Our climate-related financial disclosure 2021/22

July 2022

Contents

1. Foreword

The FCA wants to role model high-quality reporting

Welcome to our first climate-related disclosure report. We are very conscious that, since January 2021, we have brought in new rules on climate-related disclosures for listed companies, asset managers and FCA-regulated asset owners. We are committed to holding ourselves to the same standards of reporting and to playing our part in supporting the Government's commitment to achieving a net-zero economy by 2050.

This report sets out our approach to managing climate-related risks and opportunities. It is aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) and covers both our regulatory and corporate activities.

The FCA wants to role model high-quality reporting: we know that we have a major role as a financial regulator to help improve financial market disclosures and we believe publishing this report supports that. But this is also our first attempt at doing so. As the report notes, in several areas we need to do more to strengthen the sophistication of our analysis.

Our reporting next year will be incorporated into our Annual Report and Accounts. It will reflect the outcomes we achieve from our strategy of embedding climate and broader ESG considerations into our operations and leveraging our regulatory powers and influence across the financial services industry. It will show how we have asked more questions of ourselves and our suppliers and how we use evolving metrics and methodologies to inform our analysis.

We have learned a lot from the process of producing this report and I want to thank the many FCA employees from across the organisation for their efforts and cooperation in producing this report. We also welcome any comments or feedback you may have on its content.

Sacha Sadan
Director, Environmental, Social & Governance
Financial Conduct Authority

2. Executive Summary

The Financial Conduct Authority (FCA) is for the first time publishing its own climate-related financial disclosures. This report outlines the risks and opportunities from climate change relevant for both our regulatory and corporate activities and is aligned with the recommendations of the TCFD. It also covers the steps we are taking to strengthen our understanding of these risks and opportunities, and our actions in response to them.

We have committed to holding ourselves to the same standard as we expect of firms - to 'walk the walk' - on ESG issues

Climate change creates financial risks and opportunities that will affect all economic actors. Risks can be divided into the physical risks created by climate change and risks associated with the transition to a net zero economy. Financial markets require consistent, comparable and comprehensive information about these risks to inform asset pricing and capital allocation.

To support this, the TCFD was established in 2015 to create a framework to support climate-related financial decision-making and disclosure by corporates and financial institutions. The TCFD's final recommendations were published in June 2017. The UK Government was among the first to publicly endorse the recommendations. Today the TCFD has over 3,400 supporters in 95 jurisdictions.

This emphasis on transparency underpinned the initial priorities we set out in October 2019 for our work on climate change and green finance. This remains a central theme in the environmental, social and governance (ESG) strategy we published in November 2021. As part of this, we have played our part in delivering the Government's commitment to mandatory TCFD-aligned disclosure obligations across the UK economy by 2025. We have introduced disclosure rules referencing the TCFD's recommendations for listed companies, asset managers and FCA-regulated asset owners. The first disclosures under our rules by commercial companies with a UK premium listing have been published in recent months. We have worked with colleagues at the Financial Reporting Council to review these disclosures and will publish the outcome of this review later this month.

We have also committed to holding ourselves to the same standard as we expect of firms - to 'walk the walk' - on ESG issues. This means not imposing obligations and expectations on market participants, regulated firms or security issuers if we are not prepared to take similar steps ourselves. This report is a demonstration of that principle in action. We will continue to increase transparency on the effect of climate change along the value chain and for our own regulatory actions and operations.

Ultimately, we want to ensure we are fit for purpose in executing our regulatory and corporate responsibilities so that our organisation effectively responds to relevant climate-related risks and opportunities. This puts us in a strong position to meet the Government's expectation that we have regard to its commitment to achieve a net zero economy by 2050. Achieving this requires comprehensive action to embed climate considerations into our own approach to governance, risk management and strategy, and using appropriate metrics and targets to measure our progress in managing climate-related risks and opportunities.

The report outlines our progress towards integrating climate relevant wider ESG strategies, organisational structures, resources and tools across the FCA and its activities. Like many, we are on a journey: we need to build on what we have done so far to ensure we effectively integrate climate considerations in what we do and how we operate, and to work with industry to do this. We highlight in this report some areas where we want to make further progress.

The report is structured around the four pillars of the TCFD framework: governance, strategy, risk management and metrics and targets.

Table 1: Summary of our reporting against the TCFD's recommended disclosures

Governance
a) Board oversight of climate-related risks and opportunities
• The Board and a number of its committees oversee aspects of the organisation's approach to managing climate-related risks and opportunities. The Board has agreed to amend relevant Board committee Terms of Reference to reflect this explicitly. • The Board has committed to undertaking training to support it in executing its responsibilities on climate-related issues.
b) Management role in assessing and managing climate-related risks and opportunities
• Our Executive Committee and Executive Regulation & Policy Committee have specific responsibilities for a range of matters connected to climate considerations, including oversight of our strategy, operations, policy making and regulation. • Our Chief Executive, certain Executive Directors and the Director of ESG have individual responsibilities assigned to them for climate-related matters. Where appropriate, these are reflected in their individual objectives. • Our Director of ESG, who reports to the Chief Executive, has a mandate to embed climate and wider ESG considerations seamlessly and comprehensively across the FCA's functions. • A description of wider management responsibility for assessing and managing climate-related risks and opportunities can be found under 'role of management below executive level'.
Strategy
a) Climate-related risks and opportunities the organisation has identified over the short, medium and long term
• A sector-by-sector description of the climate-related risks and opportunities that we have identified, and transition strategies and target-setting, can be found under 'how climate-related risks and opportunities impact regulated financial sectors'. • A description of risks and opportunities relevant for our own operations can be found under 'how climate-related risks and opportunities impact the FCA's own operations'.
b) Impact of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning
• Our approach to responding to climate-related risks and opportunities was outlined in our ESG Strategy, setting out the outcomes we are aiming to achieve and associated actions we are taking across 5 themes. • Our FCA Strategy incorporates an ESG commitment, drawing on the ESG Strategy. Specific resource has been allocated to ESG issues across all relevant external-facing and internal-facing functions. • A description of the steps we are taking to support the financial sector's transition to net zero can be found under 'financial sector transition strategies and target setting'.
c) Resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario
• We have used 3 climate scenarios developed by the Network for Greening the Financial System (NGFS) to conduct an initial assessment of the resilience of our strategy. A summary of our analysis can be found under 'resilience of our strategy to climate scenarios'.

Table 1: Summary of our reporting against the TCFD's recommended disclosures

Risk Management
a) Organisation's processes for identifying and assessing climate-related risks
• We are applying the FCA's cross-organisational Risk Management Framework to our work on climate issues and have amended our risk taxonomies to take climate risks into account more explicitly. • We have set out our key areas of focus, informed by our assessment of where the greatest risks of harm lie, in our ESG Strategy. This includes a programme of work and timeline. • We have expanded our risk identification capabilities with respect to climate issues including through introducing relevant questions to the Financial Lives Survey. We have also established a Market Intelligence & Engagement Team within the ESG Division to work with teams across the FCA to horizon scan for climate-related risks. • A description of our process for identifying and assessing climate-related risks can be found under 'our overarching approach to risk'.
b) Organisation's processes for managing climate-related risks and (c) processes for integrating the identification, assessment and management of climate-related risks into the organization's overall risk management
• We are rolling out our updated risk tolerance framework, which will incorporate specific key risk indicators relating to our own climate-related risks. • We have integrated the ESG Division into relevant supervisory and policy decision-making committees that consider the management of climate-related risks. • We have amended our Risk of Harm, Cause of Harm and Own Risk taxonomies to integrate climate-related risks. • A description of our process for managing climate-related risks and integrating climate risk management into our overall risk management can be found under 'our overarching approach to risk'.
Metrics and Targets
a) Metrics to assess climate-related risks and opportunities in line with strategy and risk management process and (c) targets used to manage climate-related risks and opportunities and performance against targets
• We published a set of ESG-related regulatory outcomes and metrics in April 2022 alongside the FCA Strategy. These will help us to track and assess climate-related risks and opportunities. We will revisit the outcomes, targets and metrics as our work on ESG issues progresses. • Metrics and targets to manage our own operational climate-related risks and opportunities and our performance against them can be found under 'metrics and targets to evaluate our response to climate-related risks and opportunities'.
b) Scope 1, Scope 2 and Scope 3 greenhouse gas (GHG) emissions and related risks
• Scope 1, Scope 2 and Scope 3 GHG emissions and associated risks for the FCA can be found in Table 4 and Table 5 and the commentary that follows them under 'metrics and targets to evaluate our response to climate-related risks and opportunities'.

3. Introduction

Promoting the flow of high-quality climate-related information is critical if we are to encourage better business, risk and investment decisions and effectively support the transition to a net zero economy. The TCFD has developed a set of recommendations which are now widely adopted globally by both issuers and financial firms as a tool for disclosure of the risks and opportunities arising from climate change.

We are undertaking significant international and domestic work to strengthen TCFD-aligned disclosure requirements for financial institutions and corporates. Improved information flow will help enable the financial sector to support the transition to a net zero economy. While the TCFD recommendations are primarily aimed at private sector organisations, its pillars and recommendations can usefully be applied to inform climate-related financial disclosures by public authorities like ourselves.

We are undertaking significant international and domestic work to strengthen TCFD-aligned disclosure requirements

We have organised our disclosures according to the TCFD's 11 recommended disclosures. The document is structured around the four pillars of the TCFD recommendations: governance (chapter 4), strategy (chapter 5), risk management (chapter 6) and metrics and targets (chapter 6). It considers these issues across both our regulatory responsibilities and our corporate operations. Our disclosures have also been informed by the accompanying sector guidance as well as the TCFD's other relevant guidance materials.

