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Association for Financial Markets in Europe

Response to FCA consultation paper on climate-related disclosures by standard listed companies and select ESG topics in capital markets

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Introduction

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to respond to FCA Consultation Paper 21/18 on Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets (the "Consultation Paper"). We set out below our responses to the questions raised in the Consultation Paper.

Proposals to extend climate-related disclosure requirements for certain standard listed companies

Q1: Do you agree with our proposal to extend the application of our existing TCFD-aligned disclosure requirement (set out in LR 9.8.6R(8)) to issuers of standard listed equity shares, excluding standard listed investment entities and shell companies? If not, what alternative scope would you consider to be appropriate, and why?

AFME welcomes the FCA's initiative to enhance climate-related disclosures and agrees with the proposal to extend the application of the existing TCFD-aligned disclosure requirements beyond premium listed commercial companies to issuers of standard listed equity shares, excluding standard listed investment entities and shell companies.

This initiative has the potential to greatly improve the quantity and quality of climate-related financial disclosures, a key enabler of the financial sector's role in mobilising capital to support the transition to net-zero carbon emissions. We especially welcome that, in introducing TCFD-aligned disclosure rules in the Listing Rules, the focus remains on the corporate entity itself, rather than on the securities that it issues, as this approach improves the availability of key entity-level metrics and targets. Figure 1 set out in the Consultation Paper portrays effectively how the proposal will help enhance market integrity, help financial services firms' develop products that better meet consumers' climate-related preferences, and mitigate the risk of consumers' buying unsuitable products.

For UK-headquartered groups, we consider that disclosure should apply only at the consolidated group level and that there should not be a separate disclosure requirement at subsidiary level. This approach would be consistent with the recent BEIS consultation process on proposed TCFD-aligned disclosures for certain UK companies and LLPs.

Q2: Do you consider that issuers of standard listed GDRs and standard listed issuers of shares other than equity shares should also be subject to our TCFD-aligned disclosure requirements? If not, what alternative approach would you consider to be appropriate, and why?

We believe that issuers of standard listed GDRs should also be subject to the TCFD-aligned disclosure requirements, as GDRs are traded as domestic shares. As above, for UK headquartered groups, we consider that disclosure should apply only at the parent company level and that there should not be a separate requirement at subsidiary level.

However, we believe that the inclusion of companies issuing only shares other than equity shares would be disproportionate and only accompanied by marginal improvements to climate-related disclosures. As the TCFD recommendations apply at the entity-level, rather than to the securities, the rules would not be proportionate to the level of economic activity undertaken by a third-country firm and the level of trading activity of shares other than equity shares listed in the UK. In addition, under the FCA's approach, all companies within a listing category should be subject to the same rules irrespective of where they are headquartered. For a large number of firms, including those headquartered outside the UK which issue shares other than equity shares directly through their parent undertakings, the climate-related disclosure requirements will then apply to the group consolidated reporting for their entire group operations, including in third countries where the adoption of the TCFD's recommendations is still sporadic. We therefore believe that standard listed issuers of shares other than equity shares should remain outside of the scope of the requirements.

Q3: We welcome views from market participants on whether to apply TCFD-aligned disclosure rules to issuers of standard listed debt (and debt-like) securities, and how best to do this. In particular, we seek input on the following:

a. ***What climate-related information from issuers of these securities would market participants find decision useful and how far would these information needs be met by TCFD aligned disclosures?***

b. ***Do market participants' information needs differ according to the different types of issuer in LR 17?***

c. ***If you consider that we should apply TCFD-aligned disclosures rules to issuers of standard listed debt (and debt-like) securities, should some issuer types be excluded from the rule to deliver an effective and proportionate approach? If so, which types of issuers should be included/excluded and how can the scope best be defined?***

d. ***Are there any other matters we should take into consideration – e.g., competitiveness, complexity of the application of the rule, burden on issuers in LR 17, or the feasibility to comply with any potential rules?***

We do not support the application of TCFD-aligned disclosure requirements for issuers of standard listed debt or debt-like securities and consider that the scope should be limited to standard listed equity shares and GDRs.

