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

Insight Investment response

September 2021

Insight INVESTMENT

BNY MELLON | INVESTMENT MANAGEMENT

Executive Summary

Insight Investment is one of the UK's largest investment managers, managing over £740bn in assets for pension funds, insurers, sovereign wealth funds and financial institutions[1]. The majority of Insight's assets under management are in risk management solutions (primarily liability-driven investment, or LDI) and fixed income.

Climate change is one of the greatest challenges of our time. Governments and businesses are grappling with the implications, and responsible investors seek to discern how climate change might affect investment risks and opportunities. Insight is a committed responsible investor and was a founding signatory to the Principles for Responsible Investment (PRI) in 2006.[2] We believe that all risks, including environmental, social and governance (ESG) risks, can affect the value of an investment – and so any initiative that seeks to improve risk disclosures is therefore a positive and constructive development.

We therefore agree with the Financial Conduct Authority (FCA) that "high-quality information on how climate-related risks and opportunities are being managed will help clients and consumers make better informed decisions about their investments", and so we welcome this consultation.

The consultation proposals are constructive and we are broadly supportive. However, we would highlight several points that we explain further in the answers below:

- **We do not believe the consultation sufficiently considers the breadth of asset classes that might be reported upon and the relevance and availability of data for those asset classes.** The proposed rules best suit equity and corporate fixed income products for large issuers where data transparency is available, but do not necessarily suit other asset classes it is not necessarily relevant or there may be data gaps.
- **In general, we do not support firms being required to report on a 'best efforts' basis using assumptions and proxy data.** The term 'best efforts' can be interpreted from a legal perspective as highly onerous. Instead, we would be supportive of adopting either a 'comply or explain' or an 'as far as they are able' approach. The latter has been adopted by the Department for Work and Pensions (DWP) in similar regulations, and given the FCA's commitment and desire to align with the DWP rules, we believe this might be an appropriate approach to adopt.
- Given the increasing interest in this topic and the global nature of financial markets, **we would strongly recommend that regulators and policymakers work together to create a single global standard**, to avoid double reporting which can not only be burdensome but create unnecessary confusion for investors.
- We support the FCA aligning with the updates to the TCFD reporting rules as consulted in June 2021 as a long-term target. **However, we caution against mandating for metrics that are not yet fully developed, and against the use of scenario analysis where it may not be appropriate, or possible, for some assets.**

We would be delighted to engage further with the FCA on these issues, and to discuss our response in greater detail.

Insight Investment

September 2021

[1] As at 30 June 2021. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. Figures shown in GBP. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Insight Investment International Limited (IIIL), Insight Investment Management (Europe) Limited (IIMEL) and Insight North America LLC (INA), each of which provides asset management services.
[2] More information on Insight's responsible investment approach and activities is available at https://www.insightinvestment.com/investing-responsibly/.

Questions and answers

Q1. Do you agree with our proposed scope of firms, including the £5 billion threshold for asset managers and asset owners? If not, please explain any practical concerns you may have and what scope and threshold would you prefer.

We generally support this and agree that it can be challenging for small firms to implement these rules given the cost burden.

We do however note that DWP climate-related disclosure requirements for pension schemes apply to schemes from £1 billion in size. Given the cost burden for these pension schemes, we would encourage considering increasing this threshold at a later stage, if there is scope to do so.

Q2. Do you agree with our proposed scope of products? If not, what types of products should, or should not, be in scope and why?

We do not believe the consultation sufficiently considers the breadth of asset classes that might be reported upon and the relevance and availability of data for those asset classes.

As such, we believe some products should be out of scope and there should be flexibility around reporting for in-scope products if there are good reasons for it (e.g. data gaps).

<u>Out of scope asset classes</u>

We believe asset classes for which the metrics either cannot be obtained or are not relevant should be out of scope. Examples of asset classes that may fall into this category include:

- **Legacy asset-backed securities (ABS):** These have data gaps, nor is it practically possible to gather data on these at a future date because there is no corporate entity with which investors can engage from which to request the data. Unless the information was provided at deal launch we do not see any practical way to gather this data and for some ABS it may not even be relevant.
- **Currency instruments:** We do not believe that the climate-related metrics are relevant or applicable for currency instruments and therefore we believe they should be out of scope.
- **Certain derivatives:** We believe there are challenges to employing climate-related metrics with respect to derivatives instruments. Derivatives instruments (e.g. interest rate swaps, inflation swaps) often do not have an issuer linked to them to determine the metrics. Whilst it could be argued that metrics should be reported for derivatives instruments linked to a corporate (e.g. credit default swaps or equity derivatives), holders of derivatives do not have any direct ownership or influence on the company and its greenhouse gas emissions. There is also more potential for manipulation of carbon footprinting at a portfolio level where negative derivative positions are seen as ‘netting’ positive footprints elsewhere. We therefore believe there are clear nuances in the reporting of carbon metrics for derivatives and there should be significant questions to answer as to whether these should be in scope, and how they should be treated.