Figure 1: Core elements of recommended climate-related financial disclosures

Governance
The organisation's governance around climate-related risks and opportunities

Strategy
The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning

Risk Management
The processes used by the organisation to identify, assess, and manage climate-related risks

Metrics and Targets
The metrics and targets used to assess and manage relevant climate-related risks and opportunities

We are committed to strengthening our environmental performance, including on climate issues. We are working to fulfil the Chancellor's expectation set out in our 2021 and supplementary 2022 letters that we 'have regard' to the Government's commitment to achieve a net zero economy by 2050 in all our regulatory activities.

We are committed to strengthening our environmental performance, including on climate issues

Data and methodological challenges

We are clear in our work on transparency on climate-related risks and opportunities that organisations should start to disclose climate risks and opportunities even when there are gaps relating to data and techniques. We have committed to producing an annual climate-related financial disclosure and expect future iterations to build on our previous experience to strengthen our metrics and methodologies.

The main challenges we encountered in developing this report relate to risk management and calculation of Scope 3 emissions. With risk management, we have had to consider carefully how to apply our Risk Management Framework to climate issues, and ensure we are taking them appropriately into account in our approach to risk. We discuss this further in the Risk Management section of this report. With Scope 3 emissions, we have faced expected data and methodological challenges in preparing estimates of the GHG emissions associated with staff working from home and commuting to work.

4. Governance

Recommended Disclosures

- **a.** Describe the board's oversight of climate-related risks and opportunities.
- **b.** Describe management's role in assessing and managing climate-related risks and opportunities.

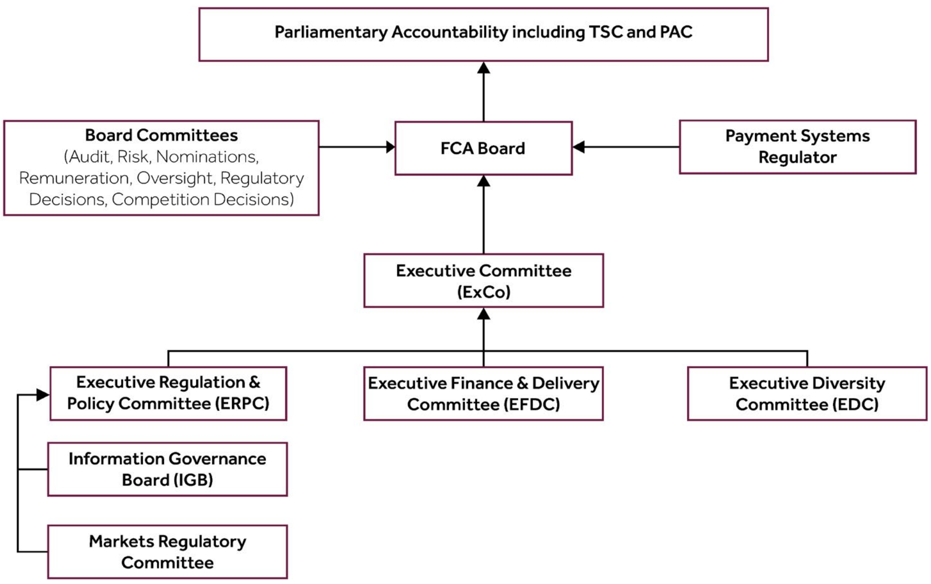
Our Board

The FCA's Board sets the organisation's strategic direction and promotes its long-term success. It provides leadership of the organisation within a framework of prudent and effective controls that best support the assessment and management of risk, including climate-related risks (see Risk Management, below).

The FCA is required by the Financial Services and Markets Act (FSMA) to have regard to generally accepted principles of good corporate governance. The Board seeks to comply with the principles of the UK Corporate Governance Code as far as appropriate. We are now applying cross-FCA governance and our Risk Management Framework to the identification and management of climate-related risks across everything we do.

The FCA is accountable to Parliament, including the Treasury Select Committee (TSC) and the Public Accounts Committee (PAC).

Figure 2: Our Board and Executive Committee structure



We are reviewing committee reporting to the Board to identify where climate-related reporting could be improved

The Board has established committees to which it has delegated specific powers, duties and decision-making responsibilities. These include the Audit, Risk and Nominations Committees. Each of these committees has responsibility for oversight of some aspect of the organisation's approach to managing climate-related risks and opportunities. For instance:

- The Risk Committee provides assurance to the Board on the effectiveness of the organisation's system of risk management and regulation, to ensure that the FCA achieves its statutory and operational objectives. The committee reviews the FCA's Risk Management Framework and processes, including in relation to climate risks and our actions in response to the Government's expectation that we 'have regard' in our regulatory activities to its commitment to achieve a net zero economy by 2050.
- The Audit Committee monitors the integrity of the organisation's financial statements and oversees the consideration of any material climate-related risks in developing its financial statements. It also ensures environmental risks are considered as part of the organisation's governance and control framework.
- The Nominations Committee is responsible for making recommendations to the Board on maintaining an appropriate balance of skills on the FCA Board and its committees. The committee also sets performance objectives for the Chief Executive and persons within the scope of the Senior Managers Regime, which may incorporate ESG-related expectations, measures and targets.

In April 2022, the Board agreed to amend the Terms of Reference for each of these committees to draw out these responsibilities more explicitly. We are also reviewing committee reporting to the Board to identify (among other things) where climate-related reporting could be improved. The Board also agreed to undertake training on how to factor material ESG issues into its decision-making and oversight.

The Board considers climate-related issues and metrics annually as a minimum, as part of its review of the FCA's Business Plan, Annual Report and annual climate-related financial disclosure.

Our executive committees' roles with respect to climate issues

Our executive-level committees underneath the Board play an integral role in our governance.

Our Executive Committee (ExCo) oversees the general strategy and activities of the FCA at the direction of the Board. This includes delivery of the FCA's Business Plan, which sets out key activities we are undertaking in 2022/23 with respect to climate, in line with our ESG Strategy and the broader FCA Strategy.

ExCo also has overarching responsibility for the FCA's operational risk management. Related to this, the committee agrees our business continuity planning and is responsible for crisis management, in line with our Crisis Planning and Response Framework. These cover any risks to our operations, including those arising from climate events (eg flooding).

The Executive Regulation & Policy Committee (ERPC) is responsible for executive decision-making on policy decisions and regulatory issues. Roles it undertakes related to climate issues include:

- Providing direction on the overall outline and approach to strategic and major policy initiatives, including those related to climate change and other ESG matters.
- Reviewing and challenging regulatory risks to the FCA's objectives and ensuring all elements of regulatory risk identification and mitigation across the FCA are joined up and effective.
- Deciding, approving, reviewing or challenging any issue that is referred to it in line with the executive procedures, including regulatory decisions.

The ESG Director is responsible for approval and oversight of our corporate environmental and sustainability objectives, targets and metrics

Executive accountability

Our CEO has ultimate responsibility for implementing the FCA strategy that has been agreed by the Board. This includes with respect to the ESG-related commitment within the FCA Strategy.

The CEO may delegate authority to one or more Executive Committees, per the structure summarised above. The CEO may also delegate to one or more individuals (eg the Chief Operating Officer with respect to our own operations).

Our Director of ESG reports directly to the CEO with a mandate to embed climate and wider ESG considerations seamlessly and comprehensively across the FCA's functions (a 'golden thread' approach). This is captured in the objectives against which the ESG Director is appraised by the CEO. The ESG Director is a member of ERPC, ensuring that climate and sustainability-related perspectives are factored into regulatory and policy discussions and decision-making. The ESG Director is responsible for approval and oversight of our corporate environmental and sustainability objectives, targets and metrics.

Role of management below executive level

A range of structures is in place to support our management in considering and addressing climate risks and opportunities below the level of our executive and its committees. These include:

- Our ongoing work to embed climate considerations into our supervisory and authorisations processes, across everything we do.
- Divisional Risk Committees and Operations Committees, which consider (among other things) climate-related projects and initiatives within their areas. For example, the Operations Committee within the Supervision, Policy and Competition Division recently considered the questions we should pose to firms regarding potential harms related to climate risk mitigation and net zero preparations.
- The establishment within ESG Division of a dedicated Market Intelligence and Engagement Team, which works in collaboration with other intelligence-gathering teams across the FCA.
- The regular management operations of the ESG Division and Operations Division, including their leadership meetings at which climate-related considerations are discussed as required.
- The regular management information provided by Operations Division on our environmental and sustainability performance (eg data on our GHGs and our key suppliers). This is an important part of the reporting to enable our ESG Director to oversee our performance against environmental and sustainability targets.

A range of structures is in place to support our management in considering and addressing climate risks and opportunities

5. Strategy

We will be deepening our policy work to support a market-led transition to a net zero economy

Recommended Disclosures

a. Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term.
b. Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.
c. Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.

Our 'golden thread' approach to embedding ESG considerations helps ensure we have regard across our activities to the Government's commitment to achieving a net zero economy by 2050. Our work programme builds on the regulatory actions we have undertaken over the last three years on climate issues, especially our work to strengthen climate-related disclosure expectations of listed companies and regulated firms. Our intention is to create a coherent, holistic regulatory approach to ESG issues. We are now increasing our focus on supervision and enforcement of climate-related issues, both in relation to our disclosure rules and wider climate-related consumer and market harms. This includes actively looking for cases of greenwashing to pursue. We will also be deepening our policy work to support a market-led transition to a net zero economy, collaborating with industry to help ensure listed companies and regulated firms have the right incentives, tools and organisational arrangements in place to set and pursue effective climate strategies.

