UK Climate-Related Financial Disclosures—Impact on Asset Managers

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The FCA recently announced a proposal for a climate-related financial disclosure regime for UK asset managers, as well as life insurers and FCA-regulated pension providers. This is an important step in the United Kingdom's implementation of a regime that is similar to the European Union's Sustainability Finance Disclosures Regulation ("SFDR"), although the United Kingdom's regime for the time being focuses exclusively on climate-related disclosure, whilst the European Union's regime encompasses environmental, social and governance considerations.

As under the EU regime, the FCA focuses on disclosure, with a view to influencing investors to commit capital to companies and projects that address climate change. The FCA will include the rules in a new "ESG Sourcebook", which will be the FCA's source for rules and guidance on ESG topics.

The Financial Stability Board's Task Force on Climate-related Financial Disclosure ("TCFD") is an international initiative for companies and investors to disclose a set of climate -information. The FCA intends that its regime is consistent with the TCFD's recommendations (and its supplemental guidance for asset managers and asset owners).

We discuss in this In Depth the FCA's proposal for climate-related disclosures and reporting by UK asset managers, together with the status and impact of the FCA's related proposals for climate-related disclosures by UK companies and the UK government's related work on a climate-related disclosure regime for UK occupational pension schemes. The FCA's proposals for climate-related disclosure align to the UK government's related work for UK occupational pension schemes to support the flow of information from asset managers to occupational pension schemes.

Status of the Climate Change Disclosure and Reporting Regimes

In addition to the FCA proposal and the rules for occupational scheme regulations, there are a number of other requirements to publish disclosures aligned with the TCFD. This table sets out the status of the United Kingdom's in-force and prospective climate change disclosure and reporting regimes.

Type of Entity	Proposal	Status and Timing
Asset managers (small firms excluded)[1]	TCFD-aligned climate-related financial disclosures, with additional TCFD related disclosures at product level.	Rules are under consultation, potentially with first reporting period from 1 January 2022.
Asset owners (life insurers and FCA-regulated pension providers, in each case offering investment-based insurance or pension products)		
Occupational pension schemes	TCFD-aligned climate-related financial disclosures.	Comes into force on 1 October 2021 and applies to scheme years ending on or following 1 October 2021.
Quoted[2] UK companies and large UK unquoted companies and LLPs[3]	Streamlined Energy and Carbon Reporting. A qualifying company must include in its directors' report disclosure on greenhouse gas emissions, an "intensity metric" and information on total UK energy use.	In force, applies to financial years beginning on or after 1 April 2019.
Premium listed companies	TCFD-aligned climate-related financial disclosures.	Applies to financial years beginning on or after 1 January 2021.

1 Asset managers with less than £5bn in assets under management (on a three-year rolling average) will be exempt.

2 "Quoted" means listed on a UK-regulated market.

3 Unless the company is a parent company, the requirement applies to UK-incorporated companies that meet two of the following three criteria: (i) turnover of £36 million or more; (ii) balance sheet total of £18 million or more; or (iii) 250 employees or more.

Type of Entity	Proposal	Status and Timing
Issuers of standard listed equity shares (excluding standard listed investment entities)	TCFD-aligned climate-related financial disclosures.	Rules are under consultation. The proposal potentially applies to financial years beginning on or after 1 January 2022.
Quoted companies[4] and large private companies and LLPs[5]	TCFD-aligned climate-related financial disclosures.	Consultation on the rules closed. Subject to Parliamentary approval, the proposal potentially applies to financial years beginning on or after 6 April 2022.

The FCA's Proposal for Climate-Related Disclosures and Reporting by UK Asset Managers and Asset Owners

The "asset managers" and "asset owners" that are in scope of the FCA's proposed climate related disclosure regime are as follows:

- **Asset managers** are UK full-scope and sub-threshold alternative investment fund managers ("AIFMs"), managers of UCITS (retail funds) and portfolio managers (in respect of their segregated accounts). Importantly, the FCA intends to include in scope "private equity or other private market activities consisting of advising or managing investments on an ongoing basis", effectively bringing UK private equity and debt managers that are structured as "advisor-arrangers" in scope. UK AIFMs of non-UK funds are in scope. The FCA is not expecting to apply the disclosure rules to non-UK AIFMs that market their funds in the United Kingdom. We discuss further the impact of UK AIFMs and portfolio managers below.

