlight differences between the approach of that firm compared to the wider group approach to climate risk.

Generally, we found entity-level reporting was compliant with the FCA's expectations. However, we identified six key themes from our review that firms should be alert to when planning for the June 2024 reporting deadline. We consider these below.



IDENTIFICATION OF CLIMATE-RELATED RISKS AND OPPORTUNITIES

Before drafting the entity report, firms need to identify and manage the different climate-related risks and opportunities that they are exposed to across their business activities and their investments. These risks and opportunities should be identified based on a short, medium and long-term time horizon and included within the entity report, along with actions that the firm might take to prevent the risks identified.

In our review we found that 52% of firms provided a detailed overview of the key climate-related risks and opportunities they had identified across their operations and investments. In the best of these examples, this detailed overview was typically broken down across physical and transition risks, and included an assessment of impact based on financial cost and time horizon. A further 33% of firms provided a more limited reporting approach, setting out a high-level description of some risks and opportunities arising from climate change, but providing less analysis on the time horizon of these risks and opportunities, or how they might be different across asset classes, strategies and other business activities.

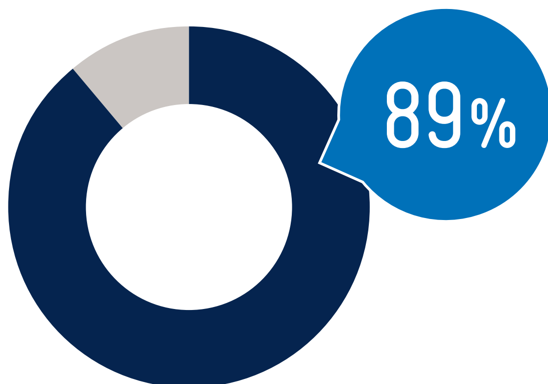
A small number of firms (15%) had very limited reporting on the climate-related risks and opportunities.

In our view, it shows a mature approach to climate risk where a firm is not only able to identify the risks and opportunities, but also able to quantify the impact these might have on the firm. Best practice in listed firms is moving towards including this financial quantification, and we'd expect entity reports to bring in more quantification of risks and opportunities in the next year or two. However, some firms will likely need to spend time on providing more qualitative analysis – considering these risks and opportunities should be part of how firms are strategically thinking over the long-term, not just an exercise for inclusion in the entity report.

MAPPING REPORTS TO TCFD RECOMMENDATIONS

The FCA expects firms to report in line with the TCFD Recommendations – including the asset manager sector guidance. Most (89%) of the reports we reviewed explicitly aligned their structure with the TCFD Recommendations, or included a reference table in their report which mapped the report to the TCFD Recommendations. The remaining reports we reviewed did not include this mapping to clearly demonstrate how they aligned with requirements, although we did not see anything to suggest they did not demonstrate compliance with the TCFD Recommendations.

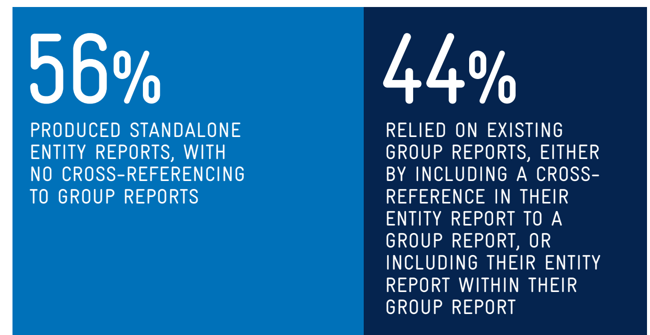
In our view, best practice (as shown by firms already reporting) is to align the report with the TCFD requirements, either explicitly or by including this separate mapping to the TCFD Recommendations. Firms reporting for the first time in 2024 should consider following a similar approach – whether that is through direct mapping of the TCFD headings and principles, or through a separate mapping table. This has the added benefit of making it easier to demonstrate compliance with the FCA rules, which supports the senior manager sign-off for the below mentioned compliance statement.



89% OF THE REPORTS REVIEWED HAVE MAPPED THEIR REPORT TO THE TCFD RECOMMENDATIONS

INTERACTION WITH GROUP-LEVEL AND THIRD-PARTY TCFD REPORTING

Under the FCA's rules, whilst firms are permitted to cross-reference their group-level TCFD reports to fulfil their obligations, they need to report on any material differences at entity level compared to their group reports. Of the total population of reports we reviewed, 56% produced standalone entity reports, with no cross-referencing to group reports. The remaining 44% relied to varying degrees on existing group reports, either by including a cross-reference in their entity report to a group report, or including their entity report within their group report.