This chapter examines how the risks and opportunities arising from climate change have impacted how we operate and our strategic approach. We differentiate between our regulatory functions and our own operations and consider the ramifications of a number of different climate scenarios. We use scenario analysis to explore how different transition pathways could impact the sectors we regulate and how that could affect our regulatory strategy.

Risks and opportunities arising from climate change

Climate risks can be categorised broadly into physical risks and transition risks. Physical risks are caused by changes in climate and an increase in the frequency and severity of weather events, which can damage infrastructure, disrupt supply chains and worsen working conditions. Transition risks are caused by the adjustment towards a net zero economy, which will involve significant changes to policy, technology, law and investor and consumer attitudes.

Physical and transition risks can act as drivers of existing types of financial risks. As examples, the drivers of Business Continuity Risk, Health and Safety Risk, and IT Systems Availability and Resilience Risk are not limited to environmental factors, but climate change has the potential to exacerbate or trigger these risks and events. These may translate into harms for consumers and markets, and from a regulatory perspective, pose threats to our operational objectives of protecting consumers, protecting financial markets and promoting competition in the interests of consumers. They may also create risks to our ability to carry out our responsibilities.

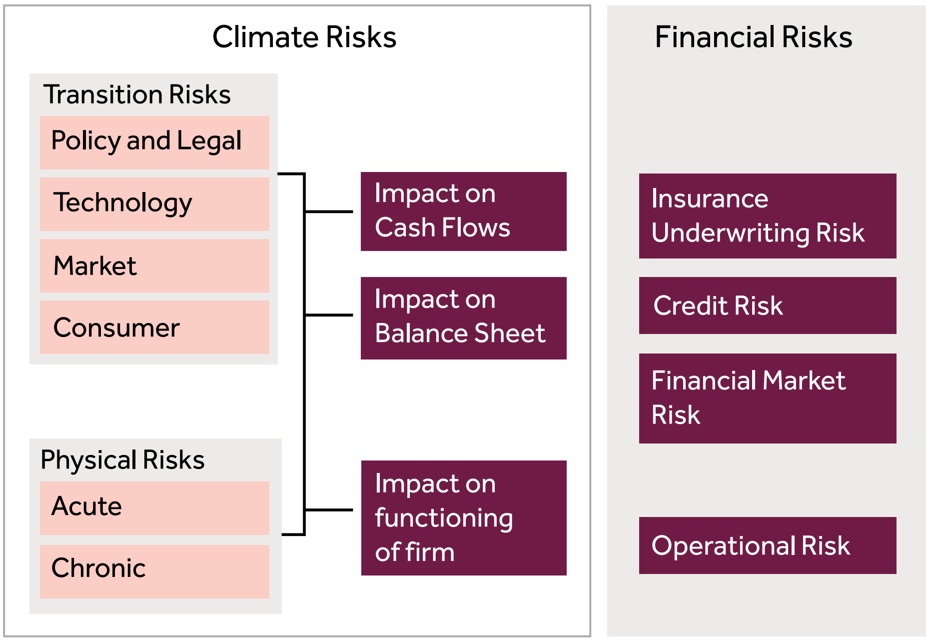
Physical and transition risks can act as drivers of financial risks and these may translate into harms for consumers and markets

We co-chair with the Prudential Regulation Authority (PRA) the jointly established Climate Financial Risk Forum (CFRF) of industry representatives and other stakeholders. The purpose of the CFRF is to build capacity and share best practice to advance the financial sector's responses to the financial risks from climate change. Since the CFRF's establishment in 2019 we have invested significant resource in convening and facilitating the CFRF's work programme across topics including disclosures, risk management, innovation and scenario analysis.

In pursuit of that, the CFRF published in June 2020 a guide to help firms manage and adapt to climate-related risks and opportunities. The guide set out how physical risks and transition risks can be reflected in:

- insurance underwriting risk
- credit risk
- financial market risk
- operational risk

Figure 3: financial risks affected by climate risk (CFRF guide)



The risks are broad in nature and capture a range of different firms

We discussed each of these risks, and the additional risks of asset write-downs and reputational impacts, in the Climate Change Adaptation Report (CCAR) we published in October 2021 (see Chapter 4 of the CCAR). We also identified that ESG data gaps might affect the ability of firms to address these risks. And we set out an initial overview of how climate-related risks and harms were reflected in the following areas:

- pensions and retirement income
- retail investments
- retail lending
- wholesale markets
- general insurance underwriting

We continue to view the risks that the CFRF identified as being key to the industry and how it responds to the climate crisis. The risks are broad in nature and capture a range of different firms. They also have relevance over the short, medium and long terms. For instance, climate-related insurance underwriting risks may crystallise in any given year (if flooding, snowfall or wildfires are prevalent) or may affect the business model and future prospects of a firm over the medium or long terms, requiring a wholesale review of strategy.

How climate-related risks and opportunities impact regulated financial sectors

Building on the analysis in our CCAR, this section summarises the climate-related risks and opportunities across each of the sectors we covered, including relevant risks of harm to consumers and markets.

In future years, we will deepen this analysis through use of regulatory returns, public disclosure and other inputs.

CDP found in 2021 that the portfolio emissions of 84 global financial institutions are on average 700 times larger than their direct emissions

Financial institution operations

The main climate risks for most financial institutions relate to the impact of physical and transition risks on their counterparties and the assets they hold or manage. CDP found in 2021 that the portfolio emissions of 84 global financial institutions are on average 700 times larger than their direct emissions. Concentrations of lending, investing, trading and underwriting for carbon-intensive sectors such as oil and gas, manufacturing, transportation and construction create the most material exposures for financial market participants. However, financial firms with physical operations such as offices, data centres and branch networks could also be exposed to physical risks from their own operations. We expect firms to take these risks into account in how they operate and how they plan for the future.

Pensions and retirement income

Pension funds face significant long-term physical and transition climate risks

Pension funds face significant long-term physical and transition climate risks that could result in deterioration in value as a consequence of write-downs and broader underperformance. In a worst-case scenario, if firms fail to amend their investment and stewardship strategy in response to material climate risks, they risk breaching their fiduciary duty and consumers may lose money or access to products. In response asset owners and asset managers need to analyse the exposure of their portfolios and engage with relevant counterparties to aid their transition and, as a last resort, to consider reallocating capital. New technology offers significant opportunity to strengthen end investor engagement on climate change by allowing consumers to express granular non-financial and voting preferences to asset managers and trustees.

Retail investments

Changing consumer sentiment is driving unprecedented demand for ESG investment products. The Investment Association found that inflows into 'responsible funds' hit record levels in 2021 at £16bn for the year. This was up £4.3bn on 2020 (£11.7bn) – the previous record year. The FCA 2020 Financial Lives Survey found that 80% of consumers would like their money to 'do some good' as well as providing a return.

The FCA 2020 Financial Lives Survey found that 80% of consumers would like their money to 'do some good' as well as providing a return

This growing demand for ESG funds offers opportunity for the investment sector to develop new products that more closely align with consumer needs and non-financial preferences. This could provide consumer benefit if products are designed and distributed appropriately. However, poor quality ESG information could be a barrier to effective design, delivery, disclosure and distribution of ESG investment products. This creates a risk of greenwashing due to misalignment between the non-financial preferences of investors and the underlying credentials of the assets they hold in their long-term savings. This risks consumers not being able to trust such products. Firms should be alive to this risk and take steps to mitigate it. There are clear risks to consumers if they do not do so, and consequently there may be legal and financial risks to the firms, which could potentially undermine their viability.

Retail lending

The Environment Agency estimates that 5.2 million homes and businesses in England are at risk of flooding and coastal erosion. For the year 2019/20, modelling showed that the economic cost of flooding in the UK would have been £2.1 billion had it not been for increased flood defences; these defences limited the economic cost to an estimated £78 million. Firms need to account for the risk of acute and chronic weather events in valuation and lending decisions.

Firms need to account for the risk of acute and chronic weather events

There are also significant transition risks associated with the cost of retrofitting and any Government expectations relating to energy performance certificate (EPC) improvement targets. Firms will need to address data gaps and consider these risk factors in their decision-making and communicate this transparently to consumers. Transition factors such as increased energy costs could create risks of harm as a result of increased rates of default and reduced borrowing capacity.

Product innovation could offer opportunities to firms through offering drawdown products linked to improved EPC ratings, rollup products to fund retrofitting and potentially mortgage pricing linked to energy efficiency. This may provide benefits to consumers and enhance competition in their interests. Firms should consider impacts on financial inclusion when introducing any products containing pricing differentiation linked to energy efficiency.

Wholesale markets

Unanticipated legal, policy, societal and technological responses to climate change could create disorderly market price adjustments. This would have wide-reaching market risk implications for the capital markets with the value of bonds, loans, property, commodities and equities suddenly reducing. Funding shifts away from dirty activities towards green and transition activities could be disorderly as a result of mispricing or where investor asset divestment and portfolio reallocations threaten to overwhelm available liquidity.

The price impact of climate change will be uneven across the economy and different geographies

The price impact of climate change will be uneven across the economy and different geographies, potentially increasing dislocation and creating tail risks in certain sectors. International divergence in capital markets regulation relating to matters such as corporate disclosure and ESG ratings provision could lead to inconsistent or incomplete disclosure from investee companies, misallocation of capital and a disorderly wholesale market. Physical climate risks could create a credit risk for sovereign and corporate debt issuers and Commercial Mortgage-Backed Securities could become vulnerable to physical risks that negatively affect the underlying assets.

There are significant opportunities for commodity markets and OTC derivatives to help enable risk transfer and hedging. For example, through managing climate risks via the derivatives markets and by pooling risks and securitisation. Financial markets, especially derivatives markets, will play a critical role in enabling companies and investors to manage the climate financial risks to which they are exposed and to align with their risk management strategy.

