The Institutional Investors Group on Climate Change

IIGCC response to FCA consultation CP21/17: Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers

About us

The Institutional Investors Group on Climate Change (IIGCC) is the leading European membership body enabling the European and UK-based investment community in driving significant and real progress by 2030 towards a net zero and resilient future. IIGCC's 340+ members, representing €42 trillion assets under management, are in a position to catalyse real world change through their capital allocation decisions, stewardship and engagement with companies and the wider market, as well as through their policy advocacy.

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Executive summary

IIGCC supports the FCA's proposals to extend TCFD-related disclosure requirements to asset managers, life insurers and FCA-regulated pension providers. The publication of high-quality, consistent disclosures on climate-related risk and opportunities by in-scope firms will help to increase market transparency, inform pricing and capital allocation, and drive investment in the projects and activities that can enable us to reach net zero. The proposals also represent a critical step in enabling the flow of decision-useful climate information across the investment chain and up to pension schemes, who depend on the disclosures made by asset managers in order to understand their own exposures to climate-related risks and opportunities.

In October 2020, IIGCC responded to the FCA's consultation to introduce reporting aligned with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations for premium listed issuers.[1] In September 2021, we submitted a response to the FCA's consultation on extending TCFD disclosure requirements to standard listed issuers.[2] IIGCC has also issued responses to a wider range of consultations under HM Treasury's roadmap to mandate TCFD-aligned disclosures across the economy by 2025. This includes the Department for Work and Pension's proposed TCFD rules for trustees of occupational pension schemes,[3] as well as the Department for Business, Energy and Industrial Strategy's proposals to mandate climate-related financial disclosures by publicly quoted companies, large private companies and LLPs.[4]

Building on the input we received from members during these processes, and feedback on the specific proposals to extend TCFD disclosure requirements to firms in scope of this consultation, we wanted to take the opportunity to summarise the key issues raised regarding climate-related disclosure. Specifically, IIGCC recommends that the FCA:

[1] IIGCC response to CP 20/3, available here.
[2] IIGCC response to CP 21/18, available here.
[3] IIGCC initial response to DWP TCFD consultation (Oct 20), available here. IIGCC response to final DWP proposals, available here.
[4] IIGCC response to BEIS TCFD consultation, available here.

- considers extending the proposed scope of firms in future, to ensure a wider range of firms are able to identify and manage climate-related risks and opportunities in a manner proportionate to their size and the complexity of their business model.
- collaborates with regulators and governmental departments to manage potential data and reporting gaps stemming from mismatched sequencing and disclosure requirements across the HM Treasury TCFD roadmap.
- ensures that entity-level TCFD reports that rely on cross-referencing remain understandable in their own contexts.
- introduces flexibility for in-scope firms to calculate the proposed core metrics and undertake scenario analysis 'as far as they are able', in acknowledgement of transitional challenges in obtaining relevant, decision-useful data from investee companies.
- reviews the formulas for calculating core metrics to ensure they are fully aligned with the DWP TCFD disclosure regime and support trustees' information needs.
- references the recommended disclosures established by the Paris Aligned Investment Initiative's (PAII) Net Zero Investment Framework (NZIF), where in-scope firms are seeking to align their portfolios with net zero.

IIGCC response to selected consultation questions

Consultation question 1: 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.

IIGCC agrees with the FCA's proposed scope of firms as a first step in extending TCFD disclosure requirements to FCA-regulated asset owners and asset managers. However, we believe that climate change presents a material risk to all firms, irrespective of size. We therefore recommend that the FCA considers extending the scope of firms in future (as part of a third implementation phase) to those below the £5bn threshold.

IIGCC acknowledges that the proposed scope covers a substantial majority of UK assets under management (AUM) and should therefore support the flow of decision-useful information across the investment chain. However, it is important to ensure that all firms are ultimately able to implement effective frameworks for identifying and managing climate-related risks and opportunities. The TCFD framework provides a basis for firms to make disclosures that are proportionate to the nature, scale and complexity of their business, meaning smaller asset managers and asset owners should be able to report in line with the requirements. Recognising that these smaller firms will need more time and support to build capabilities, the regime could initially operate on a 'comply or explain' basis before becoming mandatory.