As the TCFD recommendations apply at the entity-level, rather than to the securities, we are concerned that extending the application to issuers of listed debt securities would be disproportionate, in particular for issuers based outside the UK. For many firms, including those headquartered outside the UK which issue debt directly through their parent undertakings, the climate-related disclosure requirements would then apply to the group consolidated reporting for their entire group operations, including in third countries where the adoption of the TCFD's recommendations is still sporadic.

We therefore believe that standard listed issuers of debt or debt-like securities should remain outside of the scope of the requirements. The inclusion of such issuers in the scope of the requirements could dissuade international issuers from issuing listed debt in the UK and thereby impact the competitiveness of the UK debt markets.

Q4: Do you agree with our proposal to mirror the structure and wording of LR 9.8.6R(8) and LR 9.8.6BG to LR 9.8.6EG for companies with a UK premium listing? If not, what alternative approach would you consider to be appropriate, and why?

Yes we agree with the proposed approach and support the consistency of requirements for companies within the revised scope.

Q5: Do you agree that, subject to the TCFD's final guidance materials being broadly consistent with those proposed, we should incorporate them into our existing and proposed handbook guidance provisions as described (including both the existing guidance relating to LR 9.8.6R(8) and our proposed new guidance relating to LR 14.3.27R):

a. ***the TCFD's proposed updates to the TCFD Final Report and TCFD Annex***
b. ***the TCFD's proposed standalone guidance document on metrics, targets and transition planning***
c. ***the TCFD's technical supplement on measuring portfolio alignment.***

If not, what alternative approach would you prefer?

We generally agree that the clarification of TCFD metrics is helpful where it would increase the consistency of corporate and financial institutions disclosures. For these disclosures to be meaningful, this is predicated upon the timely availability of high quality data that must be consistent and comparable. While we broadly support aspects of the proposed disclosure guidance e.g. climate-related metrics, and believe that these will add value over time, there needs to be a clearly defined implementation timeline, particularly given the binding status that the requirements are rapidly acquiring. This should allow for reliable, high quality data to become available and facilitate meaningful industry disclosures.

Overall, data remains a significant challenge, in particular where there is reliance on obtaining this from banks' clients. Since the TCFD issued its final report in 2017, significant progress has been made in several areas. While some metrics have matured, others are nascent and yet to be disclosed on a consistent basis across the market. Some such examples include:

- Forward-looking climate-related metrics: these are particularly challenging and institutions would benefit from guidance to ensure consistency of preparation; and
- Carbon price(s) (external and shadow/internal): there is no established market and methodologies are inconsistent.

Given the above, significant data gaps need to be addressed and standardised methodologies need to develop before such metrics can be widely used. This would promote consistency and better comparability of disclosures. As such, we recommend an incremental approach to climate-related metrics, whereby those at a mature stage of development are implemented first. In contrast, those metrics and financial impacts that are at an earlier stage of development, should not be made mandatory at this stage and should be introduced later as data availability improves in the market. There is also a need to highlight any potential risks associated with data accuracy as new metrics embed. To that end, we would recommend explicit requirements for disclosure commentary outlining any limitations in data and methodologies in preparing disclosures.

It may make sense to extend the application date by one year to move to the alignment metrics, reporting only for FY2023 in 2024. This would, for example, align with plans in Switzerland for TCFD implementation across the real economy.

Q6: Do you agree that we should update the Technical Note 801.1 to reflect the proposed new rule and associated guidance in this CP?

Yes we agree that the Technical Note should be updated to reflect the new rule and associated guidance.

Q7: Do you agree with our encouraging listed companies to consider the SASB metrics for their sector when making their disclosures against the TCFD's recommended disclosures, as appropriate? If not, please explain.

There are a number of frameworks such as, CDP, GRI, IIRC and SASB, within the industry that are either adopted or in the process of being adopted for disclosures. A significant amount of effort has already been invested in coming up with the relevant topics supported by investor outreach amongst other stakeholders.