General insurance underwriting

Insurers are exposed to physical risks due to increased frequency and severity of extreme weather events, impacting reserving and pricing. Swiss Re estimated that global insured losses from natural catastrophes were $112 billion in 2021, up from $83 billion in 2020 and $63 billion in 2019. If losses are insured, premiums would increase, which could reduce consumers' access to affordable general insurance products. Equally uninsured households would have to pay more as a result of an increase in severe weather events.

...an increase in claims due to physical risks could undermine the ability to price risks correctly

The increase in severe weather events may stimulate demand for insurance products, which would expand customer bases and premium income. However, the current natural catastrophe protection gap in Europe was estimated by Swiss Re as being $15 billion in 2019, with only 31% of annual losses from natural catastrophes being covered by insurers.

There is uncertainty around the future of policy and market developments, and an increase in claims due to physical risks could undermine the ability to price risks correctly, which could affect resilience. One growing risk relates to liability insurance for loss and damage where claimants are starting to take legal action against policyholders for climate-related risks. There is now precedent of plaintiffs starting to have success with such claims.

Firms have the opportunity to develop new products and increase their customer base in response to the transition to net zero. For example, there is likely to be increased demand for insurance as a consequence of greater awareness by potential policyholders of the potential impact of extreme weather events. Potential product innovation includes renewable energy project insurance or insurance covering public policy changes.

How climate-related risks and opportunities impact the FCA's own operations

In this section we discuss the risks relevant to our ability to carry out our regulatory and operational activities (what we term 'Own Risks'). Own risks are comprised of two elements:

Operational Risks	Execution Risks
These risks arise from our organisation and operations, particularly those that relate to our internal processes, people and/or systems, including our IT and infrastructure.	These risks relate to the execution of our regulatory strategy and approach and arise when we fail to deliver on our business activities as intended.

The FCA faces a range of risks if it does not "walk the walk"

The FCA faces a range of risks if it does not "walk the walk" in setting targets to reduce carbon emissions and preparing and executing a transition plan. These include:

- corporate, social responsibility and strategic risk: we risk failing to set expectations of ourselves on the transition to net zero that match the ambitions of the firms we regulate and of some of our peers in the public sector
- business legal and regulatory risk: we risk failing to meet the Government's expectation that we have regard to the Government's commitment to achieve a net zero economy by 2050 or to any related amendments to our regulatory principles stemming from the Financial Services Future Regulatory Framework Review

Additionally, as with many of the firms we regulate, we face a business continuity risk if the FCA or its critical suppliers are impacted by an extreme weather event and are unable to carry out regulatory functions. We discuss this further in the Risk Management section, below.

These risks are generally of relevance across the short, medium and long terms. Some may become more likely over time – eg the possibility of weather-related disruption to our operations if extreme weather events become more frequent. And while it is critical that we continue to make progress towards achieving net zero, failure to do so would increase our business legal and regulatory risk over time.

We are undertaking a programme of continual improvement in how we operate. This is targeted at driving environmental efficiency and the best use of our resources.

Our key objectives for the 2022/23 financial year are to:

- Develop a better understanding of our operational activities that produce Scope 3 GHG emissions, improving our data to ensure we understand where the greatest impacts lie. As part of this, we will identify the areas and suppliers where we can effectively influence emissions reductions.
- Assess the possibility of committing to and validating emissions reductions in line with science-based targets. Alongside this, we will begin development of our own net zero transition plan.
- Strengthen our environmental management system (EMS) through a multi-phase improvement plan that would extend its scope to our offices outside London.
- Improve internal awareness and action on environmental aspects of how we operate. We have identified a mix of short-term, immediate steps and longer-term actions and projects.

As part of assessing where opportunities lie, our staff environment network, Sustain, has proactively 'group sourced' areas where it thinks the FCA's environmental performance could be improved. We discuss the Sustain Network further, and the FCA's response to its suggestions, below.

Sustain Network

Sustain is one of the FCA staff networks. Networks are run by staff and provide a platform to share experiences and develop solutions to improve policy and practice within the FCA and PSR on areas of interest to their members. Sustain is focused on the environment and aims to promote sustainable policies and practices through:

- influencing the FCA to adopt sustainable practices in its operations and approach to policy
- providing information to staff to help them be more environmentally aware and adopt sustainable practices

Sustain has successfully advocated for the adoption of sustainable funds within the staff pension scheme. Sustain also recently surveyed its members to identify key actions they would like the FCA to take to promote sustainability. The most popular suggested action was that the FCA should publish sustainability targets for its own operations. In response, we have now set public targets for Scope 1, Scope 2 and elements of Scope 3 GHG emissions for this first time. These are set out in the Metrics and Targets section of this report (Tables 4 and 5).

Our strategic response

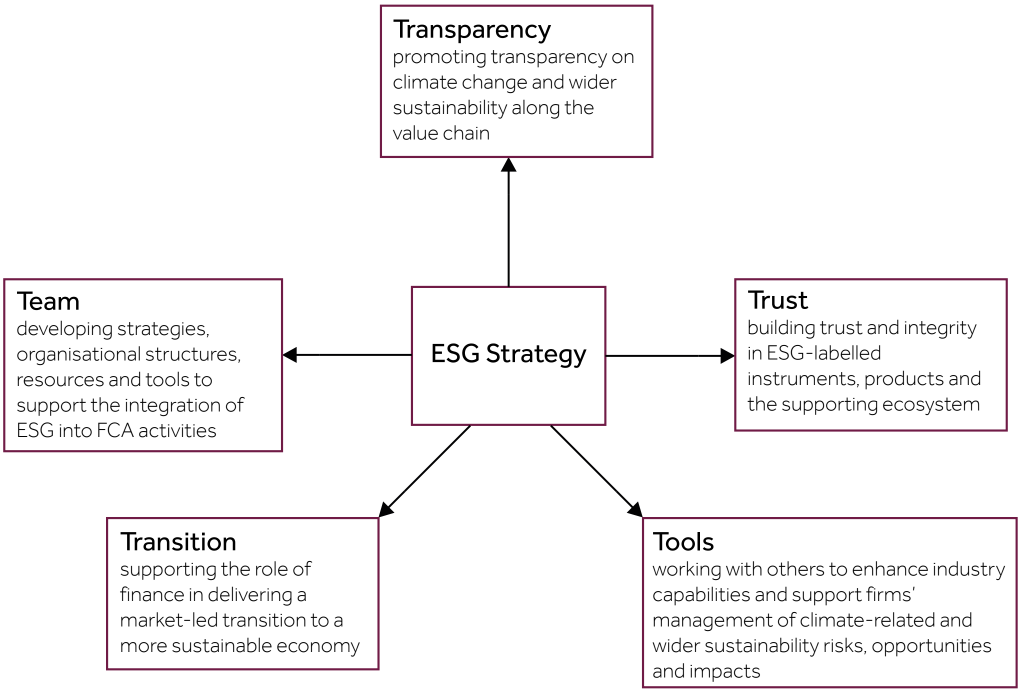
We have a key part to play in supporting the transition to net zero

We have a key part to play, alongside listed companies and financial services firms, in supporting the transition to net zero. We are undertaking a wide-ranging programme of work to embed net zero considerations across all our functions and to respond to broader climate-related risks.

Our strategic approach to doing this, and to the risks and opportunities set out above, are explained in our ESG Strategy, published in November 2021 around COP26. In the ESG Strategy, we set out the outcomes we are aiming to achieve. This reflects the approach we adopt across the organisation to how we regulate, focusing on the end-outcomes achieved for consumers and markets rather than activity or output measures. With climate issues, the key target outcomes from our ESG Strategy relate to:

- high-quality climate- and wider sustainability-related disclosures to support accurate market pricing, helping consumers choose sustainable investments and drive fair value
- trust and consumer protection from misleading marketing and disclosure around ESG-related products
- that regulated firms have appropriate governance arrangements for more complete and careful consideration of material ESG risks and opportunities
- active investor stewardship that positively influences companies' sustainability strategies, supporting a market-led transition to a more sustainable future
- integrity in the market for ESG-labelled securities, supported by the growth of effective service providers – including providers of ESG data, ratings, assurance and verification services
- innovation in sustainable finance, making use of technology to bring about change and overcome industry-wide challenges

And we explained in the ESG Strategy the actions we are taking, which are grouped under five themes:



The new FCA Strategy, published in April 2022, contains 13 commitments, of which 'a strategy for positive change: our environmental, social and governance priorities' is one. This commitment is fully aligned with the November ESG Strategy and essentially summarises that strategy.

Crucially, the FCA Strategy tethers our strategic priorities and actions to our Business Plan and cross-organisation budgeting process. This means that our ESG work, and our climate-related priorities within that, have been allocated the resource needed from across all our relevant functions - both external-facing (such as supervision) and internal-facing (such as our own operations).

In addition to the actions we set out theme-by-theme in our ESG Strategy to address the risks we have identified, we are driving internal change to enhance our own sustainability and reduce associated risks. We set out in this report how we have ensured our governance framework and risk management take appropriate account of climate considerations. We have adapted our internal structure through the creation last year of a dedicated ESG Division, headed by our first ESG Director and the establishment of a hub-and-spokes model, through which the ESG Division works with local leads throughout the organisation to provide expertise, intelligence, coordination and planning on climate-related matters.