- **Asset owners** are providers of life insurance or pension products where the holder of the product receives a return directly linked to underlying investments. This reflects the FCA's focus on disclosure in investment products that informs investor choices, such as in insurance-based investment products, "defined contribution" personal pension schemes, stakeholder pensions and SIPPs. In this respect, the regime does

[4] This comprises UK companies that have more than 500 employees and have securities admitted to trading on a UK-regulated market or on AIM.

[5] This comprises "public interest entities" (banking and insurance companies) that are currently required to produce a non-financial information statement and UK companies and LLPs that have more than 500 employees and an annualised turnover of more than £500 million.

not apply to "defined benefit" pension funds, such as occupational pension schemes, that commonly invest in private funds but do not offer investment-based products. However, the UK government has a separate initiative to bring large UK occupational pension scheme trustees, in their capacity as investors,[6] into the scope of climate change-related reporting, which is expected to take effect on 1 October 2021. We discuss further below the considerations that UK AIFMs and portfolio managers should take into account through application of the regime to asset owners and occupational pension schemes.

Impact on UK AIFMs and Portfolio Managers

Asset managers with AuM of more than £50bn will be in scope from 1 January 2022,[7] with a publication deadline of 30 June 2023. Firms will select their own 12-month reporting period, provided that the period begins no earlier than 1 January 2022 and the first entity-level disclosures are published by 30 June 2023. Other asset managers and asset owners above the £5bn AuM threshold will be in scope from 1 January 2023. The FCA expects 106 firms to be in scope from 1 January 2023, although this number could well be higher, if the FCA, as proposed, applies the scheme to UK-based private equity sponsors that are structured as advisor-arrangers as well as managers.

Asset managers with less than £5bn in assets under management (on a three-year rolling average) will be exempt.

Firms that manage portfolios of assets under the MiFID portfolio management permission will be in scope, comprising both segregated accounts and fund mandates that are managed under delegation arrangements, including those in place with EU AIFMs.

Where a UK AIFM delegates investment management to a third-party manager (including under a host AIFM arrangement), the AIFM remains responsible, although the AIFM can disclose by way of cross-references to the delegated managers' disclosures, if available. Firms that have entered into delegated portfolio management arrangements with UK-host AIFMs will therefore be indirectly in scope, to the extent the host AIFM's AuM exceeds £5bn.

As above, various life insurance and pension products are in scope. Importantly, the FCA states that, whilst such firms are required to produce an "entity-level" report (see

6 The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

7 The FCA proposes that the firms first in scope will be "enhanced scope SMCR firms" under the separate Senior Manager & Certification Regime, capturing 34 firms.

below), the amount of detail in the report will depend on whether the asset owner takes an active role in investment decisions and product design and, where the underlying funds are managed by an external asset manager, the firm can cross-refer to the external manager's TCFD disclosures. The FCA expects that 34 asset owners will initially be in scope from 1 January 2022.

In terms of the products in scope, the FCA adopts the terms "TCFD product" for this purpose, encompassing both FCA-authorised and unauthorised alternative investment funds ("AIFs") and "agreements or arrangements under which a firm provides the client with portfolio management". There is no different treatment for products that are only marketed outside the United Kingdom or portfolio management arrangements with clients outside the United Kingdom or for portfolios of assets located outside the United Kingdom. However, that product-level information must only be made available "on demand" from clients (from both AIFMs and portfolio managers) will relieve firms from providing the information to clients, such as non-UK parent entities that are not themselves required to disclose the information. It remains to be seen to what extent firms will want to produce private or public produce level disclosures, even if not strictly required, in support of their fundraising.

Timetable

The phased implementation of the rules is as follows.

Application	First Entity-Level Disclosures	First Public Product or Portfolio Disclosures	First Private "On-Demand" Disclosures
Phase 1			
Asset managers with AUM of more than £50bn	By 30 June 2023 in respect of a 12-month period beginning no earlier than 1 January 2022.[8]	By 30 June 2023 with reference to the 12-month reporting period covered by the entity-level disclosure.	From 1 July 2023.
Phase 2			
All other asset managers above the £5bn threshold	By 30 June 2024.	By 30 June 2024 with reference to the 12-month reporting period covered by the entity-level disclosure.	From 1 July 2024.