The standards need to be internationally applicable. As an example, at present many of the SASB metrics are US-centric and therefore for the suitability standards to be adopted globally, metrics need to be relevant across jurisdictions.

As the FCA notes, work continues to develop a common international reporting standard for sustainability with both the IFRS Sustainability Standards Board (ISSB) working towards a baseline international reporting standard on sustainability, and the forthcoming TCFD guidance on metrics, targets and transitional planning, these are expected to provide the specificity and granularity towards consistent and comparable disclosures.

We therefore consider that it would be preferable to keep the requirements limited to TCFD, at least at this stage, rather than introducing new metrics into TCFD. This would be aligned with the approach of other jurisdictions and we believe that it is best to wait for the outcome of the work of the IFRS Sustainability Standards Board to improve international consistency.

Q8: Do you agree with our approach to maintain a 'comply or explain' compliance basis until such time as a common international reporting standard has been published and adopted in the UK? If not, what alternative approach would you prefer, and why?

As noted in the Consultation Paper, while voluntary adoption of the TCFD's recommendations continues to increase, disclosures remain incomplete and quality remains variable across companies. To improve consistency, comparability, and the availability of sustainability information, and to stimulate companies under the scope of the requirements to mobilize resources towards sustainability reporting, the FCA should aim to make TCFD-aligned disclosures mandatory, subject to a materiality assessment. We generally consider that 'materiality' be assessed as the threshold at which ESG issues become sufficiently important to investors and other stakeholders that they should be publicly reported. This view is informed by both stock exchange listing rules and views of stakeholders.

As proposed by the FCA, these mandatory requirements should be limited to the *existing* disclosures, as the TCFD is still in the process of reviewing its proposed guidance on climate-related metrics, targets, and transition plans and the associated technical supplement on measuring portfolio alignment following the feedback received from stakeholders to the consultation ended in July 2021. If adopted, some of the proposals under consultation, such as the forward-looking portfolio-alignment metrics, may still be subject to significant variance in both methodologies and outcomes. As a result, granular disclosures may not meet high enough standards to be considered fair, clear and non-misleading.

The FCA should ensure proportionality of the reporting burden - especially for SMEs, for which a comply or explain approach should be maintained. We also note the FCA's support, both individually and through IOSCO, to the IFRS Foundation's initiative to establish an International Sustainability Standards Board (ISSB). Subject to the outcome of the ISSB's work, UK's climate-reporting frameworks should remain flexible to accommodate future international sustainability reporting standards. There is, however, a core set of metrics that companies are able to calculate with high accuracy and low cost, and users are able to interpret correctly, such as Scope 1 and Scope 2 GHG emissions. We believe that the FCA could consider making reporting on those metrics mandatory across the economy. For other proposed metrics, we would support a flexible disclosure framework that reflects the materiality of climate change risks. Alternatively, provide a qualitative explanation as to why the information is deemed immaterial (i.e. comply or explain basis).

Q9: Do you agree with our approach not to require third party audit and assurance for issuers' climate-related disclosures at this time? If not, what additional requirements would you consider to be appropriate?

We believe that third-party assurance is a critical component for an effective climate-related reporting framework. Assurance helps enhance the quality and credibility of the information reported by issuers and, in turn, by financial products' manufacturers and distributors. As a result, it would mitigate the risks of greenwashing and mis-selling. Further, financial institutions cannot be held accountable for publishing and assuring information that their clients are not themselves required to publish and assure. We therefore support the FCA's ongoing monitoring of developments and keeping their position on audit and assurance under review until the formal corporate reporting standard being developed by the IFRS Foundation is in place that would likely form the basis for an appropriate audit and assurance.

'Limited' assurance would be the most appropriate at this stage, given the current level of maturity in sustainability reporting practices and the capacity of auditing firms. We consider that seeking to obtain reasonable assurance might only be attainable and justifiable for quantitative data, where defined and established methodologies/criteria are in place for collecting and reporting such information (e.g. Scope 1 and Scope 2 GHG emissions). However, we would strongly support that the quality of information, especially regarding quantifiable and measurable data, is improved and standardised as a first step, consistently with the objectives of extending the application of existing TCFD-aligned disclosure requirements. In this respect, we note that it would not be possible to achieve 'reasonable' assurance where reported information is, for instance, largely provided based on a combination of actual data and estimations. Although the objective is to have a similar level of assurance for financial and sustainability reporting, a progressive approach is needed.