As highlighted in the consultation, some firms in scope of the proposals will already be subject to overlapping entity-level disclosure requirements, directed at shareholders, in their capacity as listed issuers. In contrast, the proposals put forward in this consultation focus on assets managed or administered by firms, and are targeted at clients and consumers. To maintain coherence between these disclosure regimes, and to avoid duplicative reporting, IIGCC recommends that the FCA provides guidance to firms captured by both regimes on how these disclosures relate to one another, and any distinctions between the type of information which is likely to be decision-useful for clients/consumers, and that which is material for shareholders.

IIGCC also notes that definitions of AUM and assets under administration (AUA) have not been provided in the consultation, and we would therefore welcome further clarity on this. For example, the Department for Work and Pensions (DWP) TCFD regime sets out a definition of 'relevant assets' for pension schemes, and the FCA has also introduced specific definitions of both AUM and AUA as part of its proposals to establish a UK Investment Firm Prudential Regime (IFPR).

Consultation question 2: Do you agree with our proposed scope of products? If not, what types of products should, or should not, be in scope and why?

IIGCC agrees with the proposed scope of products for asset managers and asset owners, and welcomes the FCA's efforts to ensure consistent coverage of climate-related information across pension products, irrespective of whether providers are captured by the FCA rules or the DWP TCFD disclosure requirements. We are also supportive of the broad definition of 'portfolio management services', which captures private equity activities. This is particularly important for defined benefit (DB) pension schemes, many of which have increased their holdings in unquoted/private equity in recent years and will therefore benefit from additional transparency on the climate-related risks and opportunities that private equity firms ae exposed to.

Consultation question 3: Do you agree with our phased implementation and timings? If not, what approach and timings would you suggest and why?

IIGCC supports a phased implementation timetable, which should provide smaller, less well-resourced firms with additional time to prepare and implement their disclosures. However, we would emphasise the need for the FCA to carefully manage any potential misalignment of the proposed timings with the implementation timelines of other TCFD initiatives.

For example, the first set of climate-related disclosure requirements for the largest occupational pension schemes and authorised master trusts apply from 1 October 2021 (with TCFD reports to be published within 7 months of the scheme year underway on that date). In contrast, the deadline for the first TCFD reports to be published by firms in scope of this consultation is 30 June 2023. The capacity of pension scheme trustees to meet their TCFD reporting obligations will depend on their ability to aggregate the disclosures made by their asset managers, which may not be readily available for a considerable period of time.

Just as asset owners depend on asset managers for decision-useful, consistent and comparable data, asset managers in turn rely on the disclosures made by investee companies. While TCFD-aligned disclosures by premium-listed issuers and firms in scope of the Department for Business, Energy and Industrial Strategy (BEIS) proposals will be available from spring 2022, disclosures published by standard-listed issuers will not be available until 2023. This doesn't leave long for the largest firms in scope of this consultation to collate and assess the necessary data from a broader range of investee holdings, in order to inform their own climate-related disclosure obligations ahead of the 30 June 2023 publication deadline. If the mismatches between these various timetables are not mitigated, the flow of decision-useful climate information across the investment chain and up to asset owners could be hampered.

IIGCC appreciates that there are limits in terms of what the FCA can do to address this challenge. However, we stress the importance of ongoing collaboration and communication between the FCA,

DWP, BEIS and others to ensure consistency between the TCFD regimes and to avoid data reporting gaps within the different organisational categories in scope of the HMT roadmap.

Consultation question 4: 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.

