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# Financial Conduct Authority Calls for Improvements in ESG Benchmarks

**April 18, 2023**

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Last month, the Financial Conduct Authority (FCA) **announced** that, after conducting a "preliminary review" of ESG benchmarks, "the overall quality of ESG-related disclosures made by benchmark administrators was poor" and improvements were necessary to ensure that the benchmarks were based on quality, consistent, and reliable data. On March 23, 2023, the FCA sent a **letter** to benchmark administrators explaining that it expected the administrators to develop, and be prepared to explain upon request, their strategies to address a number of issues raised in the letter, which address deficiencies concerning benchmark statements, benchmark methodologies, low carbon benchmarks regulations, and the robustness and reliability of ESG benchmarks. The key deficiencies identified include:

- Not enough detail on the ESG factors considered in benchmark methodologies;
- Not ensuring that the underlying methodologies for ESG data and ratings products used in benchmarks are accessible, clearly presented and explained to users;
- Not fully implementing ESG disclosure requirements; and
- Benchmark administrators failing to implement their ESG benchmarks' methodologies correctly – for example, using outdated data and ratings or failing to apply ESG exclusion criteria.

For any administrators who fail to develop strategies to address these deficiencies, the FCA intends to "deploy [its] formal supervisory tools and, where appropriate, consider enforcement action[.]"

**Taking the Temperature: The FCA has made it clear that it is and will remain focused on ensuring accurate and reliable disclosures, particularly with respect to ESG-related data. As the FCA has recognized, benchmark administrators, as users of ESG data, bear responsibility for ensuring that the data and methodologies used to formulate their**

**benchmarks are accurate and reliable. In September 2022, the FCA sent a letter to benchmark administrators detailing its "supervisory priorities" in, among other areas, disclosure and quality of data and data controls. In that letter, the FCA detailed the risks associated with each area and the expectations for administrators in addressing those risks. For example, with respect to disclosure, the FCA highlighted the growth of the ESG sector, and how "the subjective nature of ESG factors, and how ESG data and ratings are incorporated into benchmark methodologies, give rise to an increased risk of poor disclosures in ESG benchmark statements," which could result in a misalignment between the quality of the benchmark and investor expectations. In a related development, the FCA recently extended the publication date for its sustainability disclosure requirements in order to review and consider the approximately 240 responses it received during the consultation period on its proposals. In its announcement, the FCA reiterated that "[t]o create a UK market that functions competitively and effectively for the benefit of consumers, those consumers must be able to trust sustainable investment products" and that their proposals aim to "build confidence and to help consumers navigate the market and make better informed decisions." As we have observed, however, including with respect to ESG ratings, the potential for inconsistencies and inaccuracies in the source data, methodologies and weightings of the various aspects of ESG-related benchmarks continues to be an issue.**