We therefore recommend that the FCA establish a clear roadmap for the introduction of a 'limited' assurance requirement, followed by a 'reasonable' assurance requirement at a later stage. Such roadmap would increase certainty in the market and ensure the preparedness of preparers, users and verifiers alike.

Q10: Do you agree that our new rule should take affect for accounting periods beginning on or after 1 January 2022? If you consider that we should set a different timeframe, please explain why.

AFME supports the urgency of the need for enhanced climate-related disclosures and supports the FCA's proposal to make the new rule effective for accounting periods beginning on or after 1 January 2022. We agree with the views on timing expressed in the consultation paper that any delay to implementing the proposed rule would not be in the public interest and would fail to acknowledge growing demand among market participants for this information. Maintaining a 'comply or explain' compliance basis would also ease the implementation of the new rules. At the same time, in the response to Question 8, we encourage the FCA to consider introducing mandatory climate-related disclosure requirements on a core set of metrics including Scope 1 and Scope 2 GHG emissions. In this case, we believe it would be important to ensure a sensible sequencing for the introduction of the new rules.

First, the proposal should not underestimate the significant challenges for SMEs captured by an expansion of the scope to issuers of standard listed equity shares, with fewer resources and engagement tools to collect the necessary climate-related information. For smaller standard listed companies, the proposal should foresee a phased approach to the introduction of mandatory climate-related disclosures by maintaining a 'comply or explain' compliance basis for at least the first two accounting periods after 1 January 2022.

Secondly, the proposal should address the needs of financial institutions as both users of corporate reporting and preparers of climate disclosures on their own exposures, making a distinction between the requirements for the financial sector vis-à-vis those for the non-financial sector. As sustainability information flows from non-financial corporates to financial institutions - which incorporate climate risk considerations into their risk investment, products and reporting - the sequencing of disclosure requirements should recognise financial market participants' as well as ESG data providers' need for reliable information reported by issuers. The timing of the FCA's proposal should therefore ensure that financial institutions are required to report climate-related information on their own exposures only 12 months following the reporting completed by their non-financial counterparties (i.e., for accounting periods beginning on or after 1 January 2023). This intermediate period would allow financial institutions to obtain access to and process the data disclosed by borrowers and investee companies, thus ensuring the accuracy and consistency of their own disclosures.

Q11: Do you agree with the conclusions and analysis set out in our cost benefit analysis (Annex 2)?

We have no comments in response to this question.

Discussion topics on ESG integration in UK capital markets

Q12: If future changes were considered in relation to the UK prospectus regime, we would welcome views on also taking the opportunity to introduce specific requirements in relation to UoP bond frameworks and their sustainability characteristics?

Q13: Should the FCA explore supporting the UoP bond market by recognising existing standards (e.g., ICMA Principles), potentially through our recognition of industry codes criteria and process?

Q14: We would also welcome views on more ambitious measures the FCA could consider, for example to require that the central elements of UoP bonds be reflected in contractual agreements and set out in the prospectus.

Q15: We would welcome views on the potential harm set out above and what, if any, actions the FCA or the Treasury should consider.

AFME is not responding to questions 12 to 15. We would direct the FCA to the response submitted by ICMA with respect to these questions.

Q16: Should the FCA, alongside the Treasury, consider the development and creation of a UK bond standard, starting with green bonds?

At this stage, we do not see merits for the FCA, alongside the Treasury, to consider the development and creation of a UK green bond standard. AFME has followed closely the market's adoption of industry-led initiatives such as the ICMA Principles, as well as the development of the proposal for an use-of-proceeds EU Green Bond Standard based on the EU Taxonomy Regulation. In this landscape, we have seen a positive response from the market and continue to observe a steady growth in the issuance of ESG and green bonds in the UK and the EU[1]. We believe that the development and creation of any UK green bond standard should be compatible with existing initiatives, and based on the use cases to be identified for the Green Taxonomy for the UK being developed by the Green Technical Advisory Group (GTAG) appointed by the Treasury.