IIGCC's preference is for high quality data to be made available by investee companies to enable accurate and informed investment decision-making. However, given that disclosure of relevant climate-related information by companies is currently limited, IIGCC supports the use of proxy data and assumptions to address data gaps in the short-term. Any reliance on proxy data should be accompanied by transparent disclosures on the underlying methodologies, assumptions used and limitations to the approach, as outlined in the consultation. It is also important to acknowledge that the procurement of proxy data comes at a cost, which could reduce its accessibility for smaller, less well-resourced asset managers and asset owners when compared with larger investors.

Where proxy data quality and assumptions are insufficient, or considered to be unreliable, firms should have the flexibility to explain why they are unable to populate these data gaps at present. This would align the FCA's proposals more closely with the 'as far as they are able' approach established under the DWP rules, which allows trustees to explain missing/insufficient data that prevents them from calculating metrics and meeting their TCFD reporting obligations. In line with the approach taken by the DWP in their Statutory Guidance, the FCA should clarify the steps firms should take to meet requirements 'as far as they are able' in practice.

In addition, the consultation does not account for disparities in data quality and availability between asset classes. IIGCC recommends that the FCA provides flexibility for firms to adapt their disclosures to reflect the relevant characteristics of different asset classes and financial instruments, including explanations of any data gaps or assumptions the firm has made to assess their carbon emission profiles.

We would also encourage the FCA to clarify that any reliance on proxies and assumptions should taper off as the wider regime to mandate TCFD disclosures across the economy beds in and the availability of high quality, comparable and decision-useful data published by investee companies increases. To this end, additional clarity on possible future phase outs of proxies and estimations as the industry matures would be welcome.

Consultation question 5: 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?

IIGCC agrees with the flexibility to cross-refer to other reports, as long as appropriate safeguards are introduced to maintain transparency around specific climate-related risks which in-scope firms are exposed to, and to ensure that disclosures are understandable in their own contexts. That is, entity-level disclosures made by in-scope firms should provide users with a minimum baseline of information regarding the climate-related risks and opportunities that the firm is exposed to, with clear signposting to where additional information can be found where relevant (e.g. in a cross-referenced report). As noted in the consultation, the disclosures should also be accompanied by clear explanations of any material deviations between the firm's approach and that of the

group/delegated portfolio manager. However, what the FCA would consider to be a 'material' deviation is not entirely clear (e.g. between firm and group-level disclosures and entity and product-level disclosures). We would welcome further clarity or case studies from the FCA as to what could be considered a material deviation in approach.

Consolidated disclosures (such as those made at group-level) can help to reduce the risk of a 'siloed' approach to assessing climate-related risks and can help to avoid duplicative reporting and repetition. However, they can also reduce transparency on specific risks faced by the in-scope firm if they are described in 'net' terms in a consolidated report. Consequently, and in the interest of maximum transparency, it may also be sensible to include disclosures on material deviations in approach in the group-level/delegated report, as well as that of the in-scope entity.

IIGCC acknowledges and welcomes the FCA's efforts to avoid duplicative reporting by requiring a single set of disclosures for both institutional and retail clients, which should be accessible to a less technical audience. However, we would highlight that such an approach is likely to require trade-offs, which could lead to disclosures becoming over-simplified. This could reduce the usefulness of disclosures for institutional investors, who require more granular, technical information on climate-related risks and opportunities to inform their investment decision-making.

IIGCC notes that the benefits of the proposed flexibilities for in-scope firms may in practice be limited, as they will still be responsible for producing a compliance statement confirming that disclosures made in another report are consistent with the firm's own approach to the TCFD recommendations. This could raise some practical challenges, as in-scope firms would not be directly responsible for producing these reports, but will need to have sufficient visibility on/engagement with them, in advance of publication, to ensure they are accurate.

Consultation question 6: 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?