And we have developed an EMS that supports our aim of becoming a more sustainable organisation through:

- Enhancing our environmental performance. This includes working collaboratively with staff and our suppliers, in line with our Environmental Policy Statement.
- Complying with statutory obligations, such as national and local environmental regulations and statutory requirements for environmental performance reporting. Our Environmental Sustainability Report (Appendix 4 to our Annual Report and Accounts) is a key part of this.
- Maintaining our certification, ISO14001:2015 'Environmental Management System for Financial Regulation', supported by a programme of continual improvement.
- Fulfilling annual environmental objectives. Steps we are taking in this regard are set out earlier in the chapter.

We have adapted our internal structure through the creation last year of a dedicated ESG Division

The FCA Pension Plan (the Plan)

In 2021 the Trustee of the FCA Pension Plan made a number of changes to the Plan's investment options. These changes included updating the Plan's default investment strategy and broadening the full range of investment options to better reflect responsible investment principles. The equity allocation in the default investment strategy now uses a fund that reduces carbon emissions intensity by around 70%, with a commitment to target net zero emissions by 2050. In addition, the Plan also offers a range of self-select funds that incorporate responsible investment including a number of low carbon equity funds, a Positive Impact fund and two Sustainable Funds. The Plan will be publishing its first TCFD Report later this year.

Financial sector transition strategies and target setting

Firms should take a holistic approach to developing transition strategies

In recognition of the risks and opportunities set out above, as well as growing national net zero pledges by governments and wider stakeholder views, many financial institutions as well as the wider ecosystem of service providers have recently made net zero commitments. The Glasgow Financial Alliance for Net Zero (GFANZ), launched in April 2021, has brought together existing and new net zero finance initiatives into one sector-wide coalition. GFANZ aims to broaden, deepen and raise net zero ambitions across the financial system. It recently published a draft transition plan framework to support its members in driving global decarbonisation.

Firms should take a holistic approach to developing transition strategies so that they support economy-wide decarbonisation. Plans must include but not be limited to steps to meet firm-level decarbonisation commitments. Our view on this is outlined in more detail in the box later in this chapter. Key actions for financial firms include engaging effectively with counterparties, investee companies and issuers, defining sectoral decarbonisation pathways, aligning executive remuneration with climate commitments, reducing operational emissions and re-directing capital to reduce financed emissions and increase investment in transition activities.

Below is an overview of some of the initial steps being taken by some large asset owners, asset managers, insurers and banks to set specific targets and transition strategies.

Asset owners

Multiple net zero alliances and related frameworks that support asset owners have been created in recent years including the Net Zero Asset Owners Alliance (NZAOA), Paris Aligned Investment Initiative and the Investor Agenda.

Multiple net zero alliances and related frameworks that support asset owners have been created

As of June 2022, the 73 members of the NZAOA held more than $10.6 trillion assets under management. In its October 2021 progress report, the NZAOA found that of the 29 Alliance members who submitted interim targets, $4.6 trillion was being mobilised towards a target for 2025, with $1.5 trillion being mobilised towards a 1.5 degree aligned target for 2025. The underlying approaches by asset owners generally focus on four components:

- Engagement: some asset owners have set specific targets for investee company engagement. NZAOA set out an expectation that members engage directly, collectively or via their asset manager with at least 20 companies, focusing on those with highest owned emissions or those responsible for combined 65% owned emissions in portfolio.
- Portfolio emission targets: a few asset owners are setting specific targets across different asset classes. For example, NZAOA expect members to commit to a 22-32% reduction in carbon emissions by 2025 and a 49-65% reduction in carbon emissions by 2030 for equity and debt to listed corporates, infrastructure and real estate.
- Sectoral targets: some asset owners are also beginning to set decarbonisation targets for specific corporate sectors. NZAOA expect their members to aim to have sector targets in place by 2025 for 2030 targets for corporate sectors covering at least 70% of total owned emissions.
- Climate finance targets: asset owners are starting to publicly report their progress in mobilising climate finance. Few have set specific targets for this.

Asset managers

some asset managers have made commitments to exit carbon-intensive sectors like coal

Asset managers are taking a similar approach to setting net zero strategies and targets as asset owners, while recognising the need to meet their investment mandate. The Net Zero Asset Managers Initiative (NZAMI) has set an expectation that members disclose the initial percentage of their portfolio that is being managed in line with net zero, fair-share interim targets for being managed in line with net zero and an associated target date. A 2030 target should be consistent with a fair share of 50% reduction in carbon emissions. Member firms are expected to reach 100% of assets under management being net zero-aligned by 2050 at the latest.

In its May 2022 initial target disclosure report, NZAMI identified that 83 asset managers had set initial targets, with 39% of total assets under management committed to being managed in line with achieving net zero by 2050 or sooner.

As with asset owners, strategies are largely focused on engagement targets, sub-portfolio emission targets, sector targets and financing transition targets, as well as specific product-level targets. Examples include:

- **Sectoral targets:** some asset managers have made commitments to exit carbon-intensive sectors like coal or to divest from companies that generate a certain proportion of their revenues from thermal coal production. However, in some cases these targets only apply to active portfolios.
- **Portfolio targets:** firms have made commitments to a certain proportion of their assets under management in specific portfolios – such as real estate, infrastructure and private debt - being aligned to net zero by a specific year. Others have made commitments to reduce carbon intensity in particular portfolios.
- **Climate finance targets:** firms have made commitments to invest a certain amount of capital in key sectors such as low-carbon energy infrastructure and building.
- **Engagement targets:** firms are starting to set out expectations and escalation policies for investee companies relating to transition plans, associated management incentives, net zero targets and lobbying activities.
- **Product targets:** firms are starting to set product targets relating to, for example, investment flow into sustainable investment funds.

Insurers

Insurers are at an early stage in defining best practice on target-setting surrounding net zero commitment. The Net Zero Insurers Association (NZIA) is creating a Target Setting Protocol which is expected to be published by end 2022 and be applicable by 2030. This will include five-year intermediate science-based targets.

Insurers have an important role to play in enabling capital flows towards green infrastructure and carbon removal

Outside of the NZIA, firms are also taking individual steps to develop strategies to progress their net zero commitments. These largely revolve around product innovation, sectoral targets and reducing emissions associated with claims:

- **Product innovation:** firms are starting to offer and incentivise uptake of insurance policies covering electric vehicles, low mileage motorists, solar panels, battery storage or ground or air source heat pumps. Insurers also have an important role to play in enabling capital flows towards green infrastructure and carbon removal through the development of new products.
- **Reducing emissions associated with reinstatement and claims servicing:** firms are making changes to the drying process associated with home repairs after flooding and increasingly using recycled parts for motor insurance claims where appropriate. Others are building retrofitting into the claims process through cover including reinstatement and use of sustainable building materials.
- **Sectoral targets and exclusions:** some firms are starting to phase out coal-based business models from their client base and are no longer providing insurance covering the construction or operation of single fire power plants or coal mines. Others have committed to stop insuring companies making a certain proportion of their revenue from coal or unconventional fossil fuels.
- **Risk advisory:** firms are starting to provide climate data and analytical tools to financial institutions to support with portfolio analysis, financial hedging, risk evaluation tools and transition risk management strategies. Others are offering risk advisory services to support the scaling of low carbon technology.

Banks

The banking sector has seen a step-change over the last year in terms of net zero commitments and related targets and strategies. The creation of the Net Zero Banking Alliance (NZBA), as well as other initiatives such as Bankers for NetZero, the Partnership for Carbon Accounting Financials (PCAF) and the Paris Agreement Capital Transition Assessment (PACTA), and associated guidelines and tools to support climate change target setting have been key in catalysing and co-ordinating this.

Bank transition targets generally focus on a combination of reducing GHG absolute emissions, portfolio-wide and sector-specific emission intensity. Additional targets cover financial exposures relating to investment and lending activities within carbon-intensive sectors. The NZBA expects members to incorporate targets no later than 2030 with intermediary targets set for every five years after.

Some banks have set sector-specific targets for reducing carbon intensity

Strategies broadly cover strengthening capacity to assess and aggregate counterparty emissions and exposures, client engagement, exclusion policies and product innovation. Some retail banks and building societies are also setting targets relating to their mortgage book. We have considered some of these strategies in more detail below:

- **Mortgage lending:** some retail banks and building societies have started to set targets for the EPC rating of their mortgage portfolio. Firms are also pursuing product innovation such as green additional borrowing mortgages or retrofitting related products.
- **Capital mobilisation:** several banks have made commitments to channelling or facilitating the movement of a certain amount of capital into sustainable and transition finance.
- **Exclusions:** banks are starting to commit to phasing out loans to the coal sector by a certain year or to only serve clients with less than a certain percentage dependency on coal revenue by a certain year. Exclusions are sometimes confined to specific geographies or clients, and generally focus on the thermal coal sector. However, some banks have committed to excluding other high-emitting sectors such as oil and gas companies in certain circumstances.
- **Assessment of counterparty exposures:** various banks are investing in new tools to support assessment of firms in carbon-intensive sectors. This includes methodologies that build on public tools PCAF and PACTA to provide Paris-aligned benchmarks for lending and investing in certain corporate sectors to define sector-specific carbon limits for financing activity.
- **Sector specific emission reduction targets:** some banks have committed to reducing the absolute emissions and carbon intensity of their loan book in specific high-emitting sectors such as power, oil and gas and utilities. Such targets are sometimes confined to on balance sheet financing. Some banks have gone further and set sector-specific targets for reducing carbon intensity across a wider range of hard-to abate sectors such as cement, steel, mining and manufacturing.

Supporting the financial sector's transition to net zero

There is clearly significant ambition across the financial sector and extensive long-term climate commitments are being made. But while the previous section demonstrates progress, there is substantially more to do to articulate the key attributes of a credible and effective transition plan. It is critical that plans are disclosed in a consistent and comparable way that allows shareholders, clients and consumers to hold firms to account and strengthen market discipline. It is very important that firms disclose the immediate, short-term actions they are taking to achieve their climate targets and support the wider transition to net zero.