Q17: Do you agree with how we have characterised the challenges and potential harms arising from the role played by ESG data and rating providers? If not, please explain what other challenges or harms might arise?

Q18: Would further guidance for firms on their use of ESG ratings – and potentially other third-party ESG data – be useful, potentially clarifying expectations on outsourcing arrangements, due diligence, disclosure and the use of ratings in benchmarks and indices? Are there other aspects such guidance should include?

The use of ESG ratings and data products has grown considerably as investors' focus on ESG matters continues to increase and financial institutions face increasing sustainability disclosure requirements. We therefore support the FCA's consideration of ESG data and ratings. We generally agree with the challenges and potential harms identified in the Consultation Paper.

We note that the FCA is participating in the IOSCO workstream which is assessing these issues. We are providing input in response to the IOSCO consultation on ESG ratings and data products providers[2] through the Global Financial Markets Association (GFMA). We encourage the FCA to continue to participate in the IOSCO discussions and reflect on the outcome of the IOSCO recommendations once these are finalised. We will separately share our GFMA response to the IOSCO consultation which sets out our views on these issues.

[1] AFME European ESG Finance Quarterly Data Report: Q2 2021
[2] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD681.pdf

Q19: We would welcome views on whether there is a case either to encourage ESG data and rating providers to adopt a voluntary Best Practice Code, or for the FCA to engage with the Treasury to encourage bringing ESG data and rating providers' activities inside the FCA's regulatory perimeter.

Considering the increased regulatory demand for ESG data, AFME supports the development of a voluntary Best Practice Code which aims to enhance transparency and improve the comparability, quality and reliability of ESG data and ratings. We also support consideration of an extension to the FCA's regulatory perimeter to cover ESG data and ratings providers. The comparability, quality and reliability of ESG data from ESG providers currently available in the market could be increased by improving the level of transparency of rating methodologies and data processing. Supervision of ESG service providers would ensure that high integrity standards are implemented consistently across the market, and that financial and non-financial companies can rely on comparable data to meet the new disclosure requirements.

However, given the benefit in an international approach to these issues, we welcome the recent IOSCO work in this area and encourage the FCA to reflect further on the IOSCO recommendations once finalised.

Q20: If there is a case for closer regulatory oversight of ESG data and rating providers, we welcome views on:

- ***Whether transparency, governance and management of conflicts of interest are the right aspects of ESG data and rating providers' operations and activities to prioritise in regulatory oversight, and if not, what other aspects should be considered***
- ***Whether and how regulatory priorities should differ between ESG rating providers and other ESG data providers***
- ***The similarities and differences between the policy issues that arise for ESG rating providers and those that arise for CRAs, and how far these similarities and differences might inform the appropriate policy response***

We agree that transparency, governance and management of conflicts of interest are the right aspects to focus on. As discussed above, we welcome the FCA's continued involvement in the IOSCO work in this area and support the FCA reflecting on the outcomes of the current IOSCO draft recommendations on ESG ratings and data providers. We agree that since ESG rating providers operate and cover companies globally, there would be a strong benefit in a globally applicable regulatory approach, rather than proceeding now with a domestic regime.

Q21: What other ESG topics do you consider that we should be prioritising to support our strategic objective? Please explain.

We recommend that the FCA consider how it can leverage technology to enhance the usability of sustainability data[3]. For example, we welcome the proposal in the proposed EU Corporate Sustainability Reporting Directive (CSRD) specifying the format for reporting and require companies to categorise this information according to a digital system to be developed alongside the sustainability reporting standard. Digitalisation of sustainability

[3] As also proposed in the Kalifa Review of UK Fintech report, February 2021

data has the potential to reduce reporting costs, improve ease of access to information and support comparability.

We would be happy to discuss these issues further or answer any questions regarding our response.

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