Whilst this approach aligns with the FCA's rules, it would be helpful for firms relying on existing group reports to ensure their entity report can either stand alone, or read alongside the group report. We saw some examples of firms relying on specific sections of their group report but providing at times impractical references for the reader to use, making it more challenging to read and understand the firm's approach to climate-related risks. Such examples include a TCFD report making a large amount of cross-references to different publications, without providing links or page numbers to the relevant section in those publications.

We expect effective cross-referencing to potentially become more challenging for firms reporting for the first time in 2024, many of whom may be delegated investment managers for firms already complying with the FCA's rules. This means there may be more firms relying on third party reports, where it will be important for these firms to map out whether the risks and opportunities identified by those firms are applicable to their activities.

USABILITY AND ACCESSIBILITY OF THE REPORTING

The FCA's rules (ESG 2.1.3R) require that entity reports are published in a manner that makes them easy for a prospective reader to find. When considering accessibility, we found the majority of reports (70%) were easy to find, both directly from the firm's website and from a simple search online. Of the remaining 30%, these were often difficult to locate because they were not located where one might expect on a firm's website (e.g. in the documents or sustainability section of the website). For some firms, their entity report was difficult to locate amongst their wider group TCFD reports. Whilst these firms may still be compliant with the FCA's rules, firms could consider how a client may find their report, using key search terms online to test accessibility (e.g. "firm name FCA TCFD report"). We know that many firms use similar tests when checking accessibility of other regulatory-driven reports (such as their Assessment of Value reports) and so should implement a similar framework here for their TCFD reports.

No firms in our review performed any consumer testing ahead of 2023 reporting to test how messaging might be received or understood from their entity report. However, we know from our discussions that a number of firms are considering this for future years and view this as an effective way of ensuring that they produce meaningful disclosures that are usable and decision-useful.

The best examples in our review involved having a dedicated TCFD section on the firm's website, with one firm also including a direct link to the report as a footer on each page of its website; these approaches give the report sufficient prominence given its strategic and regulatory importance, and suggest a well thought out plan for how the report would be made available to clients. Similarly, some firms had also considered readability of their reports, with some of the best examples including definitions of key terms or accompanying call out boxes describing the data provided within the report. For 2024, firms (whether reporting for the first or second time) should think about readability and usability as a core part of their compliance programme - these reports can be used as an opportunity by firms to set out their core messaging around climate change to the market, rather than just being seen as a regulatory compliance requirement.

TRANSITION PLANS AND NET ZERO TARGETS

The FCA provided guidance that a firm that is headquartered in, or operating in, a country that has made a commitment to a net zero economy, is encouraged to assess the extent to which it has considered that commitment in developing and disclosing its transition plans and how (if at all) these align with the UK's 2050 net zero target. We found that many firms (70%) are either not disclosing any information on their approach to transition planning, or were brief in the description of their transition plan. In our view, the best examples we saw included a dedicated section in the report on transition planning, which set out key targets and milestones, and strategic actions to deliver on that target. One report in our review provided an assessment of progress the firm had made delivering against their transition plan since 2022, which we believe is an approach others could adopt, over time, to show their own progress and remaining actions to undertake.

From our conversations with firms we understand that many are either in the early stages of their approach to transition planning, or do not have a transition plan because they do not have a net zero target. However, based on our interviews we expect more firms reporting for a second time in 2024 will include information on their transition plan.

67%

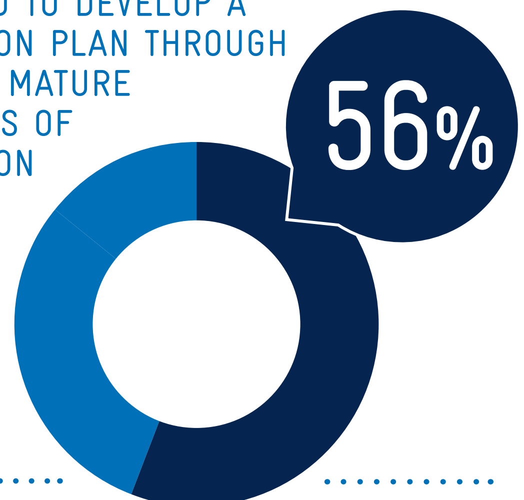
HAVE EXPLAINED THEIR APPROACH TO SCENARIO ANALYSIS, AND APPLICATION, OF THIS SUBSET, 44% HAVE PROVIDED THEIR QUANTITATIVE ANALYSIS RESULTS/EXAMPLES

74%

HAVE SET A NET ZERO TARGET

Transition planning is likely to face greater regulatory scrutiny in due course and as the Transition Plan Taskforce's ("TPT") work concludes – firms should use the asset management sector guidance produced by the TPT to inform their transition planning and to include in their 2024 report. Based on our discussions with industry, we are aware that firms would generally welcome additional guidance on the FCA's expectations around transition plan disclosures in the TCFD report. More information on this is included later on in the report.

