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Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Submitted electronically via https://comments.cftc.gov

October 3, 2022

Dear Mr. Kirkpatrick,

Request for Information on Climate-Related Financial Risk

The Alternative Investment Management Association (AIMA)[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's (CFTC or Commission) request for information[2] on climate-related financial risk (the RFI). In the Annex, we address the key themes raised in the RFI, making the points that are summarized below.

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1 AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2.5 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programs and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage $600 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialized educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

2 CFTC, Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34856 (Jun. 8, 2022).

Data

- Issues related to data (availability, materiality, quality, consistency, scope and timeliness) and analytical tools are key constraints for investment managers when it comes to their ability to understand and manage climate-related risks.

- The data challenge is exacerbated for managers with a higher share of assets under management linked to non-mainstream investment products and strategies (where mainstream is taken to be investments in the equity or issuance of large, developed-market corporates).

- When it comes to supervisory intervention, we therefore believe that it is vital to prioritize work on climate-related disclosures by companies, rather than focusing on investment managers' approaches to climate-related risk. Without robust data, investment managers will inevitably be subject to constraints in respect of their ability to focus on climate risk.

- We also strongly favor efforts to achieve greater global coherence and consistency when it comes to companies' disclosure of climate-related information. The work of the International Sustainability Standards Board (ISSB) is a helpful step in this regard, and we encourage the CFTC to continue to support the work of other agencies, as well as international standard setters, when it comes to climate risk reporting requirements.

Risk management

- Our members have in recent years made significant efforts to better understand and manage the climate-related risks to which they are exposed, reflecting investor expectations that such risks should be fully evaluated.

- Given the existing industry focus on management of climate-related risks, we would caution against overly prescriptive requirements in respect of risk management procedures relating to climate risk and instead believe that flexible, industry-level guidance on this topic is preferable. This reflects the reality that the impacts of climate risk will depend significantly on the investment classes and regions to which an investment manager is exposed, meaning that broadly applicable requirements might not be suitable.

Disclosure of climate-related risk information by investment managers to end investors

- It is not, in our view, a given that distinct requirements for investment managers are required: the first step should be to assess whether existing product disclosure rules and associated supervisory enforcement tools are sufficient to ensure that investors are not at particular risk of being misled about a product's credentials when it comes to climate risk.

- To the extent distinct climate risk disclosure rules are ultimately adopted, we generally believe these should focus on funds that explicitly promote environmental aspects in their marketing documentation or that apply material, binding non-financial criteria to their investment strategies (rather than products with more incidental ESG integration). This can help ensure that investors receive information that is meaningful and useful to their decision-making, rather than give undue prominence to ESG matters where that is not warranted by the characteristics of the product.

- Another important factor is to acknowledge the diversity of portfolio holdings and investment techniques when designing rules governing disclosure of climate-related risks. AIMA has recently devoted significant attention to the question of how to approach disclosure of short positions or derivatives exposures, topics that have often been neglected in the work of global standard setters. We share our perspectives on the treatment of short positions and derivatives exposures.

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We would be happy to elaborate further on any of the points raised in this letter.

Yours sincerely,

/s/

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AIMA

ANNEX

Data

In the RFI, the CFTC raises many important questions about the availability of climate-related data that could inform its own supervision, while also raising questions about the extent to which its reporting requirements could help registrants and/or the public to better understand or manage climate-related risks.

For our members, issues related to data (availability, materiality, quality, consistency, scope and timeliness) and analytical tools are key constraints when it comes to their ability to understand and manage climate-related risks. For instance, investment managers increasingly need access to carbon data in order to make informed investment decisions, but there are major gaps in what is currently available, reflecting shortcomings in existing corporate reporting requirements and the broad range of assets in which firms invest.

Where proxy data is available, there can still be challenges in terms of the robustness of that data, given the assumptions that will have been used in computing it. There are also myriad public and private sector frameworks and initiatives underpinning data reporting, which means that investment managers must seek to fully understand how these affect the nature of what companies report.

The data challenge is exacerbated for managers with a higher share of assets under management linked to non-mainstream investment products and strategies (where mainstream is taken to be investments in the equity or issuance of large, developed-market corporates). This includes:

- Exposures to issuers such as sovereigns, supranationals and agencies (SSAs); small, private, sub-investment grade issuers; emerging market issuers; non-single name issuer investments (e.g., structured credit portfolios); and exposures where there is no direct ownership or where security selection is not possible (e.g., indices).

