Financial Regulatory Alert

Akin Gump
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UK Proposes New Climate-related Disclosure Rules for Asset Managers

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The proposed disclosure rules applicable to UK investment managers have been published for comment by the UK's Financial Conduct Authority (FCA). The rules focus on enhancing transparency on climate-related risks and align the disclosure requirements with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). The proposed new disclosure requirements for investment managers were published at the same time as the proposal to extend certain climate-related disclosure requirements to issuers of standard listed equity shares (excluding shell companies and investment entities).

The proposed disclosures are expected to be made with respect to the manager and each of the manager's funds or other products, similar to the disclosure requirements under the Sustainable Finance Disclosure Regulation (SFDR). The proposed requirements are focused on disclosure of relevant climate-related risks and of the manager's climate-related risk management arrangements.

Background

In November 2020, the UK Chancellor of the Exchequer announced that, following the end of the Brexit Transition Period, the UK would not be adopting the EU's environmental, social and governance disclosure regime for asset managers, but rather, the UK would implement its own disclosure regime focusing on climate change.[1] In particular, the government committed to aligning its regime with, and in some cases going beyond, TCFD.

In relation to the asset management sector, the UK FCA is responsible for developing the rules to fulfil the government's policy in this area. In this regard, the FCA has now published a Consultation Paper entitled "Enhancing Climate-Related Disclosures by Asset Managers, Life Insurers and FCA-Regulated Pension Providers",[2] which sets out its proposed rules.

Timing

The FCA plans for the new rules to come into effect in two stages:

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- For asset managers with more than £50 billion assets under management (AUM), the rules would come into effect from 1 January 2022, with the first publication of reports due by 30 June 2023.
- For asset managers with more than £5 billion AUM but less than £50 billion, the rules would come into effect from 1 January 2023, with the first publication of reports due by 30 June 2024.

Firms and individuals have until September 10, 2021 to respond to the FCA's Consultation Paper.

Disclosure requirements

The proposed disclosure requirements are broadly summarised below.

General

- The disclosure rules are proposed to apply to all FCA-authorised investment managers in relation to their "TCFD in-scope business". In practice, this means that, in addition to FCA-authorised investment managers, the rules are also proposed to apply in certain limited circumstances to investment advisers.[3]
- As relevant to investment managers (and, in limited circumstances, certain advisers), "TCFD in-scope business" constitutes the provision of the following services: (i) portfolio management (with an extended definition, see below), (ii) UK Undertakings for the Collective Investment in Transferable Securities (UCITS) management and (iii) Alternative Investment Funds (AIF) management.
- "Portfolio management" for these purposes includes advising or managing investments on an ongoing basis in connection with an arrangement, the predominant purpose of which is investment in unlisted securities. The FCA's intention here is to bring within the scope broader asset management activities carried out, particularly in a group context, by private equity investment advisers and similar.
- Firms will be exempt from compliance "*if and for as long as the assets under administration or management in relation to its* [portfolio management/UK UCITS management/AIF management scope business] *amount to less than £5bn calculated as a 3-year rolling average, on an annual assessment*".[4]
- The FCA's proposed rules are generally mandatory, with certain disclosures required to be made on a "best efforts" basis.
- In general, two types of report are going to be required: "Manager Reports" (which relate to the regulated firm itself), and "Product Reports" for each of the firm's products.
- Both the Manager Reports and the Product Reports are expected to comply with the TCFD's Recommendations and Recommended Disclosures and the associated Implementation Annex.

Manager Reports

- In respect of the Manager Reports, this will require disclosures relating to:

- Governance issues (including describing (i) the board's oversight of climate-related risks and opportunities and (ii) management's role in assessing and managing climate related risks and opportunities.
- Strategy (including describing (i) the climate-related risks and opportunities the organisation has identified over the short, medium, and long term, (ii) the impact of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning, (iii) the resilience of the organisation's strategy, taking into consideration different climate related scenarios including a 2°C or lower scenario, and (iv) how this strategy has influenced decision-making and processes for delegating functions).
- Risk Management (including describing (i) the organisation's processes for identifying and assessing climate related risks, (ii) the organisation's processes for managing climate-related risks; and (iii) how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management).

- As part of making these disclosures, a firm will also have to provide "climate-related scenario analysis". The firm will have to explain its approach to climate-related scenario analysis, and how the firm applies scenario analysis in its investment and risk decision making process. Where "reasonably practicable", a firm must provide quantitative examples to demonstrate its approach to climate-related scenario analysis.
- Whilst the TCFD's Recommendations also require reporting on Metrics and Targets, the FCA is currently proposing that firms will only have to make these reports on a "comply or explain" basis.
- The Manager Report will require certification by a senior manager confirming the report's compliance with the FCA's rules.

Product Reports

- In relation to Product Reports, firms will be required to publish these annually. However, firms may also be required to provide details to clients "on demand" if this permits the client in question to comply with its own disclosure obligations under UK or third country rules.
- Where the Governance, Strategy and Risk Management descriptions for a particular product are "materially different" from the firm's overarching descriptions in the Manager Report, the appropriate descriptions for the product in question must be provided.
- The Product Reports will have to be compiled using certain specified metrics, including in relation to particular types of greenhouse gas emissions and carbon emissions. The report will also have to include – on a best efforts basis – calculations for the product of the climate Value-at-Risk, metrics that show the climate warming scenario with which the product is aligned, and any other metrics the firm thinks an investor would find useful.
- In relation to scenario analyses, a Product Report will have to provide (i) a qualitative summary of how climate change is likely to impact the assets underlying the relevant product under certain specified climate-change scenarios (an "orderly transition" scenario, a "disorderly transition" scenario and a "hothouse world"

scenario); and (ii) a discussion of the significant drivers of impact on the particular product.

- Where a product has a concentrated exposure or high exposure to carbon intensive sectors, the Product Report will also have to include a quantitative analysis under certain specified climate change scenarios.

[1] https://www.gov.uk/government/news/chancellor-sets-out-ambition-for-future-of-uk-financial-services.

[2] CP21/17, https://www.fca.org.uk/publication/consultation/cp21-17.pdf. The FCA also issued at the same time CP21/18, https://www.fca.org.uk/publication/consultation/cp21-18.pdf, which is primarily relevant to listed companies.

[3] The disclosure requirements also apply to life insurers and FCA-regulated pension providers.

[4] ESG 1.2.2 R.

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