Disclosures Based on Taskforce on Climate-Related Financial Disclosure

As above, the FCA intends that its regime is consistent with the TCFD's recommendations on disclosure (and its supplemental guidance for asset managers and asset owners), and the TCFD's recommended disclosures form an Annex to the rules. In more detail:

Entity-Level Disclosure

Firms must publish entity-level reports on an annual basis and no later than 30 June in each calendar year in a "prominent place" on the firm's website (for example, with a link

[8] Firms can select their own 12-month reporting period, provided that the period begins no earlier than 1 January 2022 and the first entity-level disclosures are published by 30 June 2023.

from the homepage to ensure that the disclosures are easily accessible). The entity report will cover disclosures in relation to all assets managed or administered.

The entity-level report will cover the following matters:

- **Governance**. The firm's governance relating to climate-related risk (the impact of climate change) and opportunities (the transition to a lower-carbon economy)—this will cover who in the firm is ultimately responsible for reviewing climate-related risks in the portfolio, such as a risk committee.

- **Strategy**. This covers the impact of climate-related risks and opportunities on the firm's strategy. In asset management terms, this requires a description of how climate-related risks and opportunities are factored into relevant products or investment strategies—how portfolio managers are accountable for managing exposure to material climate risks (such as screening out fossil fuel-related activities from potential investments) and how the manager invests in opportunities connected to the transition to net zero carbon economy (such as investment in green bonds). This includes "scenario analysis", which is stress testing portfolios as against climate-related risks (and opportunities), in part to reassure clients that different climate-related scenarios are considered in the investment decision-making process. In providing climate-related scenario analysis in relation to the portfolio, the FCA expects that firms will provide, if it is reasonably practicable, quantitative (data-based) examples to demonstrate its approach. This would involve modelling the impact of the portfolio under "orderly transition" (reduction in CO2 emissions in line with climate policy), "disorderly transition" (sharper emissions reductions at higher cost) and "hothouse world" (reduction commitments are not met and emissions continue to rise). Climate scenario analysis is not straightforward or currently broadly undertaken by asset managers, and there is some uncertainty as to the scope required.

- **Risk management**. This covers the firm's integration of climate change risks in its day-to-day risk management process—its focus on climate-related financial risks in its investment decision-making process and how its investment strategy might change to address such potential risks and opportunities. This will also cover asset managers' engagement activity with investee companies.

- **Metric and targets**. The firm will need to disclose carbon emissions on an aggregate AuM basis and climate-related targets that the firm applies across its portfolios and how it measures progress towards the target, including the related "metrics" that the firm obtains. In this regard, some managers have signed up to the "Net Zero Asset Managers Initiative" as a climate target, and managers that do not adopt a climate target must explain why this is the case.

Firms may make disclosures at a group level (as part of a group report), and a firm's entity-level report may therefore cross-refer to the climate-related disclosures made by the group as a whole or by another member of the group. This is welcome for large asset management groups and particularly those that have already implemented TCFD at a global level. The report may also refer to climate-related financial disclosures in a third party's (such as a delegate's) climate reporting.

Where a firm's approach to a particular investment strategy, asset class or product is materially different to its entity-level approach to governance, strategy or risk management, the firms must explain this, potentially requiring firms to make publicly available information on privately offered strategies.

The entity-level disclosure requirements are considerably more burdensome than the basic "sustainability risk" disclosure required for all firms in scope of the EU SFDR and potentially challenging for firms that have a broad product set with different climate risk profiles and approaches. The framework does allow firms to qualify their entity-level statements by cross-references to product-level disclosure.

Product-Level Disclosure

Firms will also produce a product- or portfolio-level TCFD report in respect of each relevant fund or managed account. This must include a number of prescribed "core" metrics, together with, on a "best efforts" basis, some additional metrics. The FCA proposes that firms may use "proxy data" or make assumptions where underlying data is not available.

Other than for FCA-authorised funds or funds listed on recognised stock exchanges, AIFMs and portfolio managers will not need to publish product-level TCFD reports. Instead, as above, these reports will be made available on demand from clients. AIFMs and portfolio managers are also required to provide climate-related data on the underlying holdings in the portfolio to clients that request it.

The product-level disclosures will comprise:

- Mandatory carbon emissions and carbon intensity metrics reporting across the portfolio, including scope 1 (direct emissions), scope 2 (from energy purchased from utility providers) and scope 3 (supply chain) greenhouse gas emissions; total carbon footprint; and weighted average carbon intensity with historical look-backs, in each case having regard to TCFD Guidance on Metrics, Targets and Transition Plans.

- For scenario analysis, a qualitative summary of how climate change is likely to impact the portfolio under various climate change scenarios and additional quantitative analysis where a particular fund or mandate has concentrated exposures or high exposures (for which the FCA does not provide thresholds) to carbon-intensive sectors. For many firms, quantitative scenario analysis will be new, and the FCA acknowledges that firms will likely need to rely on third parties to perform it.

- Additional information on a "best efforts" basis, such as "climate Value-at-Risk", progress towards climate-related targets and any other information that the firm considers is helpful for investor decision-making.

Noting that many UK firms are subject to SFDR disclosure and reporting, the FCA aims to ensure consistency with SFDR rules on, for instance, carbon-emissions metrics, although firms may need to report under both SFDR and TCFD metrics where they differ.

Requirements for Climate-Related Disclosures and Reporting by UK Occupational Pension Schemes

As noted in the table above, occupational pension schemes will be required to make TCFD-aligned climate-related disclosures from 1 October 2021. The obligations will apply to trustees of schemes with assets of £5bn or more at the end of their first scheme year to end on or after 1 March 2020 (and to trustees of schemes with assets of £1bn or more at the end of their first scheme year to end on or after 1 March 2021) and to trustees of authorised master trusts and authorised schemes providing collective money purchase benefits. Trustees of schemes whose relevant assets are £1bn or more at the end of a scheme year which falls on or after 1 March 2022 will be subject to the requirements from the beginning of the scheme year. Reporting obligations cease if a scheme's relevant assets fall below £500m on any subsequent scheme year end date.

Trustees must produce and publish a TCFD report within seven months of the end of any scheme year in which they were subject to the new requirements and should review it annually. As the requirements apply on 1 October 2021, the earliest point at which trustees will publish a TCFD report is 1 May 2022.

The TCFD report will cover the same core elements as for the entity-level disclosure required for asset managers, namely: governance (identification of climate-related risks and opportunities), strategy (the impact of climate-related risks and opportunities on the scheme's investment strategy and its assets and liabilities over various time horizons, including scenario analysis), risk management (integration of climate change risks in its day-to-day risk management process), metrics (at least one absolute emissions metrics, emissions intensity metric and additional climate change metric in relation to the scheme's assets) and targets. In particular, trustees must "as far as they are able" obtain scope 1, scope 2 and scope 3 greenhouse gas emissions attributable the scheme's assets, use the data obtained to calculate their selected absolute emissions metric and emissions intensity metric and use the metrics to identify and assess the climate-related risks and opportunities that are relevant to the scheme. In addition, trustees must set a target for the scheme in relation to one of the metrics that they have selected to calculate, and measure, as far as they are able, the performance of the scheme against the target.

The Government Department for Work and Pensions has issued draft statutory guidance (the "Guidance") for the purposes of the consultation, which is expected to come into force together with the Regulations later this year. The Government Pensions Climate Risk Industry Group has also issued practical guidance, "Aligning your Pension Scheme with the TCFD Recommendations".

Asset managers can expect to receive information questionnaires in line with pension trustees' information-gathering and reporting obligations. The guidance "Aligning your Pension Scheme with the TCFD Recommendations" referred to above includes "Enquiries to make of asset managers", with the first suggested question to ask being whether the manager has produced a TCFD report. Pension schemes are likely to use external consultants in producing their TCFD reports, in particular in producing a scenario analysis of the impact of climate change risks and opportunities on the performance of the scheme's assets. It is not currently clear to what extent pension scheme trustees or their consultants will require detailed climate-related information from asset managers (such as details of carbon emissions in the portfolio) for the purpose of the scenario analysis, noting that the guidance takes into account that there will be "data gaps" for trustees in assessing the level of climate-related risk.

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Please do not hesitate to contact us with any questions.

LONDON

Patricia Volhard
pvolhard@debevoise.com

John Young
jyoung@debevoise.com