- Alternative strategies, such as macro strategies encompassing interest rates and currency instruments, or where the manager holds derivatives to gain economic exposures. There may also be strategies, such as high frequency trading or quantitative strategies, where investment holding periods may be such that carbon risk might be less relevant than for a buy-and-hold maintain strategy or one with longer holding periods. The nature of investment exposure is also another area of differentiation, for instance those strategies using short selling (which can span both equity and debt strategies).

- Private credit strategies.

When it comes to supervisory intervention on climate-related risk, we therefore believe that it is vital to prioritize work on companies' climate-related disclosures rather than focusing on investment managers' approaches to climate-related risk (whether at the level of organization/risk management or disclosures). Without robust data, investment managers will inevitably be subject to constraints in respect of their ability to focus on climate risk.

In this regard, we believe progress is being made to address data shortcomings and, in particular, welcome the Securities and Exchange Commission's proposal[3] to require registrants to provide certain climate-related information in their registration statements and annual reports, while emphasizing the importance of data quality over the quantity of data. This will provide additional, material information to our member base, ensuring that they can best serve the needs of their ultimate end investors, which include endowments, charities and pension funds. We do not believe that an alternative approach, based on voluntary disclosure, can achieve the improvement in quality of disclosures that is needed.

We also strongly favor efforts to achieve greater, global coherence and consistency when it comes to disclosure of climate-related information. The ISSB's recent publication of exposure drafts on general sustainability-related[4] and climate-related[5] disclosures is another helpful step in this regard. We encourage the CFTC to continue to support the work of other agencies, as well as international standard setters when it comes to climate risk reporting requirements.

Risk management

We note that the RFI addresses the issue of how registered entities and/or registrants might need to adapt their risk management frameworks to address climate-related risks. Our members have recently made significant efforts to better understand and manage the climate-related risks to which they are exposed, reflecting investor expectations that such risks should be fully evaluated.

For many firms, this has entailed an overhaul of internal governance and decision-making structures to ensure the appropriate focus on climate (and other ESG) issues, while some firms have also hired dedicated ESG staff to support this enhanced focus. It is worth noting that this hiring trend is more established in Europe than North America - over half of EMEA-based firms have at least one staff member in a dedicated ESG role, compared to 15% of firms in North America and 8% of firms in APAC.[6] In part, this reflects the additional compliance burden created by implementation of the European Commission's Sustainable Finance Action Plan, and most notably the effectiveness of the Sustainable Finance Disclosures Regulation (SFDR).

Given the existing industry focus on the management of climate-related risks, we would caution against overly prescriptive requirements in respect of risk management procedures relating to climate risk and instead believe that flexible industry-level guidance is preferable. This reflects the reality that

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3 SEC, Proposing Release, The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (Apr. 11, 2022).

4 https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

5 https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

6 AIMA, "Gaining an edge: How hedge funds are navigating the new talent landscape" (2021). Online at: https://www.aima.org/educate/aima-research/gaining-an-edge.html#section-download.

the impacts of climate risk will depend significantly on the investment classes and regions to which an investment manager is exposed, meaning that broadly applicable requirements might not be suitable.

We also note that the RFI particularly addresses scenario analysis. This is an important element of the guidelines of the Task Force on Climate-Related Financial Disclosure (TCFD), but also one that is more relevant to some investment strategies than others. Consequently, we believe that it should be for individual firms to assess whether scenario analysis is an appropriate tool in light of their specific exposure to climate risk.

Disclosure

The RFI raises the possibility of considering, by registrant category, the establishment of climate-related risk disclosure requirements based on the four core elements of the TCFD's guidelines, noting the goal of "offer[ing] meaningful information about climate-related financial risks, and to foster transparency into those risks."[7]

To the extent disclosure requirements are focused on the compatibility of an investment with an investor's needs (whether in the context of risk appetite or specific ethical considerations), then it is not, in our view, a given that distinct requirements for investment managers are required. The first step should be to assess whether existing product disclosure rules and associated supervisory enforcement tools are sufficient to ensure that investors are not at particular risk of being misled about a product's credentials when it comes to climate risk.

In this context, it is important to differentiate between retail investors and professional investors and consider their differing information needs and bargaining ability; greenwashing risks are arguably more acute in the context of products sold to retail investors.

To the extent distinct climate risk disclosure rules are ultimately adopted, we believe these should focus on funds that explicitly promote environmental aspects in their marketing documentation or that apply material, binding non-financial criteria to their investment strategies (rather than products with more incidental ESG integration). This can help ensure that investors receive information that is meaningful and useful to their decision-making, rather than give undue prominence to ESG matters where not warranted by the characteristics of the product.