56% DID NOT REFERENCE TRANSITION PLANS IN THE REPORT AT ALL, WHEREAS FOR THE REMAINDER THERE WERE VARYING DEGREES OF PROGRESS, RANGING FROM ACKNOWLEDGING THE NEED TO DEVELOP A TRANSITION PLAN THROUGH TO MORE MATURE EXAMPLES OF TRANSITION PLANS



APPROACHES TO THE 'COMPLIANCE STATEMENT'

The FCA's rules require that a member of senior management signs a compliance statement in the entity report. This statement should confirm that the report aligns with the FCA's rules in chapter 2 of its ESG Sourcebook. This approach is designed to drive personal, as well as corporate, accountability for the firm's entity report.

From our review we found that only 74% of entity-level included an explicit compliance statement to specifically confirm that the TCFD report was compliant with chapter 2 of the ESG Sourcebook. Within these 74% of reports, there was significant variation in which members of senior management signed this, and in the level of detail included in the statements. 38% of statements were signed by the CEO. For the remaining, these were signed by a range of individuals, such as:

- Chief Sustainability Officers
- Chief Investment Officers
- Chief Operating Officers,
- Chief Financial Officers
- Heads of Strategy

Of the remaining 26%, firms either did not include a statement in their report, or included a statement referring more broadly to compliance with the TCFD Recommendations, rather than the ESG Sourcebook.

From our interviews with firms, we understand that most used either internal support (from compliance or internal audit) or external support to undertake a gap analysis or check of their TCFD report to confirm compliance with the FCA rules. Such an approach was typically taken to provide comfort to the senior manager that signed the compliance statement that the firm had taken decisions and judgements that aligned with the regulatory requirements. In addition, firms stated that taking this approach, particularly using third party support, allows the firm to differentiate their report between minimum compliance and any additional ambitions to be a market leader in their reporting. We would strongly recommend that firms reporting in 2024 include a specific statement around compliance with the FCA rules, to avoid any risk that their report does not fully comply with the specificity of the FCA's requirements.

7. PRODUCT-LEVEL AND ON-DEMAND REPORTING

BACKGROUND TO THE REQUIREMENTS

Alongside the entity-level reporting requirements outlined previously, PS21/24 introduced a set of requirements focused on product-level or on-demand reporting of climate-related information. These requirements target the climate-related risks and opportunities of the investment products firms offer to help consumers make more informed decisions about which products to invest in. This is the first time that a firm has been required to think about these issues at product (e.g. investment fund) level, rather than as a corporate or group. Products in scope of the reporting requirements include:

- ✔ authorised funds;
- ✔ unauthorised alternative investment funds;
- ✔ insurance-based investment products; and,
- ✔ portfolio management (such as providing recurring investment management or investment advice services to a client).

For authorised funds, the responsibility is on the fund operator to provide the product report, and make it publicly available. This is different for portfolio management activities, or unauthorised AIFs that are not listed, which are instead subject to on-demand reporting requirements. This means that the asset manager must make the report available to an eligible client within a reasonable timeframe after receiving a request from that client – the on-demand report is not required to be made available online.

Whilst the method of delivery of product and on-demand reports is different (i.e. website publication versus private provision to a client on request), the contents of the reports remain the same. For that reason, we have provided our conclusions on the reporting together. The FCA requirements applying to funds and portfolio management activities can also lead to duplicate reporting on the same strategy: for example, if the fund operator delegates investment management to a third party, then both (if managing sufficient AUM) will be in scope of the TCFD reporting requirements - product-level for the fund operator, on-demand for the delegated investment manager.

Generally, the FCA's requirements for products go far beyond the main TCFD Recommendations, which focus on organisations' climate-related risks and opportunities. For products in scope, firms must disclose product-level metrics where data is available, relevant contextual information explaining how the metrics should be interpreted and their associated limitations, and information on governance, strategy and risk management where the firm's approach in relation to the product materially deviates from the firm's overarching approach disclosed in its entity report. In particular, product and on-demand reports should include the following metrics, provided that the data is available to report against the following metrics:

1. Scope 1 and 2 greenhouse gas emissions
2. Scope 3 greenhouse gas emissions
3. Total carbon emissions
4. Total carbon footprint
5. Weighted average carbon intensity (WACI)

A firm should also disclose, *as far as reasonably practicable*, the following calculations for each TCFD product:

6. Metrics that show the climate warming scenario with which a product is aligned, such as using an implied temperature rise metric
7. Climate value at risk (CVaR).

Finally, the FCA suggests firms consider any additional information that should be included that investors might find decision-useful. Firms may therefore wish to consider engaging with their investors to gain a better understanding of what information they may find decision-useful.

