Shamamah Deen
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Financial Conduct Authority
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By email: dp-18@fca.org.uk

30 January 2019

Dear Ms Deen

Re: BVCA response to FCA DP18/8 – Climate Change and Green Finance (the "DP")

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 750 firms, the BVCA represents the vast majority of all UK-based firms, as well as their professional advisers and investors. Over the past five years (2013-2017), BVCA members have invested over £32bn into nearly 2,500 companies based in the UK. Our members currently back around 3,380 companies, employing close to 1.4 million people on a full-time equivalent basis ("FTEs") across the world. Of these, around 692,000 FTEs are employed in the UK.

Environmental, social and governance ("ESG") factors are important to many of the BVCA's member firms who seek to minimise risks and create value in their own businesses, and in the underlying portfolio companies held by the investment vehicles that they manage or advise, in order to enhance returns for investors. Those investors include insurance companies, pension funds, development finance institutions, charitable foundations and other institutional investors.

Our membership includes investment firms that focus on providing a range of financial, social and environmental returns to investors in varying combinations, including firms that focus on financial returns through climate change related strategies (such as resource or energy efficiency). Many have adopted and report under existing ESG related initiatives (a significant number are signatories to UNPRI) or provide bespoke ESG reporting (particularly environmental) to investors.

Climate change, mitigating related risks, and the transition to a low carbon economy are of increasing importance to a growing number of BVCA members – both private equity and venture capital ("PEVC") firms and investors in PEVC funds.

A General comments and scope

We welcome the FCA's timely explanation of how climate change is likely to have a significant impact on the UK's financial services market, and of how it sees climate risk and the transition to low carbon economies impacting on its statutory objectives. We also welcome the opportunity to comment on the questions posed in the DP.

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The BVCA supports the FCA's proportionate approach to measures to support price discovery in the public markets and transparency in relation to climate risk, and competition and innovation in relation to green finance. We firmly support the points made by the FCA in the DP that any regulatory intervention should be proportionate, efficient and cost-effective, should not stifle positive innovation, and should support the UK's position as an attractive prospect for international business and finance and the UK's competitiveness as a hub for green finance.

We expect that the FCA will receive feedback on the questions in the DP from a wide variety of market participants, industry bodies and special interest groups. We have limited our response to issues of importance to PEVC firms and so have responded to some and not all of the questions raised in the DP.

B Questions relating to disclosures in capital markets

Q1. What, if any, difficulties do issuers face in determining materiality? We are also interested in exploring how investors consider materiality in this context.

Whilst most PEVC funds are structured as private limited partnerships, the BVCA's membership includes publicly listed firms and funds. A meaningful proportion of our members have experience of transactions relating to companies with publicly listed securities (from buyer, seller and issuer perspectives), including from portfolio company exits through initial public offerings, take-private transactions, and portfolio company level mergers and acquisitions involving publicly listed companies. From our membership, we are not aware of any difficulties faced by issuers in determining materiality in the context of climate risk that would justify specific disclosure obligations or regulatory guidance to similar effect. We would note that the determination of materiality is issuer and situation specific, and varies considerably by factors including geography, industry, sector, supply chain, and exposure to natural resources.

The nature of PEVC investment, with a typical investment horizon of five or more years, focus on enhancing the value of private portfolio companies and typically investing in public companies only when conducting a take-private transaction, means that PEVC firms normally conduct detailed due diligence on potential portfolio companies and seldom rely solely on public disclosure by listed companies. Therefore our membership has limited cause to consider materiality in the context of publicly listed issuers from an investor's perspective.

Any regulatory obligation or guidance specific to climate risk should not itself distort markets, for example by making disclosures relating to the risks and opportunities resulting from climate change more prominent than their relative importance would justify for certain issuers for whom climate risk is a low order risk relative to other risks (for example, market, credit or counterparty risk).

Q2. We are interested in understanding whether greater comparability of disclosures would help investors in their decision-making more generally. If so, what framework would be most useful?

As mentioned above at B1, PEVC firms' investment decisions are seldom solely reliant on issuers' public disclosures, and therefore their comparability (or lack thereof) is generally of low importance to PEVC firms' investment decision-making.

If the FCA determines that the adoption of a reporting framework relating to climate risks is necessary or desirable in relation to its statutory objectives:

- it would be important to avoid (or at least minimise the impact of) both the duplication of issuer reporting obligations, and the adoption of different frameworks by listing authorities; and

- the adoption of the TCFD recommendations on a "comply or explain" basis for Premium Listed issuers, as proposed by the FCA in the DP, would seem proportionate.

Q3. Would exploring a 'comply or explain' approach, or other avenues to encourage more consistent disclosures, be an effective way of facilitating more effective markets?

Given the varying relevance of climate risks to issuers, any climate risk specific disclosure obligation on issuers should be on a "comply or explain" basis, as is also consistent with other reporting obligations and the TCFD recommendations.

C Questions relating to public reporting requirements

Q1. Do you think that a requirement for firms to report on climate risks would be a valuable measure?

The most important users of information relating to a firm's exposure, adaptation to and mitigation of climate risk are actual and potential investors in financial products managed or advised by that firm. Ensuring those recipients receive that information does not require public notification; an obligation to make that information available to actual and potential investors on a pre-contractual and on-going basis would be sufficient.

Actual and potential investors in a PEVC fund often conduct detailed due diligence that generally includes climate risk related considerations such as the firm's policies and procedures relating to environmental sustainability, exposure to fluctuations in resource pricing, and carbon. Therefore PEVC firms typically produce detailed private placement memoranda and pre-emptive due diligence questionnaires, and provide detailed responses to investors' due diligence requests, including relating to climate risk. PEVC firms are often subjected to detailed scrutiny by investors, often over a period of months, including onsite visits and interviews relating to investment, operations and risk, sometimes by professional operational due diligence specialists.