In this context, we also caution against any approach that requires detailed public disclosures about the management of climate or ESG risks (including associated metrics) on firms' websites, particularly where these relate to product lines such as segregated mandates for which investors would reasonably have an expectation that the agreed to approach with an investment manager would not be widely shared.

Another important factor is to acknowledge the diversity of portfolio holdings and investment techniques when designing rules governing disclosure of climate-related risks. We note that in other

[7] RFI, *supra* note 2, at 34859.

parts of the world, e.g., the EU, policymakers have tended to use relatively well-established climate-related – or more broadly, ESG – approaches from the long-only equity world as the basis for policy considerations regarding financial markets, overlooking the specificities of alternative asset classes. This has created uncertainty as to the treatment of short positions or positions held through derivative contracts. It also raises uncertainty about the approach to investments in asset classes that have a less direct link to climate-related concerns, including rates or currency.

AIMA has recently devoted significant attention to the question of how to approach disclosure of short positions or derivatives exposures, with latest industry thinking summarized in AIMA's ESG Handbook 2022.[8] Some key insights are set out below:

Short selling

There is a broad acknowledgement within the hedge fund industry that the goal associated with reporting on ESG factors can vary. In particular, reporting might seek to present: (1) exposure to financially material risks or opportunities; or (2) the real-world impact associated with portfolio-level positions. This distinction is sometimes referred to as single versus double materiality, particularly in the European context. The focus for individual investment managers will reflect the preferences and needs of the underlying investors in the funds they manage, but there is general agreement that both are important.

Any formal reporting approach for ESG factors needs to respond to these different underlying drivers. This holds for both regulatory and industry frameworks and leads to challenges in terms of determining the best way to deal with particular types of exposures – including short positions and derivatives – given the different needs that reporting serves. As noted above, too often these points are neglected by global standard-setters, and our members emphasize the importance of taking a considered approach to the design of reporting frameworks to ensure that they accommodate a range of investment strategies.

There is strong industry consensus that disclosure to investors of both long and short exposures to ESG risks is important, enabling investors to decide how to analyze the information that is presented to them. This may well suit investors that have allocations to multiple managers, allowing for more sophisticated review of ESG exposures.

There is also strong industry consensus that short positions can drive change in the underlying economy – i.e., achieve impact. Attributing impact to short selling can be challenging, particularly where issuer cost of capital is used to measure impact, but this same challenge exists for investing in general and for other elements of responsible investment. Firms have generally found that investors are open to discussing in a nuanced way the positive contribution of short selling to managing ESG risk and achieving impact.

[8] Online at: https://www.aima.org/sound-practices/guides-to-sound-practices/aima-esg-handbook-2022.html.

Derivatives

In contrast to a situation in which an investor directly owns a security or asset, accounting for derivatives is not necessarily straightforward in an ESG context. Accordingly, there is a spectrum of views regarding the appropriate treatment of derivatives, with no overall industry consensus around these different viewpoints.

At one end of the spectrum, some managers take the view that, when assessing exposure to ESG risks, they should not look through to the underlying market referenced by the derivative contract. This view is predicated on the fact that derivatives contracts are distinct from the underlying market and should, according to this approach, more rightly be analyzed in terms of their capacity to support liquidity in the underlying market and facilitate the exchange of risk. Managers expressing this viewpoint argue that a look-through approach risks double counting of exposures, given that those that physically hold the underlying asset will most likely be performing their own, distinct ESG assessment.

On the other hand, it can be argued that having derivative exposure does have a meaningful impact on the underlying market, particularly where the counterparty offering the derivative exposure hedges its own risk through the physical holding of a security, leading to an indirect impact on the cost of capital for issuers. At the same time, they make the case that consistent treatment of derivatives positions by all market participants, based on netting of the delta-adjusted derivatives positions with other long and short exposures, would support an accurate reflection of the overall position in the market. There is, however, additional complexity for derivatives referencing commodities, in terms of assessing the fungibility of the underlying referenced by different contracts.

Under this approach, derivatives could be treated differently depending on whether the underlying could be argued to have a sustainability angle (for example, commodities, equities, and single-name Credit Default Swaps) or whether the underlying is less obviously connected to controllable real-world impact (FX and interest rate swaps).

For some managers, whether to look through to the underlying security and consider associated ESG factors could also depend on the intentionality of the derivative. For example, whether it is being used to hedge risk or whether it is instead being used to invest in particular securities explicitly on account of sustainability considerations. Some managers reject this approach, arguing that accounting approaches more broadly are not typically based on the notion of intentionality, potentially leading to an unhelpful differentiation solely for ESG considerations.