Our analysis below sets out our detailed findings, which broadly found that firms have adopted a mixed approach to disclosing these metrics in their product reports. Some firms were silent on missing disclosures, whereas others included analysis on the rationale for not disclosing certain metrics, e.g. a fund's WACI.

In-scope firms must report on their in-scope products annually. Firms are able to rely on their entity reports in relation to governance, strategy and risk management where the approach at product level is not materially different to their entity-level approach. Product reports, like entity reports, must be easily and readily available on the firm's website, and must additionally be included or cross-referenced in an appropriate client communication.

Our review has identified 6 key themes across product and on-demand reporting that firms should be considering when preparing their 2024 reports.

DATA COVERAGE

The FCA's rules allow some divergence from its requirements. In particular, this can be where there are gaps in underlying data or methodological challenges and these gaps or challenges cannot be addressed using proxy data or assumptions without the resulting disclosure being misleading. Typically, firms were more able to provide data coverage for investment in listed equities than other asset classes.

More than half of the product reports we reviewed included narrative on the challenges around data coverage. Some provided additional information to explain the steps taken to seek more data coverage and the actions they would take in future to increase data coverage of disclosures. The best product reports set out the minimum reliance on data coverage. For example, stating that any data coverage under 70% of a fund's investments should not be relied upon by a client, or that they would then not include a disclosure due to this lack of data availability.

In our view this approach considered the FCA's expectations - it made information more decision-useful and understandable for clients. Without providing this level of narrative, it might be challenging to understand why certain information is not disclosed, or why data only covers certain asset types.

DISCLOSURE OF PRODUCT METRICS

As set out already, the FCA's rules require firms to publish product-specific metrics and targets where data is available.

Of the funds that we analysed, most disclosed their scope 1 and 2 emissions. However, only 33% of funds disclosed their scope 3 emissions, with 35% of reports explaining why scope 3 reporting was not included. The remaining 32% of reports did not include any reference to scope 3 emissions. Whilst the FCA allows for data gaps in disclosures, its guidance suggests firms should explain these data gaps in their reports – firms should reflect on this in producing their 2024 reports.

More than half of firms (54%) provided disclosures on both CVaR and Portfolio Alignment. Of the remaining 46%:

- 17% only included Portfolio Alignment indicators[3]
- 4% only included CVaR
- 25% of the reports did not include either metric.

Typically, where reports did not include CVaR, this was because the firm believed it would lead to a misleading disclosure, or because they could not get adequate portfolio coverage of CVaR. Whilst this is understandable, particularly for year 1 reporting, firms should be considering how they develop their approach further for their 2024 reports. In particular, firms could consider if there are different metrics they could report against in the interim whilst waiting for improvements in CVaR data. Whilst the ***TCFD guidance*** includes requirements on Portfolio Alignment metrics, these have not formally been adopted into the FCA's rules – therefore there is (currently) no requirement for firms to include Portfolio Alignment disclosures within their product reports.

Where firms have not disclosed certain metrics in their product reports, the rules require them to provide explanations of the data gaps or methodological challenges driving these omissions. Further, this should consider why those challenges cannot be addressed through use of proxies and assumptions. In our view, the best disclosures were those that included the full metrics, or that explained the reason for a data gap, and the plan implemented by the firm to close out that gap.

[3] Please refer to the Portfolio Alignment Teams (PAT) ***report***, 'Measuring Portfolio Alignment – Technical Considerations' for further details. It should be noted that the PAT document does not constitute a core document of the TCFD and therefore is not referenced in PS21/24.

USE OF SCENARIO PLANNING AND QUANTITATIVE ANALYSIS

Under the FCA's rules, all products must include a minimum of qualitative analysis of how climate change could impact the product's holdings in an orderly transition, disorderly transition and hothouse world. For those products with high exposure to carbon intensive sectors, quantitative as well as qualitative analysis is required.

Typically, firms used the Network for Greening the Financial System's (NGFS) qualitative scenarios to conduct their product scenario analysis. Some firms considered impacts on their products against these scenarios on a short, medium and long-term basis - whilst others took a more simplistic approach, considering one outcome rather than the outcome across different time horizons.

We found that most firms used qualitative (65%) rather than quantitative scenario analysis, almost regardless of whether the product had high exposures to carbon intensive sectors. This was explained in reports, with firms believing more data is required before they can conduct quantitative analysis successfully. In our interviews with firms, they also suggested that they will focus on enhancing their scenario analysis capabilities over the coming years to enable better quantitative outcomes. We also think more time should be spent on validating scenario testing outcomes - in some funds we reviewed they disclosed a higher fund valuation in a hothouse world scenario. Whilst this might be appropriate in certain circumstances, from our work in other industries we believe that such an outcome typically underplays the wider market and financial impact of a hothouse world outcome. Where funds set out such increased valuation, firms should independently review this outcome to consider whether it is appropriate.

APPROACH TO CARBON INTENSIVE SECTORS

The FCA's rules require that, where a product has concentrated exposures or high exposures to carbon intensive sectors, firms make additional quantitative disclosures on scenario analysis in the product report. However, the FCA did not define what percentage of a product is invested in carbon intensive industries before it becomes concentrated or has a high exposure. Due to the lack of guidance in this area, firms have taken different approaches to defining concentrated or high exposure. For example, most firms used a minimum percentage exposure (around 70% of reports we reviewed), whilst others (around 30%) relied on the fund's exposure to carbon intensive industries compared to its benchmark. Many firms that we spoke with were concerned that due to differing definitions of concentrated/high exposure, two near-identical funds could be taking very different approaches to evaluating their exposure to carbon intensive sectors and whether they need to make the additional disclosures on scenario analysis. Based on our conversations with firms, and information included in the product reports, we expect the approach taken to defining concentration or high exposure to be refined in the coming years. A number of firms suggested they will add more qualitative analysis overlay to their identification of funds with a high exposure or concentration in carbon intensive industries, alongside expansion of their analysis to additional asset classes. At the moment, some firms are limiting analysis to equities and bonds.

In addition to this, firms' approaches to specifying what carbon intensive sectors their products are exposed to differed in complexity and minimum requirement. The majority of reports we reviewed detailed their exposure to Carbon Emitting Global Industry Classification System sectors, whereas others simply disclosed the total proportion of the portfolio with exposure to carbon intensive sectors without specifying what those sectors were. Only a quarter of the reports detailed exposure to sectors outside of the frequently cited high-exposure categories, of utilities, materials, industrials and energy. Whilst firms should ensure their own approach is robust in identifying carbon intensive sectors and provide useful disclosures to guide their clients, it would be most helpful for additional guidance to be provided by the FCA.

INTERACTION WITH FIRM REPORTS

Under the FCA's rules, it is possible for product reports to refer to entity-level reports in relation to governance, strategy and risk management. Such cross-referencing should be used where the product-level approach is not materially different to the entity-level approach. 60% of reports did not disclose any material differences between the product and entity-level approaches, while 40% detailed distinct changes pertinent to the specific fund or indicated a divergence from the firm's overarching climate investment strategy. Over time, firms may start to disclose more of these differences in product reports, particularly as additional regulatory requirements start to apply to sustainable funds. The FCA (and clients) might expect to see, for example, a sustainable fund to approach governance and risk management differently to a 'non-sustainable' fund. In our review, those that disclosed a divergence in their approach typically did so due to the specific sustainable investment strategy of the product.

USABILITY AND ACCESSIBILITY OF THE REPORTING

The rules on accessibility of the product reports are the same as for entity reports, as reported on above. All of the firms we interviewed expected product reports to be more useful, and more widely read, for clients than the entity reports, increasing the importance of these reports being usable and accessible. This seemed to be recognised in the approach taken by most firms. Of the funds that we analysed, 70% provided direct access to their product reports via links on their main website. The remaining 30% of reports were accessed either as part of a combined report encompassing the firm's entity and product reports or via secondary links from the firm's main website.

However, there were some issues with a number of complex terms being used in many reports without definition. For example, firms disclosed the fund's WACI or CVaR without explaining what these terms mean. The best examples we reviewed included definitions of complex terms used in the reports, and narrative to explain the data and graphics used.

Firms should be mindful of these accessibility and usability issues ahead of the next round of reporting in 2024. As with entity reporting, the FCA has strongly emphasised the need for firms to produce decision-useful disclosures for their clients, and reports that are hard for consumers to locate or understand without further knowledge or information will not meet that expectation. While no firms in our review had performed any consumer testing on their product reports, a number of firms that we interviewed are considering this for future years, particularly in light of the FCA's new ***Consumer Duty***.

8. KEY CHALLENGES WITH IMPLEMENTING TCFD REPORTING REQUIREMENTS AND AREAS FOR FURTHER GUIDANCE

In early 2022, the IA established its TCFD Implementation Forum to support members with implementing the FCA's rules in PS21/24. The Forum serves as a platform for members to engage in peer-to-peer knowledge sharing, discussing experiences, challenges and best practice relating to TCFD implementation. To supplement the above review, the IA undertook a survey of its membership to take stock of the key challenges members have faced in implementing the FCA's TCFD rules.

DATA

The well versed challenges of availability and quality of ESG data continue to be significant hurdles for asset managers in their TCFD reporting efforts. In many asset classes, the implications of climate-related risks are either not apparent or the data is simply unavailable. And, whilst proxy data and assumptions can be leveraged, the FCA rules specify that firms must not disclose metrics or quantitative scenario analysis where the use of proxy data or assumptions would render the resulting disclosure misleading.

The existence of data gaps has meant that many members have opted to set coverage thresholds below which they do not report carbon emissions data. The rationale behind this decision is the concern that any disclosure below this threshold would not provide investors with decision-useful information and could potentially be misleading. Consequently, asset managers have found themselves needing to exclude certain UK domiciled products from their disclosures.

At present, there exists no specific guidance regarding the level at which these thresholds should be set, leading not only to significant disparities in coverage thresholds throughout the market but also a highly resource-intensive process for members as they seek to determine where their threshold should be set.

Furthermore, there is an increasing need for improved ESG data quality assurance processes to be put in place for ESG data and rating providers. Data accuracy may be impeded by an array of factors. For example, methodologies used by data providers may vary significantly, meaning that there are often significant differences in reported emissions from the same issuer reported by different data providers. Additionally, several types of ESG data may seem like raw/reported data but actually embed assessment or value judgement and this value judgement can impact the quality of the data due to its inherent subjectivity. These factors naturally undermine asset manager confidence in the data on which they are relying for their TCFD reporting as well as create significant pressure asset managers' due diligence processes.

SCENARIO ANALYSIS

Another area of challenge is the requirement for members to perform scenario analysis – this has led to many asset managers unsure as to the scope, length and detail of what is required when analysing various scenarios. During the IA's TCFD Implementation Forum meetings, the various approaches towards conducting scenario analysis have been debated, including the use of NGFS scenarios, in-house modelling versus use of external providers, use of CVaR, and the use of forwarding looking metrics. Whether to disclose CVaR – required by the FCA to be disclosed 'as far as reasonably practicable' – has been considered very carefully by asset managers, many of whom concluded that its disclosure would lead to potentially inaccurate or misleading results.

Ultimately, the divergence in approaches has led to questions in the market around how comparable scenario analysis disclosures would be between companies and thus how useful they might be to end investors.

Other challenges also faced by firms with TCFD implementation include cross referencing to group reports, aligning the timing of disclosure with annual reports and coping with the volume of reporting. Based on our discussions with firms, and analysis of reports, there are five key areas where additional guidance or clarification could be helpful for firms.

Below are some key areas where further guidance would be helpful:

1. Carbon intensive sectors

The FCA rules stipulate that where a TCFD product has 'concentrated' or 'high' exposure to carbon intensive sectors, asset managers must conduct quantitative as well as qualitative scenario analysis. Consistency in defining concentrated or high exposures to carbon intensive sectors and consistency in approaches to disclosing scenario analysis is important for investors to be able to effectively compare products and evaluate risk. In PS21/24, the FCA committed to engaging with industry to support the development of industry guidance and best practice, including through bodies such as the Climate Financial Risk Forum (CFRF), and said it would keep its rules and guidance under review. Based on our discussions with firms, we think further guidance in this area is key. Whilst some members have made use of the GICS classifications in order to define a carbon intensive sector, that still leaves questions around what might constitute 'high' or 'concentrated' exposure and in the first round of reporting, definitions using a percentage methodology have seen very broad variations. This risks situations where two funds are holding very similar investments but one is deemed to have high exposure to carbon intensive sectors whereas the other does not.

2. Producing on-demand reports for sub-advised portfolio management

We spoke with firms about the potential duplicative nature of reporting. Whilst it makes sense for a fund operator to produce a product-level report for the fund, it makes less sense that a delegated investment manager is then expected to produce an on-demand report for that same fund if they manage the investment strategy for it – it will lead to duplication and be unhelpful, since the reports will be available and published at same time.

The FCA could provide more clarity here to ensure each product only requires a single product or on-demand report. This would remove some potentially duplicative processes within firms, or between third parties. It would also save costs for a number of firms, without creating any investor protection risk. Whilst the FCA's rules allow reference to third party reports, it would be helpful to provide this additional guidance on removing duplication.

3. Reference date for disclosures

Whilst the publication date for TCFD reports is clear (30 June annually), it does not require a specific date in the calendar year that a firm should use as the reference point for disclosure. This is particularly impactful for some investment strategies - for example, highly active funds could see great turnover in their investment holdings, meaning disclosures are out of date compared to the investments by the time the disclosure is made. More clarity in this area will, whilst not removing this risk, ensure a consistent approach for reference date across industry.