IIGCC broadly agrees with the FCA's proposals. However, the approach outlined by the FCA in relation to scenario analysis is less prescriptive than the rules that pension scheme trustees will need to adhere to under the DWP TCFD rules. Trustees will depend on the disclosures made by their asset managers in order to fulfil their own climate-related obligations. This includes scenario analysis, which trustees will need to undertake at least every three years under the DWP rules (including the first year the rules enter into force). The proposals in this consultation do not indicate how regularly in-scope firms will need to undertake scenario analysis. We acknowledge that proposals for in-scope firms to provide 'on demand' climate data to clients will mitigate this issue to some extent. Nevertheless, we believe it would still be helpful for the FCA to be more specific on expectations for in-scope firms with regards to scenario analysis, in order to uphold consistency with the DWP requirements. In addition, IIGCC recommends that the FCA provides clarity on the circumstances in which in-scope firms would be expected to review whether new scenario analysis is required (e.g. as a result of a material increase in the availability of data).

Where in-scope firms are seeking to align their portfolios with net zero, IIGCC encourages the FCA to reference the recommended disclosures established by the Paris Aligned Investment Initiative's

(PAII) Net Zero Investment Framework (NZIF).[5] These disclosures, which can be made in line with the TCFD reporting structure, are intended to support transparency over, and robust implementation of, net zero commitments. The recommended disclosures to be made under the TCFD's governance, strategy and management pillars can be found in the disclosure section of the NZIF.[6]

Consultation question 7: 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?

IIGCC broadly agrees with the FCA's proposed 'comply or explain' approach to climate target setting, which should help to support the transition to net zero.

IIGCC also notes the UK Government's legislative commitments to achieving net zero by 2050, and public commitments by many asset owners and managers to align their portfolios with net zero by 2050 or sooner. Through IIGCC, more than 110 investors representing $33 trillion AUM have contributed to the development of the NZIF to align their portfolios to the Paris Agreement. In addition, the establishment of the Net Zero Asset Managers Initiative (NZAM),[7] which currently has 128 signatories representing $43tn in AUM, further demonstrates the asset management sector's commitment to supporting the net zero transition.

Where in-scope firms are seeking to align their portfolios with the goals of the Paris Agreement, and net zero emissions specifically, IIGCC recommends disclosure against the following additional metrics and targets in line with the TCFD framework, as currently set out in the disclosure section of the PAII's NZIF:

- The targets, and metrics associated with these targets, as set out in the NZIF including:
  - Emissions reduction targets (Scope 1 and 2 emissions) covering listed equity, fixed income, real estate, expressed in absolute or intensity terms (CO_2e/£mn invested). Scope 3 emissions to be phased in over time and measured separately.
  - A target for increasing the percentage of AUM invested in assets in material sectors that are i) net zero, or meeting criteria to be considered net zero ii) 'aligned' to a net zero pathway iii) 'aligning' to a net zero pathway.
  - A target for allocation to climate solutions representing a percentage of revenues or capital expenditure (capex) from AUM. At present, the NZIF defines 'climate solutions' in accordance with the EU Taxonomy mitigation criteria. We note the UK Government's commitments to establishing a UK Green Taxonomy, driven by the Green Technical Advisory Group. Going forward, targets set by in-scope firms could leverage the criteria established by the UK Taxonomy.
  - A target for engagement to ensure at least 70% of financed emissions in material sectors are either net zero, aligned to a net zero pathway, or the subject of direct or collective engagement and stewardship actions.

[5] PAII Net Zero Investment Framework, available here.
[6] See page 23 of the PAII Net Zero Investment Framework.
[7] More information on NZAM, available here.

- A description of how these targets were calculated, and evidence and information that was used to inform the target setting process.
- The science-based scenario(s) or pathway(s) used to guide target setting and assess the alignment of companies, including the name of the relevant model(s), and critical assumptions used.
- The datasets or methodologies used to assess alignment of assets, and the extent to which these are consistent with the key features of the methodologies.
- Performance against targets over time, and any updates or adjustments to targets that are relevant.