<u>In scope products</u>

These rules best suit equity and corporate fixed income products for large issuers where data transparency is available, but do not necessarily suit other asset classes due to data gaps.

The data gap issue is expected to be significant. We do not believe that it is reasonable to mandate firms to report on a best-efforts basis where there are data gaps and issues. We would support these metrics for in-scope products to be reported on a ‘comply or explain’ basis, or on an ‘as far as they are able’ approach. The ‘as far as they are able’ approach was adopted in the DWP rules and there could be benefits in further aligning these rules with the DWP rules. This is further discussed in our response to question 4. It is expected that data gaps will improve over the coming years so these issues will be addressed over time.

Examples of asset classes where there is currently a data gap or methodology issue include:

- **Government bonds and supranational issued instruments:** While the core metrics are theoretically possible for government bonds and supranational instruments, there can be issues with double counting (e.g. for portfolios with sovereign and corporate exposure) and the scope of what accounts for the entities' emissions must be agreed e.g. production vs consumption-based. There is also scope for methodological inconsistencies with the additional metrics.
- **Private debt and loan securities:** Currently there is no established infrastructure for data collection from issuers of private debt. Whilst at Insight we look to plug this data gap with questionnaires and direct engagement, our dialogues show that a number of smaller companies do not have the infrastructure to supply the requisite information. It may be sensible to consider exempting securities based on issuer size.
- **Newly-issued ABS:** There can sometimes be data available for these securities, but not always, and in some cases it will not be relevant (e.g. credit card ABS). We hope the availability of data will improve over time so that new deals provide the required information. Insight is already working on initiatives aimed at encouraging these to be developed at an industry level.
- **Securities issued in jurisdictions with no climate reporting regime:** Not all regimes will have climate reporting regimes and therefore some flexibility will be needed to cater for circumstances where the issuer of a security does not report the required metrics.

<u>Other considerations</u>

Note that multi-asset portfolios can have a mixture of asset classes. We therefore believe reporting at an asset-class level, rather than at a product-level, is more appropriate for multi-asset portfolios.

Q3: Do you agree with our phased implementation and timings? If not, what approach and timings would you suggest and why?

We agree with the phased approach of larger firms being required to report before smaller firms.

We believe it is important to get the sequencing right as much as possible. It would be important for the disclosure requirements to apply first to issuers before it is mandated for consumers of that data such as asset managers and asset owners. We appreciate the FCA's efforts on this in the UK, but further work is needed by IFRS at an international level for this to be the case globally.

However, given the desire to make progress on this quickly, we would be comfortable with the proposed timing as long as there is a realistic expectation by policymakers of the output. Specifically, we believe the following:

- Certain products should be out of scope altogether (see our response to question 2).
- Where products are in scope but there are data gaps or calibration issues, any disclosure should be done on a basis of either a (i) 'comply and explain' or (ii) 'as far as they are able' approach. This is explained further in our response to question 4 below.
- Additional metrics are not yet fully developed and it is difficult for firms to assess the issues around reporting these. We therefore believe that the reporting of additional metrics should be voluntary at this stage and should only be mandated once these metrics have been fully developed. We expand on this in our response to question 14 below.

Q4: Would there be significant challenges in using proxy data or assumptions to address data gaps? If so, please describe the key challenges and implications as well as any preferred alternative approach.

In general, we do not support firms being required to report on a 'best efforts' basis using assumptions and proxy data. The term 'best efforts' can be interpreted from a legal perspective as highly onerous, and it is questionable if the benefit of applying such a requirement would sufficiently offset the costs.

Mandated reporting should only apply where data is available, relevant, and methodology is clear.

Requiring firms to report on the basis of proxy data and assumptions is likely to be problematic for several reasons:

- Even assumptions need data to support them.
- The data and results are likely to be unreliable and not comparable.
- Firms can use assumptions to their favour which makes the output questionable.
- We also question the value that the FCA attributes to this: i.e. investors being able to compare the same product with the same investment firm over time. In practice, if proxy data and assumptions are used, it is highly likely that the methodology and assumptions will evolve and change over time, meaning that investors will not be able to compare outputs easily.