...there is substantially more to do to articulate the key attributes of a credible and effective transition plan

Transition Plan Taskforce and key features of a transition plan

We are working closely with the Treasury, E3G and the UK Centre for Greening Finance and Investment to help shape the UK's Transition Plan Taskforce, playing an active role in its Steering and Delivery Groups. The Taskforce published a Call for Evidence on a sector-neutral framework for private sector transition plans in May. We have set out our initial view on key features of a transition plan below.

Our view is that – to meet the needs of investors, clients and consumers - transition plans should cover how firms are: (i) setting their own climate-related targets and intending to decarbonise to meet those targets, (ii) responding to financial risks and opportunities stemming from the global transition and (iii) using their sphere of influence to accelerate an orderly transition.

In addition, plans should align with an economy-wide transition, be integrated with financial statements, have a clearly defined scope, focus on concrete near-term actions that are underpinned by robust governance and be reported on and verified transparently. We recognise that firms will face uncertainties and will need to make assumptions when developing their plans, these assumptions should be disclosed transparently as part of the plan.

We are also co-chairing the Transition Plan Taskforce's workstream on user and preparer guidance. A core component of this this is engaging industry to road-test the draft outputs of the Transition Plan Taskforce to ensure they meet user needs in informing capital allocation, stewardship activity and wider decision-making.

We look forward to drawing on the Taskforce's outputs to further develop our regulatory expectations relating to the disclosure of transition plans by listed companies and regulated firms. We will also publish our own transition plan in 2023.

We are already taking action to integrate expectations on the disclosure of transition plans into our rules. As a first step, last year we incorporated the TCFD's guidance on transition plans into our final rules on climate-related disclosures by listed companies, asset managers and FCA-regulated asset owners.

Active investor stewardship on climate change is critical to mobilising a whole economy transition to net zero

Active investor stewardship on climate change is critical to mobilising a whole economy transition to net zero. Transition plans need to provide the necessary information for investors to act as effective stewards and enable a market-led transition by upholding market discipline. We worked with the Financial Reporting Council (FRC) and the Stewardship Regulators Group to engage preparers, users and wider stakeholders on how existing stewardship mechanisms in this area can be made more effective, and the potential value of new mechanisms. The findings from this outreach will feed into the work of the Transition Plan Taskforce, including an exercise to 'pilot' a sector-neutral transition plan disclosure framework.

Robust transition planning is contingent on effective information flow. Our Data, Technology, and Innovation Division has an extensive work programme to enhance the capabilities of both regulators and industry on ESG data and disclosure. We hosted a Sustainability TechSprint in October 2021 to encourage ideas on how global regulators can harness technology to monitor ESG data and disclosures. We also worked with the City of London Corporation to run the next iteration of the Digital Sandbox, which identified a sustainability cohort composed of 12 organisations that focused on solutions to industry challenges in the realm of ESG data and disclosures. Lastly, we have accepted 10 firms into the Green FinTech Challenge 2021 to support the development of innovative products that will aid the transition to a net zero economy, either through our regulatory sandbox or our innovation pathways services.

To mitigate potential harms stemming from the transition to net zero we need to understand how the transition affects financial markets at the system level

To mitigate potential harms stemming from the transition to net zero we need to understand how the transition affects financial markets at the system level. Our Economics Division is working on two complementary tools to support this. First, we are developing a systems thinking framework to help us understand emerging transition risks and mechanisms by which financial services can facilitate decarbonisation. Second, we are building a sustainable finance data dashboard which will enable us to monitor progress being made by the financial services sector towards net zero and transition risks developing. Both these tools will help to create a robust analytical foundation for our decision-making in this area.

In addition, the CFRF launched this year a new Transition to Net Zero Working Group to develop a holistic practitioner-led risk based approach to transition to net zero planning. This will complement the work of the Transition Plan Taskforce and other related initiatives such as GFANZ.

Resilience of our strategy to climate scenarios

We need to understand the resilience of our regulatory and operational strategy to different long-term climate scenarios. As an initial step towards this, we have used three publicly available NGFS scenarios to make a qualitative assessment of this over a 30-year time horizon. The NGFS scenarios selected cover a broad range of social, political and economic assumptions:

- **Net zero 2050 – orderly scenario:** assumes that climate policies are introduced early and gradually become more stringent. This results in global warming on track to being limited to 1.5 °C. Both physical and transition risks are relatively subdued.
- **Divergent net zero:** disorderly scenario: considers higher transition risk due to divergent policies across countries and sectors. Net zero is reached by 2050 with global warming on track to being limited to 1.5 °C but with higher costs. This results in a high burden being placed on consumers.
- **Current policies:** hot house world scenario: assumes that few additional climate policies are implemented in jurisdictions. Global efforts are insufficient to halt significant global warming leading to emissions rising until 2080 and at least 3°C warming. This leads to severe physical risks and impacts.

We have outlined in the table below how regulated sectors might be affected by climate-related risks under each scenario. We have also explored how our regulatory and operational strategies might need to change to respond to potential risks and opportunities under different scenarios. This analysis is critically important in the context of the immediate and deep emission reductions required across all sectors required to limit global warming to 1.5°C. The recently published third instalment of the IPCC's Sixth Assessment Report notes that warming can only be limited to 1.5°C if emissions peak before 2025 at the latest and reduce by 43% by 2030. Even limiting warming to 2°C requires emissions peaking before 2025 at the latest and be reduced by 25% by 2030.

The recently published third instalment of the IPCC's Sixth Assessment Report notes that warming can only be limited to 1.5°C if emissions peak before 2025 at the latest and reduce by 43% by 2030

Table 2: Impact of climate scenarios on regulated sectors

	Sector	Impact
Net Zero 2050 – Orderly	Retail lending	Legislative change and wider transition risks could drive a range of consumer harms relating to product access, treatment of vulnerable consumers and sale of unsuitable products.
	Pensions and retirement income	Write-downs due to transition risks and broader underperformance could reduce the value of pension funds and lower long-term savings.
	Retail investments	Risk of greenwashing surrounding ESG-related funds and advice exacerbated by increased consumer pressure and demand in this area.
	Wholesale markets	Firms take a tick box approach to compliance with legislation and regulation relating to climate-related disclosure requirements.
	General insurance underwriting	Increased carbon price and wider transition risks likely to impact product pricing, terms and conditions, potentially reducing access.
Divergent Net Zero - Disorderly	Retail lending	Disorderly transition increases risk of poorly planned public policy intervention which creates risks such as sale of unsuitable product where a firm lends on a property that subsequently requires retrofitting.
	Pensions and retirement income	Severe reduction in GDP growth likely to reduce household incomes and lower savings rates, increasing likelihood of shortfalls.
	Retail investment	International regulatory divergence on climate-related disclosure increases risk of poor advice due to incomplete and inconsistent information.
	Wholesale markets	Divergent approaches to capital markets regulation leads to inconsistent and incomplete disclosure driving misallocation of capital and a disorderly wholesale market. Unanticipated policy responses create conditions for disorderly price adjustments, increasing tail risks.
	General insurance underwriting	Disorderly transition could change the scope and pricing of casualty policies reducing the ability to offer certain insurance products.
Current Policies – Hot house	Retail lending	Coastal erosion, subsidence and flooding impact property value significantly risks reducing consumer access to lending and creating financial difficulty for consumers. Lenders need sufficient internal expertise to understand physical risks and set appropriate risk tolerances.
	Pensions and retirement income	Physical risk events increase asset outflows as consumers access savings sooner. Inflows are also likely to be lower as savings rates reduce due to higher morbidity affecting the capacity of consumers to earn and save. Wider risk of asset write-downs following physical weather events.
	Retail investments	Significant strengthening of advisor access to granular physical risk data is needed to provide advice that accounts for such risk.
	Wholesale markets	Increased tail risk as a result of increased extreme weather events and data gaps relating to granular physical risk data creates increased risk of a disorderly wholesale market. Volatile pricing likely as a consequence of increased frequency of shocks and asset write-downs.
	General insurance underwriting	Physical risks lead firms to increase product exclusions, as well as claims and supply chain costs, that in turn reduce coverage and consumer access, and increase premiums. Risk of disorderly firm failure if firms do not base underwriting on robust data on exposures.

Net zero 2050 scenario – our regulatory approach

Given transition and physical risks are expected to be limited, our ESG Strategy and wider FCA Strategy is expected to remain relatively resilient. Our supervision and analysis of public climate-related disclosures, including on transition plans and strategies, would allow us to continuously evaluate the financial sectors transition pathway and determine appropriate regulatory interventions to support this. Increased supervisory resource may be required to assess potential consumer harms across retail sectors like general insurance and mortgage lending where transitional risks may reduce consumer access. Over time we would expect to reduce resource allocation to international standard-setting workstreams once a robust international ESG regulatory framework is established.

Net zero 2050 scenario – our own operations

Our focus would be on developing and refining a robust and comprehensive transition plan for our operations, underpinned by a clear net zero commitment and associated near-term targets. We would need to continue to invest in strengthening our understanding of our own Scope 3 GHG emissions data and integrating this into how we engage and select our suppliers. Lastly, we would also need to factor the anticipated financial impact of transition risks relating to policy change into our operational costs. For example, as a result of a carbon tax or requirements relating to the energy fuel mix in power generation.