IIGCC also stresses that the capacity of in-scope firms to set and monitor climate-related targets depends heavily on the quality, consistency and comparability of the disclosures made by investee companies. At present, there are a number of mismatches between the disclosure requirements established across the various UK TCFD-related initiatives (e.g. FCA rules for listed companies operating on a 'comply or explain' basis, and BEIS disclosures operating at the level of the 4 TCFD pillars, rather than 11 recommended disclosures). These inconsistencies could lead to reporting coverage gaps and insufficiently granular disclosures by companies, which in turn undermines investors' ability to assess climate-related risks and opportunities and develop robust, quantifiable and verifiable climate-related targets. As noted in our response to Q3, the FCA must collaborate with other governmental bodies and regulators to ensure this issue is managed.

Consultation question 8: 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?

In line with our response to Q5, IIGCC broadly agrees with the flexibility for AFMs to cross-refer to climate-related disclosures made by delegated managers. As noted previously, it will be critical to ensure that delegated disclosures accurately reflect the climate-related risks and opportunities that the in-scope firm is exposed to, with any material deviations from the in-scope firm's approach clearly explained.

Consultation question 9: 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?

IIGCC is in broad agreement with the proposals, but would reiterate the need for disclosures to remain understandable in their own context. For example, an FCA-regulated platform provider cross-referencing a multitude of asset managers' reports without providing users of the disclosures with a baseline level of information on the specific climate-related risks and opportunities the firm is exposed to would be unhelpful. While entity-level disclosures around governance, risk management and strategy could cross-reference other reports, asset owners should ensure they are publishing minimum aggregate disclosures at product-level to uphold transparency.

Consultation question 10: 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?

IIGCC supports the FCA's proposals to introduce TCFD disclosure requirements at the product-level. These disclosures will help to provide clients and consumers with specific, decision-useful information on the climate-related risk and opportunities that products/portfolios are exposed to, and how these risks and opportunities are identified and managed. However, as noted previously, there will be disparities in terms of data availability and quality between different asset classes that firms will need to navigate.

IIGCC agrees with the proposed requirements for in-scope firms to provide climate-related data and data on their underlying holdings on request. This should enable other actors across the investment chain (such as pension schemes) to meet their own TCFD-related disclosure obligations. However, as noted in our response to Q7, the ability of asset managers and asset owners to provide this data depends on the extent to which investee companies are also making consistent, comparable climate-related disclosures.

In addition, IIGCC would like to highlight the need to manage challenges stemming from mismatched sequencing between the FCA's timelines and those established under the DWP rules. As noted previously, trustees rely heavily on the data produced by in-scope firms to inform their own climate-related disclosures, and will need to publish TCFD reports from 2022 onwards. As in-scope firms will only be required to respond to data requests from 1 July 2023 under the proposals, the FCA should consider providing additional clarity/guidance on how these firms can support the flow of decision-useful information to these clients in the interim.

Consultation question 11: 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?

IIGCC broadly supports the proposed core metrics. Establishing an agreed suite of metrics across the industry will help to enable the disclosure of consistent, comparable and decision-useful information for clients and consumers.

IIGCC recognises the value of weighted average carbon intensity (WACI) as a core metric, noting that it is an established metric under the TCFD recommendations, and aligns with the optional emission intensity metric under the DWP's statutory TCFD guidance. However, there remain a number of outstanding challenges with its use. For example, WACI has limited applicability across the range of asset classes that are within scope of PAII, does not calculate ownership of emissions, and cannot assign responsibility for emissions to investors. As this is a requirement for understanding and measuring an investor's contribution to net zero goals, as set out in the NZIF, IIGCC believes that an enterprise value including cash-based (EVIC) carbon footprint metric is the more appropriate core metric. Establishing an EVIC-based carbon footprint metric as the single core emissions-intensity metric would promote greater standardisation of disclosures, aligning with the recommended emissions intensity metric under the DWP's statutory TCFD guidance, as well as the approach taken under the EU's Sustainable Finance Disclosure Regulation (SFDR). It should also be noted that the TCFD itself is considering EVIC as a recommended approach for reporting financed emissions, based on the methodology established by the Partnership for Carbon Accounting Financials (PCAF), the leading standard setter for emissions reporting within the financial sector.