We think it would be better for firms to focus their time and efforts in developing industry solutions to help resolve these issues, rather than be focused on trying to develop sub-optimal solutions on their own to meet mandatory requirements. We believe the FCA could encourage the establishment of working groups to ensure this takes place at a pace that is acceptable for both policymakers and industry.

Instead of a ‘best efforts’ approach, we would be supportive of adopting either (i) a ‘comply or explain’ approach, or (ii) an ‘as far as they are able’ approach.

- By a ‘comply or explain’ approach, we mean an approach whereby firms report on the basis of data that is available to them; if there are data gaps or methodology issues which prevent reporting, firms are permitted to not report but are required to explain why.
- By an ‘as far as they are able’ approach, we mean the approach that has been adopted by the DWP and The Pensions Regulator (TPR) on TCFD (Task Force on Climate-Related Financial Disclosures) reporting for pension funds. This seems to strike a good balance between encouraging reporting whilst ensuring that the effort and cost deployed to try to fill data gaps are not disproportionate. Given the FCA’s commitment and desire to align with the DWP rules, we believe this might be an appropriate approach to adopt.

We question whether UK regulators should adopt two different approaches for the same reporting (i.e. the FCA adopting a ‘best efforts’ approach while the DWP adopts an ‘as far as they are able’ approach). There are likely to be entities caught under both regulations and it would seem more appropriate for the regulations to adopt the same approach.

Q5: Do you agree with our proposals for the provision of a TCFD entity report, including the flexibility to cross refer to other reports? If not, what alternative approach would you prefer and why?

Yes, we support this.

Q6: Do you agree with our proposed approach to governance, strategy and risk management, including scenario analysis? If not, what alternative approach would you prefer and why?

We agree with the FCA aligning with the TCFD approach focusing on governance, strategy and risk management.

Scenario analysis may not be appropriate, or possible, for some asset classes (please see our answer to question 16). While we strive for commonality in metrics and scenario analysis, it must also be acknowledged that the one-size-fits-all approach will not work for all asset classes.

Therefore, we would recommend that firms have flexibility to apply judgment over whether it is appropriate or possible to produce this, combined with an explanation as to why if this is not produced.

Q7: Do you agree that firms not yet setting climate-related targets must explain why not? If not, what alternative approach would you prefer and why?

Yes, we support this at a firm level, but we caution against adopting such approaches on a product level as it will not be relevant for all products.

Q8: Do you agree with our proposals for AFMs that delegate investment management services to third-party portfolio managers? If not, what alternative approach would you prefer and why?

Yes, we support this.

Q9: Do you agree with our proposals for asset owners to cross-refer to group-level, third-party or delegate reports, where relevant? If not, what alternative approach would you prefer and why?

Yes, we support this.

Q10: Do you agree with our proposed requirements for product or portfolio-level disclosures, including the provision of data on underlying holdings and climate related data to clients on demand? If not, what alternative approach would you prefer and why?

We support the proposal that data be provided once a year to clients upon their request, at the product or mandate level. This is preferable to making reports available on a website which would not suit many clients' need for confidentiality.

However, we do not support the mandatory provision to clients of climate-related disclosures on underlying holdings (or at a granular portfolio level). While we are committed to high standards of client transparency, in many situations this will not work in practice because licensing agreements with data providers do not always permit granular data to be shared with third parties. We would recommend this information be provided at an aggregate product or mandate level instead.

Note that multi-asset portfolios can have a mixture of asset classes. We therefore believe reporting at an asset-class level, rather than at a product-level, is more appropriate for multi-asset portfolios. This is because the formulas for different asset classes can be different (e.g. different denominators) and so they cannot easily be aggregated.

Q11: Do you agree with the list of core metrics, including the timeframes for disclosure? If not, what alternative metrics and timeframes would you prefer and why?

Yes, we agree with the core metrics set out. We support the alignment of the metrics to TCFD and DWP recommendations. As set out in our response to question 4, we believe there is room for further alignment, specifically relating to the use of a 'best efforts' approach by the FCA versus an 'as far as they are able' approach by the DWP in situations where there are data gaps.

Please note the issues related to data gaps and certain products that we believe should be out of scope are set out in our response to question 2.

Q12: Do you agree that firms should calculate metrics marked with an asterisk according to both formulas set out in columns A and B of Appendix 3? If not, please explain why, including any challenges in reporting in accordance with either or both regimes.