Divergent net zero scenario – our regulatory approach

Transition risks are likely to be significant, with a need to devote additional resource to strengthening international ESG regulatory co-ordination due to divergent policy approaches being taken across jurisdictions. More generally disorderly price adjustments and increased tail risks would likely increase firm failure. Additional supervisory resource would be required to support client asset resolutions. Poor policy co-ordination could result in sudden product changes and impact the ability of consumers to access and afford general insurance and mortgage lending. This would require enhanced supervisory oversight and increased attention to the needs of vulnerable consumers. This would reduce our ability to effectively resource many of the business-as-usual activities we undertake to protect consumers and financial markets and promote effective competition.

Divergent net zero scenario – our own operations

Many of the effects expected under a net zero by 2050 scenario would also apply. Our transition planning would likely need continuous iteration and additional resource given the divergent nature of the transition.

Current policies scenario – our regulatory approach

Many of the negative effects expected under a divergent disorderly scenario would apply even more acutely in this scenario, for example around a disorderly wholesale market. Worsening economic conditions and reduced long-term savings levels will significantly weaken many consumers' financial resilience and increase vulnerability. In addition, firms providing secured lending and insurance underwriting relating to assets exposed to physical risks would face severe financial losses. Responding to significant consumer harms such as reduced access to products, poor treatment of vulnerable consumers and sale of unsuitable products across retail sectors would likely require a large amount of supervisory resource. We would also need to strengthen our oversight of how firms offering general insurance and mortgage lending factor granular physical risk data into their decision-making. Our regulatory strategy would need to focus almost entirely on responding to crystallising harm and away from more discretionary activities including thematic supervisory work, market intelligence and innovation related activity.

Current policies scenario – our own operations

The FCA could face business continuity disruptions attached to a significant increase in heatwaves, flooding and power outages. Such extreme weather events could disrupt the ability of staff to work both in the office and at home. In June 2021, flooding across parts of east London, in close proximity to our Stratford office, demonstrated that flooding represents a material physical climate risk for the organisation. The organisation would therefore need to continue to invest in ensuring all of its activities, and that of its core suppliers, service providers and data centres, can be carried out remotely where necessary.

Each of these scenarios reinforce the importance of our work to deliver effective integration of climate considerations across the FCA's functions. For next year's climate-related financial disclosure, we will significantly strengthen our use of scenario analysis with further depth and coverage of quantitative impacts, leveraging improved data, disclosure by real economy and financial firms, climate science and improved methodologies to do so. This will help us build out a central climate transition scenario for industry, based on commitments, targets and strategies set out by firms, and our work to support the delivery of that scenario.

6. Risk management, metrics and targets

Recommended Disclosures

a. Describe the organisation's processes for identifying and assessing climate-related risks.
b. Describe the organisation's processes for managing climate-related risks.
c. Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.

We are at an early stage in transforming our approach to the identification, assessment, mitigation and management of climate-related risks across our organisation. Delivering this, through the actions outlined in this chapter, is central to our work to embed climate considerations across all our functions.

Our overarching approach to risk

Achieving our statutory and operational objectives relies on our ability to influence the conduct and culture of the industry we regulate and our own ability to operate effectively. It also relies on the financial resilience of firms to the risks they face, which is important to us as the prudential regulator of 49,000 firms. Our risk management framework is designed to help us make regulatory judgements regarding the risks of harm and how we should prioritise our interventions, including through the analysis of trends and the identification of emerging risks. We explain this further in this section.

Climate risks could impact our ability to achieve our objectives, and hence directly influence our work as both a regulator and a corporate entity. We are committed to taking the necessary steps to manage these risks effectively, and to further develop how we measure our impact. This in turn will further improve our ability to mitigate associated consumer and market harms.

Climate risks could impact our ability to achieve our objectives, and hence directly influence our work as both a regulator and a corporate entity

In order to identify, assess, track and mitigate risks, our risk management framework includes an organisation-wide operating model built around the three lines of defence:

- **First line:** Our front-line operations are responsible for identifying, assessing, mitigating, and reporting consumer and market harms and the risks they face through their work.
- **Second line:** Our Risk & Compliance Oversight Division (R&CO) owns the Risk Management Framework for our Own Risks and provides risk management expertise, advice, support, challenge and oversight. It also provides independent assurance over all risk management processes.
- **Third line:** Our Internal Audit function provides independent challenge to the standards and effectiveness of risk management across the organisation.

This provides us with a robust approach to directly managing and controlling our Own Risks, namely the risks to our operations and how we execute our regulatory strategy. This in turn helps to ensure we effectively identify, assess, mitigate, manage, and report risks of harm to consumers and markets, as well as any associated public confidence risks.

As noted in the Governance section of this report, the Board has agreed to amend the Terms of Reference of key board committees to refer to reviewing and challenging key climate risks and any mitigating actions we have taken. This includes the Risk Committee and Audit Committee.

Climate issues in our risk taxonomies

Our risk taxonomies enable the consistent categorisation of risks to help improve the adequacy, effectiveness and efficiency of our risk management activities. We use three different risk taxonomies that cover:

- Risk of Harm – risks posed to consumers, firms and markets
- Cause of Harm – factors which can lead to harm if not addressed
- Own Risk – operational and execution risks facing us as an organisation (as explained above)

A key step we have taken to embed climate risks into our risk management framework is ensuring that our risk taxonomies support the categorisation and tracking of ESG risks. We are currently working on further improvements to aid reporting. This provides a clear and consistent tool for colleagues across the organisation to identify and categorise climate-related risks. Our Risk of Harm and Cause of Harm taxonomies enable the mapping of climate-related risks that could impact the markets we regulate and the consumers within those markets. Likewise, we have mapped the climate-related risks that could impact our ability to operate and carry out our functions as an organisation to our Own Risk taxonomy.

We have a range of mechanisms to identify risks and their causes in practice, including those related to climate

Furthermore, a member (or members) of our senior management team have responsibility for relevant elements of the Own Risk taxonomy in line with their overall responsibilities. This will help ensure that accountability for the ownership and management of those risks across the organisation is clear.

Risk identification and assessment

We have sought to assess, develop and enhance our internal risk management capabilities (Operational Risk and Execution Risk, together 'Own Risk') within the ESG Division, leveraging existing organisational risk management strengths and established best practice.

Over the coming year, we will continue to strengthen our management of ESG-related Own Risks across the FCA as a whole, as well as further embedding risk management within the ESG Division to help us manage and control our Own Risks.

This should in turn help us ensure we effectively identify, assess, mitigate, manage, and report on external ESG-related Risks of Harm, and make sure we are better able to deliver the right interventions at the right time and in the right way. As part of our work, we will identify and operationalise the support needed from our ESG and R&CO Divisions to fully incorporate climate-related risks into the FCA-wide risk management processes.

We have a range of mechanisms to identify risks and their causes in practice, including those related to climate. In terms of our regulatory role, these range from the work of our supervisory and Market Oversight teams via their direct interactions with financial firms/sectors and listed companies, to the role of our ESG Division and other areas in gathering intelligence and data on external developments. For instance, our Financial Lives Survey (FLS) is a major source of information on consumer trends and risks.

The FLS now includes a number of ESG-related questions to assess consumers' interest in, and engagement with, ESG and responsible investing, including climate-related investing. There are also questions which focus on assessing greenwashing risks, where products promoted as being 'sustainable' overstate or mislead with respect to their actual ESG-credentials.

We will be increasingly using the FLS, and other means of gathering consumer and firm insight, to identify and assess a wider range of climate-related risks that may affect consumers.

We have also established a dedicated Market Intelligence & Engagement Team within the ESG Division to enhance our ability to identify risks in the climate space. We have put in place ESG-focused resourcing across the board (including in supervisory and market oversight areas) in support of the new FCA Strategy. We summarise below the steps we have taken to embed climate considerations in how we regulate.

We have central risk management systems in place to store, manage, aggregate and report on the risks we identify. This helps to ensure that risks are identified, taxonomised, assessed consistently, tracked and mitigated, and that we have effective reporting and governance in place, all of which improves our ability to provide joined-up, effective interventions at the right time.

Oversight of the risks and objectives related to how we operate is provided by members of our senior management team or by ExCo, as set out in the Governance section of this report. This oversight includes reviewing and approving our assessment and management of operational risk, for example the risk of climate events affecting our ability to discharge our functions. It also includes reviewing and signing off the environmental objectives, targets and metrics that we set as an organisation – eg to reduce our GHG emissions. The ESG Division has been developing its capabilities to coordinate with the relevant areas across the FCA to provide a joined-up and coherent approach to manage both the climate-related risks we face as an organisation, and those we expect regulated firms to manage.

Risk appetite

Once we have used our risk taxonomies and wider tools to understand the risks we face, we can decide whether and how to act. We are currently in the process of updating our internal risk appetite framework, which will help us to determine the appropriate action for us to take to deliver against our objectives. The updated risk appetite framework currently being rolled out will incorporate specific key risk indicators relating to our own climate-related risks and meeting the Government's expectation that we have regard to its commitment to achieve a net zero economy by 2050. Our ESG Division will play a lead role in setting our key risk indicators under the framework, and the triggers and tolerances associated with each, for approval by the Board.

Our approach to measuring, mitigating, and managing climate risks will continue to evolve as our understanding of the risks grows, methodologies improve and our own technical capabilities strengthen.

The updated risk appetite framework currently being rolled out will incorporate specific key risk indicators relating to our own climate-related risks

Risk evaluation

The final aspect of our approach to risk management is evaluation. We evaluate the differences between the actual and intended outcomes of our actions and identify where we can improve our approach. We are taking steps to strengthen our approach to evaluating our own impact as an organisation, including in relation to climate change. The climate-related metrics and targets we discuss below help us to do this in a robust and transparent way. Our ESG Division will lead the annual evaluation and attestation of how we have performed against the outcomes we set for ourselves and how we have managed the associated risks. This will then be challenged through our organisational governance.