IIGCC believes it would be beneficial for the FCA to reference additional metrics and targets for investors seeking to align their portfolios with net zero. At present, the proposed metrics focus solely on portfolio carbon emissions, but in order to reach net zero, investors will also need to increase the allocation of capital to climate solutions which support the transition to a carbon

neutral economy. IIGCC therefore recommends that the FCA references the additional metrics and targets aligned with the PAII's NZIF, per our response to Q7.

More broadly, it would be helpful if the FCA provides guidance on how firms can articulate the purpose of the proposed metrics, and how these metrics should be interpreted, in order to increase understanding of the climate-related impacts of products/portfolios and to support effective decision-making. Qualitative explanations with regards to the purpose and nature of the metrics will be essential to avoid presenting a distorted picture of the metrics to clients and consumers. For example, with regards to WACI, portfolios investing in smaller, innovative companies that support the transition to net zero, but which generate comparatively less revenue, may appear to be poor performers when assessed against a WACI metric. Conversely, where market prices for products/services generated by companies in carbon-intensive sectors increase, revenue growth could lead to falling carbon intensity independent of any change in business practice or strategy. Carbon footprint metrics can also be misinterpreted without appropriate contextual information (e.g. carbon-intensive companies with high valuations could appear more sustainable than small or mid-cap stocks with lower valuations but with less carbon-intensive business models).

Finally, IIGCC reiterates that the ability of asset managers and asset owners to calculate these core metrics will depend on the extent to which standardised, high-quality data is made available by investee companies. Until this information is disclosed on a sufficiently widespread basis, the reliability and credibility of the core metrics could be compromised, which reduces their decision-usefulness for clients and consumers. Moreover, in the absence of such data from companies, investors will continue to rely on proxy data and estimates, which as we noted in our response to Q4, presents similar challenges. IIGCC therefore suggests that the FCA introduces flexibility for in-scope firms to calculate these metrics 'as far as they are able' until the availability of TCFD data improves. This approach would acknowledge the transitional challenges investors face in obtaining relevant data from investee companies, particularly with regards to smaller AIM-listed and growth companies that aren't presently in scope of the TCFD roadmap, as well as companies in jurisdictions which are not yet mandating TCFD-aligned disclosures.

Consultation question 12: 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.

IIGCC agrees with the FCA's proposals. While the requirement for firms to calculate the formulas under both the TCFD and SFDR regimes will introduce a layer of operational complexity, it will also enable clients to compare and assess data across their UK and EU-based products and portfolios, and support greater international consistency.

The usefulness of the proposed metrics will depend on the extent to which the methodologies that underpin them are comparable with those used by other organisations across the investment chain, including pension schemes. IIGCC is concerned that the formulas set out in column A do not align with the recommended methodologies set out in the DWP's statutory TCFD guidance, which could lead to in-scope firms reporting data to pension scheme clients which is not sufficiently comparable. For example, under the proposed carbon footprint metric, the formula in column A leverages issuer market capitalisation, whereas DWP recommends the use of EVIC (which also aligns with the calculation under Column B, as the definition of enterprise value under SFDR does not deduct cash

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or cash equivalents). We suggest that the FCA reviews these formulas in order to ensure they are aligned across regimes and uphold consistency and comparability.

Consultation question 13: 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:

- *The TCFD Final Report and TCFD Annex in their updated versions, once finalised;*
- *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?

IIGCC agrees that it would be appropriate for the FCA to reference the updated TCFD Final Report, Annex, and proposed guidance, to the extent that the proposals align with those put forward in this consultation.

As part of our response to the June 2021 TCFD consultation on metrics, targets and transition plans,[8] IIGCC and its members raised a number of concerns with regard to the proposed metrics and targets, as well as the supplementary guidance for financial services firms. We outlined these concerns below for the FCA's consideration.