We do not support having to report metrics calculated using two different formulas. This would increase the reporting burden and be potentially confusing for investors. We support the FCA adopting one set of standards, based on the TCFD recommendation as the global standards for climate reporting.

We believe the recent changes put forward in the June 2021 consultation on updates to TCFD recommendations are likely to align TCFD reporting more closely to SFDR reporting, in terms of the inclusion of Scope 3 emissions. Double reporting may not therefore be necessary. Given clients in scope for SFDR will require this reporting anyway, making SFDR reporting optional rather than mandatory would be more appropriate for other clients.

We encourage regulators and authorities to work together to ensure that standards developed are aligned at a global level to minimise these issues going forward. Specifically, they may want to consider denominators that are relevant by asset class (e.g. market capitalisation is not a useful metric for calculating the carbon footprints of fixed income portfolios).

Q13: Do you agree that, subject to the final TCFD guidance being broadly consistent with that proposed in the current consultation, our proposed rules and guidance should refer to:

a. The TCFD Final Report and TCFD Annex in their updated versions, once finalised

b. The TCFD's proposed guidance on metrics, targets and transition plans and the proposed technical supplement on measuring portfolio alignment If not, what other approach would you prefer and why?

Although in principle we support alignment with upcoming changes to TCFD rules as they are undoubtedly useful and good aspirational targets, we think it is too soon to mandate rules on this basis. The additional metrics and methodologies are not sufficiently developed and are open to manipulation. We believe this should only be mandated once the methodologies have been fully developed.

Q14: Do you agree with our approach to additional metrics and targets? If not, what alternatives would you suggest and why?

The additional metrics are undoubtedly useful and good aspirational targets, but we have concerns that the underlying methodologies are not sufficiently developed and are open to manipulation. We see little value in requiring reporting of these metrics, and a significant burden and cost for firms trying to second-guess how to implement such a requirement before the metrics are fully formulated. We recommend that reporting of additional metrics is not mandated before they are fully developed.

Q15: Do you agree with our approach to governance, strategy and risk management, including scenario analysis at product or portfolio-level? If not, what alternative approach would you prefer and why?

In general, yes, but as per our response to question 6, it must be recognised that scenario analysis may not be appropriate, or possible, for some asset classes (please also see our answer to question 16). While we strive for commonality in metrics and scenario analysis, it must also be acknowledged that the one-size-fits-all approach will not work for all asset classes.

Therefore, we would recommend that firms have flexibility to apply judgment over whether it is appropriate or possible to produce this, combined with an explanation as to why, if this is not produced.

Q16: What form(s) could quantitative scenario analysis outputs at product or portfolio-level take? What do you consider the cost and feasibility of producing such outputs might be? How useful would such outputs be for users' decision-making?

VaR analysis is most likely to be the measure used for decision-making purposes. However, it is important to note that VaR is more appropriate for some asset classes than others: it is a very subjective measure and likely to lead to completely different results for the same securities depending on the inputs and assumptions made in models.

Furthermore, in general, scenario analysis works better for equities than corporate bonds. A portfolio of corporate bonds is likely to hold bonds with multiple maturities, which in some cases will make scenario analysis inappropriate. Between now and the time horizon considered under a scenario analysis, the underlying holdings within a portfolio could change completely, which raises questions as to the relevance of any output from scenario analysis; and scenario analysis with a time horizon beyond the maturity of a particular bond will have no value for decision making purposes.

This informs our answers to questions 6 and 15, explaining that firms need flexibility to apply judgment over this for different asset classes.

Q17: Do you agree with our proposed approach that would require certain firms to provide product or portfolio level information to clients on request? If not, what approach and what types of clients would you prefer and why?

We support the proposal that data be provided once a year to clients upon their request, at the product or mandate level. This is preferable to making reports available on a website which would not suit many clients' need for confidentiality.

Q18: Do you agree with our proposed approach for life insurers when mirroring an external asset manager's strategy? If not, what alternative approach would you prefer and why?

No comment.

Q19: Do you agree with our specific proposals for asset owners, including the proposed threshold to exclude the smallest default schemes? If not, what alternatives would you prefer and why?

No comment.

Q20: Do you agree with the analysis in our CBA? If not, we welcome feedback in relation to the one-off and ongoing costs you expect to incur and the potential benefits you envisage. Contextual information about your firm's size and structure would be helpful.

For asset classes where there are data gaps, the cost of collating data for these metrics can be disproportionate in relative to the benefit.

We believe the resources and time would be better spent in working with regulators and the wider industry, through working groups, to develop relevant industry standards.

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