4. Transition plan disclosures

The FCA has included guidance (2.2.2G) in its ESG Sourcebook around considering the UK's net zero target when disclosing information on a firm's transition plan. Whilst the FCA's rules do not create a requirement to have a transition plan, nor do they require all firms to implement a net zero target, the FCA has stated that it will develop more detailed requirements on transition plans[4] and have regard to the findings of the Transition Plan Taskforce[5]. This process could result in mandatory reporting of transition plans. It would be helpful for the industry if the FCA provided further clarity on its direction of travel.

5. Alternative securities

For certain asset classes, metrics and methodologies to measure climate emissions and risk are less developed. Derivatives, currency instruments, and sovereign debt are all examples of alternative securities which have provided significant reporting challenges for asset managers. Clear guidance from the regulator and/or from the TCFD around how these asset classes should be treated would provide helpful direction to members, many of whom have large holdings in alternative assets.

[4] https://www.fca.org.uk/publication/policy/ps21-24.pdf
[5] https://transitiontaskforce.net/wp-content/uploads/2022/04/TransitionPlanTaskforce-TofR-3.pdf

9. BEYOND TCFD

WHAT DOES THE FUTURE LOOK LIKE FOR SUSTAINABILITY REPORTING IN THE UK?

Having led the way on climate-related disclosure, the UK is now looking ahead to driving decision-useful information on broader sustainability factors across the economy. The UK's agenda on sustainability reporting regulation is being driven by the UK's latest ***Green Finance Strategy*** (GFS), published in March 2023.

The GFS sets out how the UK Government intends to mobilise green investment and make the UK the world's first net zero-aligned financial centre. A major part of the Government's plans to achieve those ambitions will be new sustainability reporting initiatives, including the UK Sustainability Disclosure Requirements (SDR) regime[6].

The UK SDR regime is the UK's flagship policy to drive decision-useful information on sustainability across the economy. It builds on the UK's implementation of the TCFD recommendations by introducing sectoral requirements that are advanced by relevant regulators and Government departments, underpinned by an overarching framework to promote consistent disclosure throughout the value chain[7]. The regime will also follow the same four-pillar structure as the TCFD Recommendations: Governance, Strategy, Risk Management and Metrics & Targets[8]. There will be corporate-level reporting requirements covering how companies manage their sustainability-related risks and opportunities that the Government has indicated will consist of UK-adapted versions of the new ***UK Sustainability Disclosure Standards (UK SDS)*** (UK-adapted versions of the ISSB Standards) and transition planning disclosure requirements drawing on the ***UK Transition Plan Taskforce (UK TPT) outputs*** where appropriate[9].