With regards to the proposed cross-industry climate metrics, IIGCC's key concern related to their high-level nature, which provides excessive flexibility for companies to interpret and calculate them in a variety of ways. In order to effectively operationalise the proposed metrics, it will be essential for standard setters to build on the proposals by introducing consistent, standardised methodologies for calculating them.

IIGCC's TCFD consultation response also emphasised the need for a differentiated approach between the metrics and targets to be developed and disclosed by investors (e.g. firms in scope of this FCA consultation) in relation to portfolio alignment, and those to be made by companies in order to support investors' assessments of current and forward-looking alignment of their holdings. The proposed metrics in the TCFD consultation have been developed on a cross-industry basis, and do not sufficiently distinguish between the relevance of the metrics and targets for investors and companies respectively.

With regards to the proposed technical supplement on measuring portfolio alignment, IIGCC agreed with the 7 criteria proposed by the Portfolio Alignment Team. However, we are cautious about the continued expectation that implied temperature rise metrics are the most optimal portfolio alignment metrics, given the current challenges associated with such a methodology. Our preference is to focus on alignment against net zero emissions rather than a temperature metric, because net zero emissions by 2050 is a clearer and more specific goal, and greater transparency against this goal is possible compared to temperature metrics. While in theory, a temperature metric is an attractive option to express portfolio alignment, there are concerns as to whether portfolio performance can be summarised into a single temperature metric (e.g. 1.5°C, 2°C) in a technically robust way that

[8] IIGCC response to TCFD public consultation on metrics, targets and transition plans/technical supplement on measuring portfolio alignment, available here.

avoids producing misleading results. However, IIGCC acknowledges that forward-looking assessments of alignment for assets and measuring portfolio performance are critical for achieving the transition to net zero, and we support continuing efforts to develop recommendations in this area.

Consultation question 14: Do you agree with our approach to additional metrics and targets? If not, what alternatives would you suggest and why?

IIGCC welcomes the FCA's efforts to promote the use of forward-looking metrics that support assessments of the alignment of assets, and enable investors to allocate capital and undertake engagement in a way that drives the transition to net zero in the real economy. IIGCC also supports the proposals to calculate these additional metrics on a 'best efforts' basis, which recognises that methodologies and best practice for calculating these metrics are still developing. We have provided more detailed feedback on the additional metrics proposed by the FCA below.

- Climate Value-at-Risk (VaR) – IIGCC recognises the value of forward-looking impact metrics such as climate VaR to assess potential future financial impacts of physical and transition risks on a portfolio/product. However, we would welcome additional clarity on the proposed methodology for calculating this metric, which has not been directly addressed in existing TCFD guidance, nor the recent TCFD consultation on climate-related targets, metrics and transition plans. In addition, we would also highlight climate-adjusted probability of default (PD) as another complementary metric for assessing the credit impact of physical and transition risks.
- Implied temperature rise (ITR) metrics – IIGCC is cautious about encouraging ITR metrics as a tool for measuring portfolio alignment. This is due to the challenges associated with expressing the nuance of alignment credibly in a single temperature metric, as well as current limitations of underlying data and existing methodologies, all of which risk misleading users of disclosures until these challenges are resolved. As noted above, our preference is to focus on alignment against net zero emissions rather than a temperature scenario, on the basis that net zero emissions by 2050 is a clearer and more specific goal. However, IIGCC remains committed to supporting the future development of forward-looking alignment metrics for portfolios, and we stand ready to engage with the FCA on this issue going forward.

IIGCC notes that under the DWP proposals, trustees are recommended to report against a minimum of one additional climate change metric as part of their TCFD reporting, namely Climate VaR, ITR, and/or a data quality metric. Given current challenges around data availability and quality, which are well noted in the consultation, we suggest that the FCA considers including data quality as an additional metric. This would also align the proposals more closely with the requirements faced by pension scheme trustees.

In addition, where firms set climate-related targets at the product-level, and are seeking to align their products with net zero, IIGCC recommends disclosing against the metrics and targets set out in the PAII's NZIF, in line with our response to Q7. These metrics and targets take account of the need to support the transition to net zero by driving emissions reductions in the real economy and increasing investment in climate solutions.

Consultation question 15: 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?

IIGCC supports the FCA's efforts to ensure consistency between the scenario analysis requirements for in-scope firms and the requirements for pension schemes under the DWP rules. However, as noted in our response to Q6, we recommend that the FCA clarifies how frequently in-scope firms will need to undertake scenario analysis, and the circumstances under which fresh analysis should be considered in intervening years. Overall, the proposed approach strikes an appropriate balance between supporting the information needs of trustees, while also remaining proportionate for firms. As capabilities in this area continue to evolve, and in light of the growing range of resources and third-party service providers, more firms will be able to move from qualitative analysis to more sophisticated quantitative analysis over time.

IIGCC supports proposals to require firms with concentrated exposures to carbon-intensive assets to undertake quantitative analysis as soon as practicable. We understand the rationale for the FCA's decision to avoid being overly prescriptive in defining thresholds for 'concentrated' or 'higher' exposures to carbon-intensive sectors, which could create unintended incentives for divestment. However, we feel it would still be helpful to provide guidance that enables asset owners and asset mangers to determine what sectors/holdings should be considered carbon-intensive. For example, under NZIF, investors are expected to assess their 'high impact' investee companies against a number of current and forward-looking alignment criteria that constitute a net zero transition plan. NZIF defines high impact companies as those on the CA100+ list, as well as those operating in sectors consistent with the Transition Pathway Initiative (TPI) sectors.[9]

In line with our response to Q6, IIGCC recommends that firms seeking to align their portfolios with net zero should explicitly include a 1.5-degree scenario as part of their analysis. We would draw attention here to the recent International Energy Agency (IEA) Net-Zero Emissions Scenario,[10] which provides a wealth of data that can help firms to assess the implications of a 1.5-degree transition pathway on key macro variables (e.g. carbon pricing) as well as the energy sector specifically and key end use sectors (e.g. Auto, Steel).

Finally, and consistent with our previous responses, IIGCC emphasises that the ability for asset owners and asset managers to undertake scenario analysis will depend on the extent to which investee companies are providing decision-useful, comparable information to support these disclosures. For example, the recent BEIS consultation to extend TCFD disclosures to a wider range of public and private companies does not include proposals to require in-scope firms to undertake scenario analysis. While such disclosures remain voluntary, it will be challenging for investors to provide this information in a comprehensive way. We therefore suggest that the FCA introduces these requirements on an 'as far as able' basis until the availability of data from investee companies increases.

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[9] See Appendix B of NZIF for more information, available here.

[10] IEA's Global Roadmap to Net Zero Emissions by 2050, available here.

Consultation question 16: 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?

IIGCC supports scenario analysis as an essential tool for asset managers and owners to assess, manage and report on their portfolios' exposure to physical and transition risks (as well as capturing emerging climate-related opportunities). However, in order to support effective decision-making, it is critical to ensure that the results of scenario analysis are interpreted in a holistic manner, particularly in relation to the net zero transition. For example, firms may be investing in transitioning companies that may not be presently aligned with the objectives of the Paris Agreement, but it is essential that companies with credible transition pathways have access to capital to support their progression towards more sustainable business models. The results of scenario analysis could be distorted, and potentially create unhelpful incentives for divestment, unless scenario analysis takes account of the projected downward emissions trends of these transitioning companies.

Consultation question 17: 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?

IIGCC agrees with the provisions for certain firms to provide on-demand product reports to clients. The proposals recognise that clients need full transparency over the exposure of portfolios to climate-related risks and opportunities, and should also enable clients to meet their own climate-related reporting obligations. The approach also correctly recognises that public disclosures in respect of certain products/activities (e.g. segregated mandates and discretionary portfolio management services) will not be appropriate.

Consultation question 19: 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?

IIGCC agrees with the proposed approach.