Quarterly and annual environmental reporting (including climate risks) to investors in PEVC funds is common, and (particularly for certain larger fund managers and sustainability focussed fund managers) is often detailed and produced by external specialist consultants engaged by the PEVC firm.

Therefore actual and potential investors in PEVC funds, who are the most important recipients of climate risk information relating to the PEVC firms that manage those funds, generally receive the information that they require relating to climate risk (or if they do not, and that information is of importance to the investors, they may choose not to invest).

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The extent of information on relevant climate risks that is typically available to investors in PEVC funds, and the negotiating power of investors to require PEVC firms to provide additional climate risk reporting, means that imposing an additional obligation on PEVC firms to disclose less bespoke information publicly would seem of limited benefit to investors and a disproportionate cost on PEVC firms, particularly smaller firms that are less able to absorb related costs.

If the FCA decides to impose an obligation on firms to make climate risk summary information public:

- that obligation should not conflict with a firm's obligations under the UK and other relevant financial promotion and marketing regimes, e.g. exposing firms to the risk that they may be required to make fund information public which could be regarded as breaching marketing restrictions in certain jurisdictions;

- the obligation should not duplicate other obligations to which firms may be or become subject (for example, the EU proposals on sustainability), which is less likely to occur if the obligation is on a principles or outcome basis;

- FCA authorised firms subject to the obligation should be given the option to rely on disclosures made by affiliates to meet the obligation. Take as an example a corporate financial services group that includes (A) a UK regulated investment adviser that is one of a number of investment advisers that provides investment advice to (B) a US investment manager in the same group that manages an investment fund into which third party investors invest. If B meets the obligation to publicly disclose information relating to climate risk in relation to its customers (the investors in the fund managed by B), any requirement on A to publicly disclose climate risk information as well would seem redundant, as A's disclosure would be covered by B's disclosure in relation to the fund, and A's disclosure could mislead actual and potential investors in the fund who are unaware that A is one of a number of investment advisers in relation to the fund;

- an obligation to make the summary publicly available on a website seems preferable to including it in a firm's statutory accounts as:

    - information on a website is more accessible than information in a firm's statutory accounts (which requires accessing companies house, downloading the accounts, and identifying the relevant section); and
    - including a climate risk summary in a firm's statutory accounts would incur additional auditor costs, of particular relevance to smaller venture fund managers who manage smaller funds, for whom additional costs would have a greater relative impact.

Q2. Do you have any suggestions for what information could be included in a climate risks report?

Any climate risks report should only include matters of financial relevance. As the relevance and relative importance of climate risks will vary considerably between firms, a prescriptive list of mandatory information in a climate risks report could result in misleading disclosures (particularly for firms for whom market, credit or counterparty risk is more significant), and so should be avoided. Firms have varying access to information in relation to climate change risks relating to

investments (for example, the manager of a fund-of-funds that is invested in a PEVC fund would typically have access to less information relating to the underlying portfolio companies than the PEVC fund manager). If any prescriptive contents requirements are adopted in relation to underlying investments, they should be proportionate and reflect firms' access to relevant information.

We note that certain larger private equity firms have dedicated ESG teams who provide a range of functions from engaging with portfolio companies to develop best practice, to providing bespoke ESG reporting. We also note increasing demand for more detailed and standardised climate risk reporting from larger investors who have adopted the recommendations of the Task Force on Climate-related Financial Disclosures, and from certain pension funds who are pre-empting the adoption of the Law Commission's recommendations on Pension Funds and Social Investment.

Any proposal for prescriptive items or contents of firms' climate risk reports should:

- be proportionate, particularly in relation to smaller PEVC managers, in order to avoid disproportionate costs to smaller managers with lesser income and ability to absorb additional analysis and reporting costs.; and

- follow engagement by the FCA with relevant sectors; the BVCA can assist in relation to PEVC firms and their fund investors.

To reduce the likelihood of misleading recipients, and to avoid extraneous information that is not decision-useful, the summary should set out how a firm seeks to manage relevant climate risks to its own operations and to its customers. (The underlined wording above is additional to the FCA's proposal at para 5.24.)

Q3: Do you have any views on which regulated firms should be required to compile a climate risks report?

In the context of the professional investors in PEVC funds and PEVC industry practice (see response to Q1 above) the obligation to disclose a climate risks report publicly would seem to result in costs to PEVC firms that are disproportionate to the benefit to those firms' actual and potential professional client investors, particularly in relation to smaller venture fund managers with greater relative costs.

D BVCA responses to certain additional questions

Q1. How can authorities, including the FCA, most effectively work with industry to meet investor demand for green investment opportunities and encourage those raising capital and investing in it to pursue sustainable outcomes?

The FCA should focus on its statutory objectives, promote competition and transparency wherever possible, deploy proportionate regulation where necessary, and focus attention on risks to retail investors if retail demand for green investment product grows.

Q3: In light of the EU work on taxonomy, what are your views on the form common standards and metrics for measuring and reporting against green financial services products should take?

We look forward to the report of the technical expert group on sustainable finance that is advising the European Commission. A single and decision-useful taxonomy would be of benefit for retail investors in publicly-listed securities, whereas multiple taxonomies could confuse and undermine the benefits of a common standard.

Q4: How could regulators and industry best work together as part of the Climate Financial Risk Forum?

The BVCA supports the creation of the Climate Financial Risk Forum, and the opportunity for the FCA and PRA to develop policy and best practice in relation to climate risk with market participants.

We would be happy to discuss the contents of this letter with you; please contact Tom Taylor (ttaylor@bvca.co.uk).

Yours faithfully,

Tim Lewis
Chair, BVCA Regulatory Committee