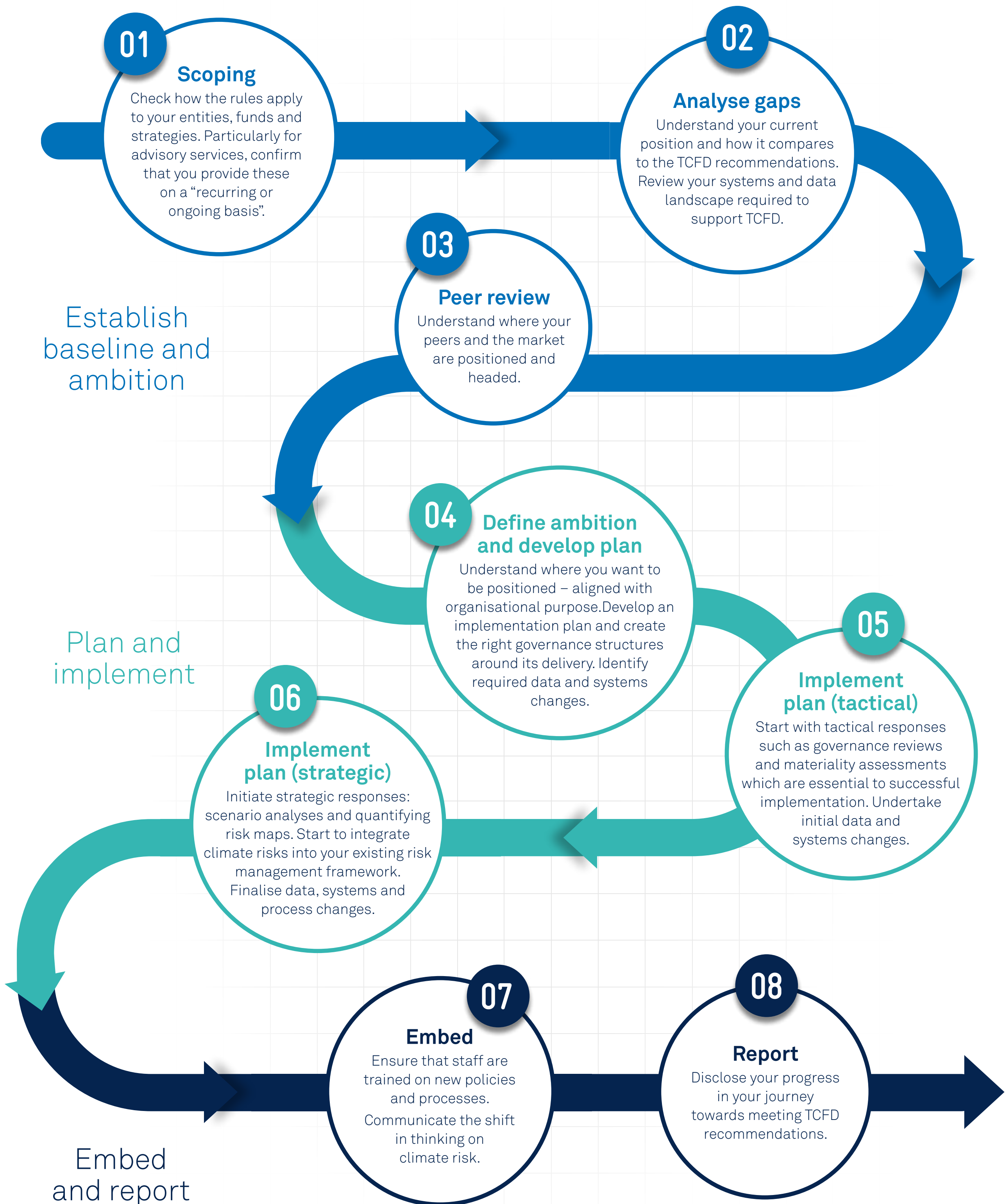
It has been announced that the IFRS Foundation, from 2024, will take on the monitoring of firms' climate-related financial disclosures from TCFD. The inaugural ISSB Standards – IFRS S1 and IFRS S2 – fully incorporate the recommendations of the TCFD. The IFRS has made clear that firms may continue to use the TCFD recommendations if they wish, and indeed that using the recommendations would be 'a good entry point' for firms as they move towards using the ISSB's Standards[10]. The FCA confirmed in its Policy Statement on SDR its intention to consult in 2024 on updating its TCFD-aligned disclosure rules for listed companies to reference the ISSB's standards. Elsewhere in its Policy Statement, the FCA acknowledged that as the ISSB standards are designed for corporate reporting, the FCA envisages asset managers using the standards as a 'starting point' when deciding what information would be decision-useful to clients and consumers.

In the UK, the FCA has already advanced its UK SDR rules for asset managers, building on the TCFD-aligned requirements in PS21/24, in its PS23/16 on UK SDR and investment labels[11]. The FCA is expected to consult on a wider application of the UK SDR requirements in PS23/16, potentially including asset owners, in due course[12]. Asset managers will need to assess their current practices for compliance with the TCFD reporting requirements under PS21/24 against what will be required under UK SDR. Ultimately, UK SDR will require a range of additional sustainability disclosures at an entity and product level, which would be included in what is currently the TCFD entity and product-level reports required under PS21/24. The pre-contractual disclosure requirements will come into effect from 31 July 2024 where a firm is using labels under SDR and from 2 December 2024 where a firm is using sustainability-related terms without a label. Ongoing annual product-level disclosure requirements will apply 12 months after a label is first used. Entity-level disclosure requirements come into effect from 2 December 2025 for firms with AUM > £50bn, and one year later for firms with AUM > £5bn. In many of our conversations with firms, they considered that their initial project team, brought together to manage the 2023 initial reporting approach, will be disbanded, and reporting will move into a business as usual activity, typically in the Finance function of the firm. Given the above changes that will likely fundamentally change the look and contents of these disclosures in the coming years, firms should consider how they will continue to keep on top of the reporting requirements that apply to them, and whether this will be resourced sufficiently by existing reporting teams.

[6] https://www.fca.org.uk/publication/policy/ps23-16.pdf
[7] https://assets.publishing.service.gov.uk/media/61890e64d3bf7f56077ce865/CCS0821102722-006_Green_Finance_Paper_2021_v6_Web_Accessible.pdf
[8] Figure B in the UK Government's ***Roadmap to Sustainable Investing***
[9] https://assets.publishing.service.gov.uk/media/643583fb877741001368d815/mobilising-green-investment-2023-green-finance-strategy.pdf
[10] https://www.ifrs.org/sustainability/tcfd/
[11] https://www.fca.org.uk/publication/policy/ps23-16.pdf
[12] https://www.fca.org.uk/publication/policy/ps23-16.pdf

10. HOW TO APPROACH REPORTING IN YEAR 1

Below we have set out the typical approach we see firms following to comply with the FCA's TCFD reporting requirements. This could be a useful starting guide for those firms complying for the first time in 2024.



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