We are taking steps to strengthen our approach to evaluating our own impact as an organisation, including in relation to climate change

Further steps we have taken to embed climate considerations in our risk approach

In addition to the above, we have undertaken a number of further steps to embed climate considerations in our approach to risk:

- Setting out our expectations through our ESG Strategy, the FCA Strategy and our broader communications to stakeholders, such as the letter we sent to the Chairs of authorised fund managers in July 2021 on the design, delivery and disclosure of ESG and sustainability funds.
- Enhancing our broader processes. In addition to the changes to risk management outlined above, we have integrated ESG considerations into supervisory and policy committees, forums and processes dealing with climate risks, including through the attendance of experts at relevant committees. This helps to ensure climate considerations are understood and factored in as supervisory and policy decisions are being made.
- Providing colleagues with the training and tools they need. This has included ensuring they are aware of climate issues, how they relate to our statutory and operational objectives and what questions they should be asking of regulated firms and individuals to assess climate risks (including how to recognise good versus poor responses).
- Reviewing the climate-related requirements for suppliers, based on underlying risk, and ensuring that our procurement processes are improved to generate assurance that these requirements are met.
- Liaising with other regulators such as the PRA on emerging and existing climate-related risks and, where appropriate, how we can work together to address them.

These changes are materially improving our capacity to identify, assess and mitigate climate-related risks.

Metrics and targets to evaluate our response to climate-related risks and opportunities

...we are committed to being accountable, through clear outcomes, metrics and targets, including for our ESG priorities

Recommended Disclosures

a. Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.
b. Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
c. Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

As outlined in our Strategy and Business Plan, as well as our ESG Strategy, we are committed to being accountable, through clear outcomes, metrics and targets, including for our ESG priorities. This section outlines the climate-related metrics and targets we are using across both our internal operations and regulatory activity.

Metrics and targets for our regulatory activity

In the FCA Strategy, we outlined our cross-cutting commitment on ESG ('A strategy for positive change: our environmental, social and governance priorities'). Alongside this, we published on our website the metrics we were putting in place to assess our success against the outcomes we want to achieve under that commitment. All of the metrics are relevant to climate-related risks and opportunities, and are summarised in Table 3, below. As these metrics are new for the 2022/23 financial year and are still under development, we do not have baselines against which to judge them and so have not set specific, numeric targets. We will revisit the outcomes, targets and metrics as our work on ESG issues progresses, as part of seeking to continuously improve.

Table 3: FCA's climate-related metrics for regulatory activity

Outcomes	Metrics
High-quality climate- and wider sustainability-related disclosures to support accurate market pricing, helping consumers and market participants choose sustainable investments and drive fair value.	Increase in quality and quantity of climate-related and sustainability disclosures (metric for quality to be determined).
Trust and consumer protection from misleading marketing and disclosures around ESG-related products.	Monitor the incidence of misleading marketing for ESG products.
	Increase in consumer trust of ESG-related products.
	Monitor Enforcement and Supervisory cases of financial crime, fraud, and mis-selling of ESG related products.
Active investor stewardship that positively influences companies' sustainability strategies, supporting a market-led transition to a more sustainable future.	We are working with industry leaders and other regulators to decide how to develop indicators for the effectiveness of stewardship. Active investor stewardship has been identified as an important way to pursue environmental and social goals in the transition to a more sustainable future. We will develop a metric that indicates how investor engagement and the exercise of existing shareholder rights, such as shareholder resolutions and voting, are being used to encourage positive ESG outcomes.

Metrics and targets for our own operations

Each year, we report on key environmental sustainability metrics in our Annual Report and Accounts. We have done so again this year (see Appendix 4). In Table 4, below, we have reproduced key data on our GHGs and, alongside each, have added the specific targets that have been agreed for the 2022/23 financial year.

In Table 5, we have provided additional GHG and electricity supply information. Where applicable, we have set out targets for these metrics too. Some data are initial estimations only, and these figures and the corresponding baselines and targets may be amended. For instance, we have developed prototype models to estimate the Scope 3 emissions related to staff working from home and commuting to our offices. We have gathered data from staff on their working from home arrangements, heating, lighting, commuting methods, etc, and have combined this with publicly available data on home and travel energy usage to produce our figures. We fully recognise that the calculations provide only an approximation of these Scope 3 emissions, but we have chosen to publish them in the interests of transparency. We will be refining our models over the coming year.

...we have developed prototype models to estimate the Scope 3 emissions related to staff working from home and commuting to our offices

We are committed to regular, high-quality reporting, and so will be publishing sustainability metrics on our website during the course of this year. We will then report on our performance against those metrics.

-81% by 2027 from baseline 2017/18 (limit to 9.5 tCO2e)

-91% by 2027 from baseline 2017/18 (limit to 394 tCO2e)

-90% by 2050 from baseline 2019/20 (limit to 130.8 tCO2e)

London 100% renewable (FY 2021)

Table 4: Scope 1 and Scope 2 GHGs and Scope 3 GHGs from business travel

Climate and environmental KPIs	Baseline	Targets	Actual FY 2021/22
GHGs Scope 1	50 tCO2e (FY 2017/18)	-81% by 2027 from baseline 2017/18 (limit to 9.5 tCO2e)	4.11 tCO2e
GHGs Scope 2	4,439 tCO2e (FY 2017/18)	-91% by 2027 from baseline 2017/18 (limit to 394 tCO2e)	398.78 tCO2e
GHGs Business Travel Scope 3	1,308 tCO2e (FY 2019/20)	-33.6% by 2027 from baseline 2019/20 (limit to 868.5 tCO2e) -90% by 2050 from baseline 2019/20 (limit to 130.8 tCO2e)	49.92 tCO2e -96% from baseline 2019/20

Table 5: Additional data on Scope 3 GHGs and use of renewable electricity

Climate and environmental KPIs	Baseline	Targets	Actual/estimate FY 2021/22
GHG estimation Working from home Scope 3	n/a	n/a	1,396 tCO2e
GHG estimation Staff commuting Scope 3	n/a	n/a	447 tCO2e
GHGs estimation Purchased goods and services Scope 3	Estimation of 21,122 tCO2e (in FY 2021/22)	- 29.4% by 2027 from baseline 2021/22 (limit to 14,912 tCO2e) -90% by 2050 from baseline 2021	See 'Baseline' column
GHGs emissions Post and courier Services Scope 3	18 tCO2e (FY 2020/21)	-5% from baseline 2020/21 (limit to 17 tCO2e)	15.6 tCO2e - 13.5% from baseline 2020/21
Renewable electricity supply	London 100% renewable (FY 2021/22)	100% renewable electricity supply in all offices (subject to pre-existing contracts)	London 100% renewable

Given the nature and scale of the FCA as an organisation, we do not think there are large or unusual risks related to our Scope 1, Scope 2 and Scope 3 GHGs emissions. The primary risks we have identified are set out below:

- While the UK Emissions Trading Scheme (UK ETS) does not directly apply to the FCA, future changes to the activities in the scope of the UK ETS could potentially extend to our operations. Similarly, other legislative, regulatory and policy change (such as the creation of a UK carbon tax) could affect our operations and/or finances. However, given the Government consulted only recently on the possible introduction of a Carbon Emissions Tax and decided to implement the UK ETS instead (from 1 January 2021), we do not consider this risk to be material in the near term.
- Changes in how we organise our technology and the scale of our data retention needs could impact our GHG emissions. We are starting to actively monitor the Scope 3 GHGs associated with our suppliers, including IT partners, and are factoring climate considerations into our supply chain management and procurement processes. As with all organisations, we need to work collaboratively with our suppliers to reduce the Scope 3 GHG emissions in our supply chains.
- The year-on-year increase in staff working in our offices once more may result in increases in our Scope 1 and Scope 2 emissions, and in our Scope 3 emissions related to staff commuting. However, there should be corresponding decreases in Scope 3 emissions associated with staff working from home. We are working to improve our measurement of Scope 3 emissions, including from commuting and home working, to help us develop a better understanding of our total emissions.

We are in the process of determining appropriate risk triggers and limits related to the KPIs in Table 4. We will actively track the triggers and limits once they are in place to ensure we identify promptly any risk to our delivering on the KPIs. Where necessary, we will take suitable mitigating action.

We are working to improve our measurement of Scope 3 emissions, including from commuting and home working, to help us develop a better understanding of our total emissions

Annex 1
Abbreviations used in this paper

Abbreviation	Description
CCAR	Climate Change Adaptation Report
CEO	Chief Executive Officer
CFRF	Climate Financial Risk Forum
EMS	Environmental Management System
EPC	energy performance certificate
ERPC	Executive Regulation & Policy Committee
ESG	environmental, social and governance
ETS	Emissions Trading Scheme
ExCo	Executive Committee
FCA	Financial Conduct Authority
FLS	Financial Lives Survey
FRC	Financial Reporting Council
FSMA	Financial Services and Markets Act
FY	financial year
GFANZ	Glasgow Financial Alliance for Net Zero
GHG	greenhouse gas
KPI	key performance indicator
NGFS	Network for Greening the Financial System
NZAMI	Net Zero Asset Managers Initiative

Abbreviation	Description
NZAOA	Net Zero Asset Owners Alliance
NZBA	Net Zero Banking Alliance
NZIA	Net Zero Insurers Alliance
PAC	Public Accounts Committee
PACTA	Paris Agreement Capital Transition Assessment
PCAF	Partnership for Carbon Accounting Financials
PRA	Prudential Regulation Authority
R&CO	Risk & Compliance Oversight
TCFD	Taskforce on Climate-related Financial Disclosures
tCO2e	tonnes of carbon dioxide equivalent
TSC	Treasury Select Committee

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12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk