Financial Conduct Authority Consultation Paper 22/20

Sustainability Disclosure Requirements (SDR) and investment labels

UK Finance response

Deadline: 25 January 2023

Sent to: Submitted by email to cp22-20@fca.org.uk

INTRODUCTION

UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms, we act to enhance competitiveness, support consumers, and facilitate innovation. We work for and on behalf of our members to promote a safe, transparent and innovative banking and finance industry.

We are pleased to respond to the SDR and investment labels consultation paper (CP 22/20) which seeks to help consumers (also referred to as "retail investors") navigate an increasingly complex investment product landscape, protect them from greenwashing, and promote trust.

The banking and finance sector plays a key role in supporting the global decarbonisation transition and our wider sustainability commitments. Our members are committed to helping finance the transition across the economy, including through lending to crucial areas of the transition. The banking and finance sector is also committed to decarbonising its portfolios and financing the green economy, in line with the UK's sustainability goals.

If you have any questions relating to this response, please contact Ian Bhullar, Strategic & Sustainability Policy Principal, at ian.bhullar@ukfinance.org.uk.

KEY RECOMMENDTIONS

We share the FCA's conviction that any regulatory measures introduced should aim to build transparency and support consumers in navigating the market for sustainable investment products, and also ensure that sustainability-related terms are proportionate to the profile of the solutions offered.

To ensure that these rules work as effectively as possible, we have set out detailed recommendations from the banking and finance sector in this response. Our key recommendations are:

- Many banking and finance firms operate across international borders, with clients and value chains across the globe. Welcoming the FCA's continued support for international sustainability disclosure baselines including the work of the International Sustainability Standards Board (ISSB), we call strongly for **alignment of the UK's sustainability disclosure and product labelling regimes with those of other jurisdictions**, while seeking to learn from the experiences of our international partners. Divergence from other jurisdictions generates challenges for international firms serving clients across borders, and our goal should remain harmonisation as far as possible. Our response calls out specific opportunities to enhance alignment with international best practice, and we also call for efforts to agree **equivalence or substituted compliance arrangements** where alignment is not possible.

- Regarding the timeline for disclosures, it is important that there is a **gradual and targeted implementation of all rules**, including for labelling and classifying products, to allow adequate time for implementation. The rules will have an operational impact on firms, who will need time to allocate resources, systems, and controls to implement the regulations.
- We are concerned that some instruments supporting a large part of the framework, e.g. **the UK Green Taxonomy, the ISSB guidelines and the recommendations of the Transition Plan Taskforce (TPT)**, are not yet in place. More clarity is needed on planned implementation timelines for those components, and how delays to them will impact the implementation of the proposals in this consultation.
- There is an important category of products that could be left out of the labelling regime if a bespoke treatment or label is not considered. Key among these are **passive investments or structured products tracking a sustainable index used as a benchmark**. We call on the FCA to provide more clarity on how the system will apply to passive sustainable investments. This could be, for example, an **additional label** that accommodates a more top-down or **principles-based approach**. The banking and finance sector would welcome the opportunity to work more closely with the FCA to develop this.
- We would support clarifying that the scope of the product labelling regime applies to **discretionary portfolio managers (DPMs)**, so that DPMs are eligible to qualify for sustainability labels without only relying on holding eligible funds within the portfolio.
- We suggest that the outstanding question on the treatment of **overseas funds** should be addressed as soon as possible to ensure a level playing field and eliminate fragmentation of consumer outcomes. Investors' portfolios often have significant allocations to assets in markets where sustainability-related reporting requirements are not as advanced as in the EU and UK regimes – the disclosure and labelling regimes should take account of this lack of a global level playing field.
- To avoid any subjective interpretation, we urgently call for clarity on how **"involuntary greenwashing"**, e.g., misstatements due to regulatory/ criteria confusion, can be avoided and how the FCA would treat those cases should they surface. In particular, we would welcome examples of best practice on anti-greenwashing governance.
- The FCA should avoid inadvertently creating a **"no sustainable label"** categorisation, which appears to be a de-facto result of the consumer-facing disclosure requirements.
- The FCA should develop and introduce a **reporting template**, in collaboration with industry, which will contribute to greater consistency and standardisation of information.

We set out a range of specific recommendations where we would welcome **further clarity** in the rules or accompanying guidance, including clarity on the definition of "credible standard", clarity on the labelling criteria (particularly for the "Sustainable Improvers" and "Sustainable Impact" categories), and on whether more than one label can be applied to the same product if it includes a mixture of applicable functions.

We would be delighted to discuss our recommendations or detailed comments with FCA colleagues at your convenience, and thank FCA colleagues for their extensive engagement as part of this consultation.

DETAILED COMMENTS

Scope and timelines questions (Q1-3)

Q1: Do you agree with the proposed scope of firms, products and distributors under our regime? If not, what alternative scope would you prefer, and why?

We support the principle of introducing a product labelling regime to regulate investment products and services offered to clients, with a single regime for financial services and asset managers. We also welcome the FCA's strategic approach which is focused on building trust and integrity in sustainable financial instruments, solutions and the supporting ecosystem, and supporting retail investors in making informed choices. We agree that tackling greenwashing should be a core regulatory priority and welcome the introduction of the general anti-greenwashing rule which applies to all regulated firms to combat concerns that firms may be making exaggerated, misleading or unsubstantiated sustainability-related claims about their products, where these will not stand up to closer scrutiny.

We would support clarifying that the scope of the investment labelling regime applies to **DPMs**, so that they are eligible to qualify for sustainability labels without only relying on holding eligible funds within the portfolio. This may require some reworking of the proposed rules, so that they can apply for managers constructing portfolios directly with shares and bonds as well as / instead of funds. We would be happy to collaborate with the FCA to support this work. Our response to Q9 provides further detail on applicability of the regime to DPMs.

The FCA should also clarify the extent to which **structured products** are considered as in scope of the regime. This could include, for example, structured products which may have an underlying basket or index of assets that align with sustainability characteristics (e.g., a Paris Agreement-Benchmark index under EU Low Carbon Benchmark Regulations) and where the manufacturer adheres to the proposed principles to be able to qualify for a sustainability label, in a similar way as funds. Our response to Q5 provides more detail on structured products and passive investments. Furthermore, we would welcome more clarity on the FCA's plans for **closed-ended exchange-traded products** that could realistically qualify for the sustainable impact label if desired. In addition, we ask that the FCA provides an overview of plans to facilitate the launch of new products to fund **voluntary carbon credits** and the existence of a voluntary carbon market on platforms including the London Stock Exchange.

We would welcome **further guidance and clarity** to support interpretation of the proposed rules on the following issues:

- The scope and applicability to **financial advisers**[1] and which of the products they provide advice on are in the scope of the rules.
- The scope and applicability to **manufacturers** and their responsibilities with regard to distributors as referred to in Annex C, §3.3 on "Distribution of products and investment services".
- Applicability to **payment services providers** (even if just in the scope of the anti-greenwashing rule) with examples.
- How far **investment services** (discretionary services, wealth mandates, model portfolios etc.) are in scope, since traditionally these would be considered "services" in the UK but are captured as "products" by the EU's Sustainability Financial Disclosure Reporting (SFDR) regime and by the Consumer Duty. Misaligned regulatory frameworks across multiple jurisdictions are challenging to manage effectively. The proposed amendments to the ESG

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[1] In this context, financial advisers are defined in relation to the following activities:

(a) Sales of Equity of Fixed Income products (e.g., certificates, derivatives, structured notes, credit solutions, etc.) to both corporates and financial institutions;

(b) Financial experts advising third parties on topics related to ESG: e.g. assess client's investment approaches, help them in assessing ESG regulations, provide access to databases, research etc.

Sourcebook (specifically ESG 1.2.4) define what types of portfolio management are in scope by reference to certain specified ESG rules being applicable, rather than by reference to the activity being performed. We recommend that ESG 1.2.4 instead be used to specify which rules apply to portfolio management.
- How to navigate **limited data availability** and reliance on limited quality data from ESG ratings providers, particularly taking on board the outputs of the ESG Data and Ratings Code of Conduct Working Group mandated by the FCA and established last year.
- How the labelling regime will acknowledge firms and products using other **well-respected frameworks** like the International Capital Markets Association (ICMA) and Loan Market Association (LMA) principles if they do not qualify for the FCA's regime.

It is important that the FCA should also consult on the extent of and coverage for **overseas products**. This is an important part of the framework, particularly in the case of distributors — and more detail on timings and any temporary measures will be critical. We encourage the FCA to align timings so there is not a significant lag between the implementation of the SDR rules/labelling regime and rules for overseas funds. Future work on this issue should be sensitive to the need for maximal alignment with other jurisdictions' frameworks that have been or will be rolled out in future. The FCA should consider giving temporary recognition to overseas regimes (e.g. the EU's SFDR Article 9 funds) as "equivalent" to a UK sustainability label, at least until the end of the post-Brexit Temporary Marketing Permissions Regime (TMPR) for overseas funds at the end of 2025.

The FCA should continue to ensure that regulatory standards for sustainable investment products are **well defined**, with limited scope for different interpretations, and are easy for firms to understand and apply with little divergence across asset classes and products covered by the regime.

Finally, although this may be outside of the scope of this consultation, and noting the developments in the EU on suitability and product governance related to sustainability (e.g. MiFID II sustainability preferences requirements), we would welcome additional clarity on the FCA's expectations for how firms should approach assessing clients' sustainability preferences.

Q2: Do you agree with the proposed implementation timeline? If not, what alternative timeline would you prefer, and why?

We support the proposal that the **general anti-greenwashing rule** will become effective immediately on the publication of the Policy Statement (PS) (provisionally, from 30 June 2023), particularly in view of the FCA's indication that this constitutes a clarification of existing rules. To give firms certainty, however, we suggest that the rule should become effective no earlier than 30 June (if, for example, the PS is published sooner), and that further guidance is published in accordance with our wider questions about the anti-greenwashing rule throughout this paper. To facilitate implementation of this rule, the FCA should provide further clarity on its expectations and examples of good and bad practice.

In addition, it is important that the anti-greenwashing rule and Consumer Duty **will not inadvertently introduce the new SDR and labelling regime early**, for example by allowing the FCA to hold firms to the standards expected under the SDR and investment label regime before those standards have formally come into effect. As the anti-greenwashing rule comes into effect immediately on publication of the policy statement, this gives very limited time for any implementation programmes to be in place.

Regarding the timeline for **disclosures**, it is important that there is a **gradual and targeted implementation of all rules**, including for labelling and classifying products, to allow adequate time for implementation. The rules will have an operational impact on firms, who will need time to allocate resources, systems, and controls to implement the regulations. On that basis, the FCA should also consult with stakeholders to assess the difficulties faced by firms and their consumers in implementing and embedding the rules.

In that regard, **subject to the caveats below**, we agree that the proposed approach summarised in table 1, page 20 §3.7 of the consultation paper is appropriate, namely:
- first ongoing sustainability performance-related disclosures to be published 24 months after publication of the PS (provisionally, from 30 June 2025); and

- staggered entity-level disclosures in sustainability entity reports, with the largest firms producing their first disclosures 24 months after publication of the PS (provisionally, from 30 June 2025).

The implementation of the requirements should be sensitive to the timing of other international regulatory requirements, to ensure that a coordinated and proportionate approach is adopted. This includes:

- considering delaying implementation of the reporting requirements if non-financial corporate data expectations are not yet established, e.g. as required under initiatives like the **International Sustainability Standards Board (ISSB)** guidance;
- sequencing the introduction of the rules with the introduction of transition planning requirements, both from the voluntary guidance of the **Transition Plan Taskforce (TPT)** and as these requirements become mandatory: this will be essential for the "Sustainable Improvers" label and associated metrics gathering;
- accounting for ongoing delays to the release of the **UK Green Taxonomy**;
- reforms to the Packaged Retail Investment and Insurance Products (PRIIPs) Regulation;
- aligning with reporting requirements under **MiFID**, accounting for MiFID II amendments.

It is critical that lessons learned from the sequencing of reporting requirements under the EU's SFDR are applied in the implementation of the UK regime. Recognising that financial services disclosure will rely on progress in the wider economy, the FCA should exercise care in ensuring the appropriate sequencing of disclosure expectations. Should the disclosures regime for non-financial corporates not be implemented on time, the FCA should amend the implementation timeline for the SDR regime accordingly.

Please see Q1 above on the timeline for treatment of **overseas funds**.

Q3: Do you agree with the proposed cost-benefit analysis set out in Annex 2. If not, we welcome feedback in relation to the one-off and ongoing costs you expect to incur and the potential benefits you envisage.

We do not yet have full analysis of the expected cost-benefit balance of the proposals, with some firms expressing the view that it is too early, with the materials available, to properly assess the one-off and ongoing costs.

Classification and labelling – Category descriptions questions (Q4-7)

Q4: Do you agree with our characterisation of what constitutes a sustainable investment, and our description of the channels by which positive sustainability outcomes may be pursued? If not, what alternatives do you suggest and why.

We broadly agree with the consultation paper's characterisation of what constitutes a sustainable investment. However, we suggest that the FCA provide examples of what would not constitute a sustainable investment. We broadly agree with the consultation paper's definition of channels by which investors can help contribute to positive sustainability outcomes.

Q5: Do you agree with the proposed approach to the labelling and classification of sustainable investment products, in particular the emphasis on intentionality? If not, what alternatives do you suggest and why?

We agree with a labelling system for sustainable investment products, based on intentionality and the nature of the investment process. However, we would urge the FCA to make sure that the SDR and labelling regime is **internationally interoperable** with other regimes like the SFDR and the US Securities and Exchange Commission's (SEC's) disclosure proposals. We call for recognition mechanisms, e.g. equivalence or substituted compliance, to be implemented as far as possible. In practice, while labelling and classification systems have been developed in some jurisdictions to

catalogue and define ESG activities, they differ across jurisdictions both in terms of scope and the degree of compulsion.

While the FCA is not proposing to create a distinct label for **"non-sustainable" products**, we note that the *de facto* result of the consumer-facing disclosures is to create such a label in practice – please see our response to question 7.

There is an important category of products that we are concerned could be left out of the labelling regime if a bespoke treatment or label is not considered. Key among these are **passive investments or structured products tracking a sustainable index used as a benchmark**. We note that the sustainability objectives of the three label categories are drafted with a focus on actively managed funds rather than passive investments. In most cases, the latter are more top-down and rules-based products with quantitative investment strategies that, in our reading of the CP, would not allow them to qualify for the "Sustainable Focus" label since the sustainable objective is not linked to thematic investment or sustainability criteria at asset level. We believe the current qualifying criteria would potentially also not allow these products to qualify for the "Sustainable Improvers" label since many aspects of the proposed labelling rules are not directly applicable to these products, in particular the resources & governance principle (principle 4) and stewardship principle (principles 5).

We therefore call on the FCA to provide more clarity on how the system will apply to passive sustainable investments. This could be, for example, an **additional label** that accommodates a more top-down or **principles-based approach**. The banking and finance sector would welcome the opportunity to work more closely with the FCA to develop this.

Without clarification, there is a risk that the proposed labels set thresholds which will be impossible to meet, and this could create major barriers to the healthy development of the green product market and dry up the supply of capital for the sustainable transition — excluding, for example, products eligible under Article 8 of the EU's SFDR, which need to promote sustainable investment, but where this is not a primary objective.

Q6: Do you agree with the proposed distinguishing features, and likely product profiles and strategies, for each category? If not, what alternatives do you suggest and why? In particular, we welcome your views on:

a. ***Sustainable Focus: whether at least 70% of a 'sustainable focus' product's assets must meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme?***
b. ***Sustainable Improvers: the extent to which investor stewardship should be a key feature; and whether you consider the distinction between Sustainable Improvers and Sustainable Impact to be sufficiently clear?***
c. ***Sustainable Impact: whether 'impact' is the right term for this category or whether should we consider others such as 'solutions'; and the extent to which financial additionality should be a key feature?***

In practice, we expect that the three labels will have high overlap with certain investment styles: sustainable focus will likely include growth companies; sustainable improvers will include mature value companies; sustainable impact will have high levels of private assets. This will mean clients will be exposed to a narrow part of the market with lower levels of diversification.

"Sustainable Focus"

With regard to the 70% threshold, we welcome that the FCA has provided a clear, objective percentage figure as a benchmark. However, **more guidance is needed on how this percentage should be calculated** to ensure comparability between products and allow end-investors to take informed investment decisions. Further clarity is needed, for example, on whether the threshold should be interpreted as "best in class" or otherwise; and on how firms should calculate the 70% threshold, for example whether on a weighted basis or pass/fail approach. Early clarification on his point will be important to avoid future re-categorisations.

We ask that the FCA **publicly disclose the rationale behind the 70% threshold figure** as well as why it has been applied to the 'Sustainable Focus' category with no quantitative threshold applying to the other two categories. It is important to note that there is a limited number of "green" and "net-zero aligned" investment opportunities available to investors in the economy that would, in some cases, ensure that a fund can meet this threshold. A qualitative rather than quantitative approach might be more straightforward to apply, and this may be more straightforward to articulate to consumers and staff.

We believe some flexibility will need to be retained for this category for the purposes of **hedging and ensuring sufficient fund liquidity**, particularly for private markets-focused funds. This points to the continued need for real economy measures and incentives from government, alongside the SDR regime and other disclosure and transparency measures from policymakers.

The "Credible Standard"

We would welcome clarity on the **definition of "credible standard"**, the body or entity that would decide how to apply these criteria, and who would assess if a product has a credible standard. Per the consultation paper, the UK Green Taxonomy, once developed, could be one way of demonstrating that assets meet a credible standard of sustainability; however, this will not be prescriptive, and a gap remains while the UK Government considers the future of the Taxonomy.

In the absence of a standard methodology for determining a "credible standard" and/or a "specified environmental and/or social sustainability theme" for the "Sustainable Focus" label, firms should be allowed to use **internal proprietary frameworks, methodologies or scorecards** to determine this credible standard.

Furthermore, the FCA should provide additional clarity on the role of **independent assessors** in assessing the "credible standard" for the "Sustainable Focus" label.

"Sustainable Improvers"

For the "Sustainable Improvers" label, the CP notes feedback that **stewardship** should not be the sole defining feature of these products, and carrying out stewardship is not alone enough to qualify for the category. However, a threshold or benchmark has not been provided, as in the case of the "Sustainable Focus" label. More clarity is needed regarding:

- **expectations and key performance indicators** for measuring improvement, and whether intentionality will need to be measured over time — e.g. how much progress is sufficient;
- what metrics will be used on sustainability themes **outside of climate** given that many of these concepts remain nascent;
- whether metrics should consider **short, medium and long term scenarios**.

"Sustainable Impact"

The Sustainable Impact label similarly does not have a threshold or benchmark, and we are concerned about the **low volume of funds that will qualify for this label**. Under the current proposal, funds with the "Sustainable Impact" label would be unlikely to form any part of a retail client's portfolios, due to the requirement to deploy "new capital" and prove financial additionality which is difficult to demonstrate outside primary markets. In addition, difficulties around measuring additionality could restrict impact funds to investing in private markets and primary issuances which are generally not available to retail investors. Therefore, we would propose that the FCA consider **more detailed defining criteria as well as alternatives to the "additionality test"** for "Sustainable Impact" which might better accommodate a wider set of primary and secondary market products. We believe that this should not be narrowly defined as only investing new capital. We would be happy to engage further with the FCA on alternative approaches to demonstrate additionality.

Q7: Do you agree with our proposal to only introduce labels for sustainable investment products (i.e. to not require a label for 'non-sustainable' investment products)? If not, what alternative do you suggest and why?

We agree that out-of-scope products should be restricted from using sustainability-related terms.

While the consultation paper proposes only to introduce labels for sustainable investment products, **we note that firms with products not making sustainability claims *do fall* within the scope of the regime** as they are required to produce consumer-facing disclosures with a "no sustainable label" marking (§5.31).

In practice this does create a categorisation, akin to a fourth label, for all products even when these are not making any sustainability claims. We are concerned that this will create an unreasonably high operational burden which will offer limited benefit to consumers and investors. We suggest that the FCA consider how this can be avoided: by, for example, indicating in a separate public disclosure that the firm does not provide any products with sustainable claims.

This also has an impact on the responsibilities of distributors as per Chapter 7, §7.8. Under the proposed rules, they would need to provide retail investors with access to the consumer-facing disclosures, and it is unclear whether they would need to cover products not using sustainable labels.

It is also important to note the risk that **retail investors will view products without a sustainability label as being equivalent from a sustainability perspective** – even where their sustainability characteristics differ widely.

We would welcome more clarity with respect to products not using a label, providing **examples of acceptable and non-acceptable terminology**, and what reporting and disclosures will be expected by the FCA. This will help to provide clarity on how firms are expected to determine whether a product that cannot be labelled (or is not in the scope of the labelling rules) is using exaggerated, misleading and / or unsubstantiated claims. Investors often have highly bespoke requirements with respect to sustainable products, and financial institutions therefore need to use sustainability-related terms in nuanced ways to convey nature of these products; this should be facilitated by the regulations, provided the credentials meet the asset owner's expectations and that adequate transparency is offered by the manufacturer.

Classification and labelling - Qualifying criteria for labels questions (Q8-9)

Q8: Do you agree with our proposed qualifying criteria? If not, what alternatives do you suggest and why? In your response, please consider:

- ***whether the criteria strike the right balance between principles and prescription***
- ***the different components to the criteria (including the implementing guidance in Appendix 2)***
- ***whether they sufficiently delineate the different label categories, and;***
- ***whether terms such as 'assets' are understood in this context?***

We broadly support the FCA's objectives to develop threshold criteria that all firms must meet before marketing a sustainable investment label, and welcome the FCA's aim to raise the bar and increase trust in the market through the introduction of rigorous criteria.

However, we would support a **flexible approach** on the qualifying criteria in recognition of the state of the existing product universe. Approaches that are highly prescriptive, where options available to investors are limited, or where labels would prevent consumers from having access to investment products, should be avoided. Given that this is an area where fast development is expected, flexibility will be key to support the development of new products. In practice, investors have a wide variety of objectives, and the labelling system should not be restrictive to allow firms to satisfy this variety.

Recognising the proliferation of ESG labelling regimes and risk of adherence to multiple regimes outside of the UK, we call for a recognition system, e.g. **substituted compliance or equivalence**, to apply when firms use other respected frameworks. In such circumstances, for firms using such a system, the application of the Naming and Marketing Rule (Chapter 6) should not be triggered for overseas funds.

Q9: Do you agree with the category specific criteria for:

- ***The 'Sustainable focus' category, including the 70% threshold?***
- ***The 'Sustainable improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?***
- ***The 'Sustainable impact' category, including expectations around the measurement of the product's environmental or social impact? Please consider whether there any other important aspects that we should consider adding.***

We advocate for a closer **mirroring of international approaches** in setting thresholds and criteria, particularly to ensure interoperability with, while improving upon, the rules under the EU's SFDR and to ensure complementarity with others including the US Securities and Exchange Commission's (SEC's) disclosure rules and European Securities and Markets Authority's (ESMA's) fund names consultation paper.

Our comments on the 70% threshold are set out in the answer to Q6.

We ask the FCA to consider **removing the requirement for the funds to be aligned with a single label**. As long as the portfolio management service is investing 70% of the total value of products in labelled funds of any label category, we believe that it should be free to choose the most appropriate label. This reflects the current market practice, which focuses on diversification rather than picking homogeneous funds.

With respect to a portfolio management agreement or arrangement, under the proposed rules 90% of the total value of the products in which it invests must meet the qualifying criteria for the same label to be eligible for the label. We encourage the FCA to reconsider this restriction as it could have the unintended consequence of limiting customers' access to certain types of investment products and could cause concentration risk by channelling portfolio flows into a small set of products. One of the benefits of multi-asset funds and funds of funds is that they allow for diversification. We would **encourage the FCA to reduce the 90% threshold and remove the requirement of the underlining assets to qualify for the same label** (as opposed to any label).

As an example of the consequences of this approach, **discretionary portfolio management** (DPM) services can only use a label if 90% or more of the value of all constituent products in which they invest qualify for the same sustainable investment label. While 90% might be appropriate in the longer term, in the initial years a lower level (of 70% or 80%) may be more appropriate for DPM mandates given the lack of international consistency on product labelling today, which will mean that overseas "sustainable" funds and other assets will not count towards the 90%. This is because certain asset classes used for diversified multi asset portfolios may not naturally have an SDR flag (e.g. commodities, government bonds). This means it will be impossible to create a diversified portfolio while maintaining 90% allocation to SDR labelled instruments. This could mean that non-UK based funds which qualify under SFDR Article 9 may not necessarily qualify for UK SDR labels and therefore will not count towards the 90% limit.

This may evolve over time, at which point a higher threshold may be more easily implementable. But if the initial limit is 90%, it will be difficult for portfolio managers to construct a portfolio properly, using a global range of products which diversifies risk across different asset classes and geographies, and thus be unduly restrictive and result in outcomes that are not as good for customers.

Classification and labelling - Implementation and operationalisation (Q10)

Q10: Does our approach to firm requirements around categorisation and displaying labels, including not requiring independent verification at this stage, seem appropriate? If not, what alternative do you suggest and why?

We would welcome clarity on the approach to **independent verification for the "credible standard"** applied to "Sustainable Focus" products. The CP states that the "credible standard" is one that is "robust**, *independently assessed***, evidence-based and transparent", while this independent assessment requirement appears to be contradicted elsewhere in the CP. Examples on the use cases where independent verification is expected would be helpful for implementation. Mandatory third-party assessment will be burdensome and represents an extra cost for firms.

If no independent assessment is required, we would seek further guidance as to how the "credible standard" would be met in practice. It would be useful for the FCA to provide more examples of environmental and social sustainability themes that would be acceptable to reference in classifying products. It is noted that the FCA will consider updating the requirements over time; however, it is challenging for firms to implement evolving regulatory frameworks.

Please refer to Q6 for more comments on the "credible standard".

Disclosures - Approach (Q11-12)

Q11: Do you agree with our proposed approach to disclosures, including the tiered structure and the division of information to be disclosed in the consumer facing and detailed disclosures as set out in Figure 7?

We support the FCA's proposal for a tiered approach incorporating consumer-facing and detailed disclosures, enabling investors to choose the level of granularity of information that they wish to see. Such a structure takes into consideration that different audience types may have different information needs and levels of understanding.

We welcome the objective to promote **international harmonisation** of ESG reporting standards, including the FCA's support for the work of the ISSB. We support the objective to achieve a regime coherent with international frameworks and standards as far possible and to consider other sustainability-related disclosure requirements such as those under the EU's SFDR and the proposed requirements of the US SEC, for asset managers and their investment products. We note, however, that in practice **the current proposal is not interoperable with the requirements under the SFDR and SEC**. We urge the FCA to ensure interoperability with those jurisdictions.

Additionally, we note that a very complex regime could have the unintended consequence of making it more difficult for retail investors to understand the differences between labels with potential for misinterpretation and confusion. This could also create challenges for firms' external communication.

In terms of implementation timing for the disclosures, a lack of underlying disclosure information from companies, and in turn a lack of robust or standardised indicators for firms to reference their products against, is a key challenge. We encourage the FCA to **consider these data challenges** when setting sustainability-related metrics or disclosure requirements under the SDR and to **sequence the introduction of disclosure obligations**, as emerging regulation starts to encourage companies to disclose relevant data. We would therefore urge the FCA to provide more clarity on planned implementation timelines for these groups, and how these will relate to or affect the roll-out of the proposals set out in this consultation.

Q12: Do you agree with our proposal to build from our TCFD aligned disclosure rules in the first instance, evolving the disclosure requirements over time in line with the development of future ISSB standards?

We agree with the proposal to build from TCFD-aligned disclosure rules in the first instance, evolving the disclosure requirements over time in line with the development of future ISSB standards. In line with the objectives of the ISSB, a single set of global high quality sustainability standards should be the goal. We call for **continued co-operation among UK regulators, the EU, US regulators and the ISSB** to limit differences across the regimes, at least in respect of the baseline enterprise-value focussed disclosures.

We call for proportionality as the requirements are implemented, in line with the approach taken by the ISSB. The ISSB is considering the phasing of requirements to ensure reasonable burden on firms, and the FCA should similarly ensure that their proposals and timing balance ambition and the practical ability of companies, especially smaller ones, to implement.

Disclosures - Consumer-facing (Q13-14)

Q13: Do you agree with our proposals for consumer facing disclosures, including location, scope, content and frequency of disclosure and updates? If not, what alternatives do you suggest and why?

The consultation paper proposes to require that consumer-facing disclosures are provided for products **not making sustainability claims**. As mentioned in our response to Q7, there is a risk that this in practice will create a categorisation akin to a label for all products even when these are not making any sustainability claims and creating an operational burden on firms. There is also a risk of creating consumer confusion, distracting from the main aim to improve disclosures for sustainability products.

We would welcome further clarity on the following points:

- The **disclosure requirements of distributors** in relation to products not using a sustainability framework (please see our response to Q7 for additional feedback on disclosures on products without sustainability labels).
- The **responsibility of manufacturers as regards their interactions with distributors** remains unclear, given distributors' obligations to provide to the end-client the right information under the proposed requirements. As noted in our answer to Q1, Annex C includes a reference to the "Distribution of products and investment services" which states that distributors should consider "what impact the selection of a given manufacturer could have on the end client […]". We would welcome further clarity as the manufacturers of products not in the scope of the SDR will otherwise not produce any metrics which can be used for the consumer-facing disclosure.
- Finally, we would welcome further clarity on disclosures pertaining to "**unexpected investments**" as these guidelines would assist firms in undertaking internal testing for consumers to determine what investments may be inconsistent with a sustainability objective.

Q14: Do you agree with the proposal that we should not mandate use of a template at this stage, but that industry may develop one if useful? If not, what alternative do you suggest and why?

While there is a need to strike a balance between prescriptivity and ease of use, **we would welcome the use of templates** to maximise consistency. We otherwise expect that consistency in the levels of granularity of the information produced by corporates and financial institutions will vary. We would recommend the FCA take responsibility for creation of such a template, **in collaboration with industry**. Such a template will need to balance the need to provide detailed information to consumers while avoiding adding excessive documentation for retail clients to read.

Furthermore, the disclosure format proposed under para 5.6 – to limit disclosure to two pages of A4 maximum – could be challenging for firms to implement. This underpins the need for the FCA to provide a pro-forma template that sets clear expectations for firms. In doing so, the FCA should consider the SFDR's precontractual templates as a basis with the understanding that these templates are expected to be simplified in 2023 by ESAs.

Disclosures - Product-level (Q15-17)

Q15: Do you agree with our proposals for pre-contractual disclosures? If not, what alternatives do you suggest and why. Please comment specifically on the scope, format, location, content and frequency of disclosure and updates.

We agree that pre-contractual disclosures seem proportionate, and we agree that sustainability-related features should be disclosed in pre-contractual documents. The changes to pre-contractual disclosure documentation are likely to be significant and different to SFDR: client communication therefore needs to be carefully designed to avoid confusion.

We note however that per point 5.53, the FCA is not proposing to include requirements that mirror the EU SFDR's 'Do No Significant Harm' ('DNSH') approach, for cases when a sustainable investment does not significantly harm the sustainability objective and the FCA considers this approach could be too restrictive at this stage. The omission of any kind of DNSH requirement does leave a substantial risk of potential environmental and social harms. We encourage the FCA to consider whether the inclusion of a DNSH requirement, even if applied through a non-prescriptive approach on what constitutes "significant harm" in alignment with the EU SFDR, would be beneficial. The FCA should consult industry further if it considers implementing such a requirement.

Q16: Do you agree with our proposals for ongoing sustainability related performance disclosures in the sustainability product report? If not, what alternative do you suggest and why? In your response, please comment on our proposed scope, location, format, content and frequency of disclosure updates.

Most firms are moving towards implementing a sustainability report; therefore this would work for them. However, **flexibility will be important** especially, though not exclusively, for smaller firms for whom ongoing sustainability-related performance disclosures will come with a high operational cost.

As there are not yet standards set across the industry for sustainability reporting, it is sensible for organisations to align **to any existing disclosures** that relate to sustainability/climate, whether these include ESG/sustainability reports, corporate social responsibility reports, Taskforce on Climate-Related Financial Disclosure reports or similar, rather than introducing a separate disclosure instrument at this time. Guidance on the frequency with which product reports should be made will be useful for firms. In addition, guidance on the expectations when public data sources are not available will be needed.

So long as data sources (particularly publicly available sources) remain unavailable, we would **advise against requirements for firms to report on sustainability at product level**. Firms will need to rely on external data providers to fulfil these requirements in the absence of more robust data sources. Such reporting has limited value for end-investors, because of the variability with which external data providers report. Please see our response to Q11 regarding implementation timelines.

Q17: Do you agree with our proposals for an 'on demand' regime, including the types of products that would be subject to this regime? If not, what alternative do you suggest and why?

Firms providing portfolio management services will not be required to produce pre-contractual disclosures, and instead will be required to provide access to the pre-contractual disclosures for the underlying in-scope products, or under the 'on demand' regime.

Reporting is not required when firms provide discretionary portfolio management services to individuals or institutional investors and UK AIFMs managing unauthorised AIFs that are not listed on a recognised investment exchange. However, where firms decide to use a label for these products, and their clients need the information to satisfy their own (or their clients' or customers') sustainability-related disclosure obligations, disclosures should be made to the client upon request, once a year from 1 July 2025, for a calculation date no earlier than 30 June 2024 (i.e. 12 months after rules enter into force). We would welcome **clarity and guidance in terms of which requests should be considered as "eligible client's request"** and what the FCA's expectations are for **"a reasonable time"** as well as for an "**acceptable format** to meet their information needs".

Disclosures - Entity-level (Q18-19)j

Q18: Do you agree with our proposals for sustainability entity report disclosures? If not, what alternatives do you suggest and why? In your response, please comment on our proposed scope, location, format, content, frequency of disclosures and updates.

We welcome this approach as most firms have already opted to produce sustainability reports at the business level. However, flexibility should be allowed for firms less advanced in their reporting practices due to the cost and time implications of reporting.

We strongly support the FCA's engagement with other regulators and international standard setters like the ISSB and IOSCO and encourage continued engagement to ensure interoperability with other disclosure frameworks.

Q19: Do you agree with how our proposals reflect the ISSB's standards, including referencing UK adopted IFRS S1 in our Handbook Guidance once finalised? If not, please explain why?

We strongly welcome the reflection of the ISSB standards in the FCA proposals. It can only be of benefit to investors generally if the form and content of asset manager disclosures is consistent with and comparable to disclosures that will be required by listed companies.

Naming and marketing - Anti-greenwashing and naming rules (Q20-24)

Q20: Do you agree with our proposed general 'anti-greenwashing' rule? If not, what alternative do you suggest and why?

We **support the overarching intent** of the FCA to introduce anti-greenwashing intervention to help ensure the right consumer outcomes as the industry and regulatory landscape evolves. While we believe that existing rules in place to ensure communications are fair, clear, and not misleading (Principle 2.1, Principle 7 and COBS 4.2.1) already encapsulate right behaviours regarding the naming and marketing of sustainable financial products, the introduction of a general anti-greenwashing rule in the ESG sourcebook emphasises that these requirements apply to sustainability related features as well.

We would welcome **clarity on how the new rule interacts with existing rules and guidance in relation to communications** — for example, confirmation that it applies in a way that is appropriate and proportionate to existing rules on fair, clear and not misleading communications. There is a balance between the importance of presenting clear and easily understood consumer-facing disclosures about firms' sustainable investment processes and policies (which would likely refer to terms like "ESG integration", commitment to "net zero" and advocacy around strong "governance") and not misleading clients by using the banned terminology.

As the FCA has clarified that the claims must be proportionate to the sustainability profile of the product and service, and as this allows for a level of judgement to be exercised, we believe the challenge will be in the consistency of supervisory application and the need for the industry to have proactive feedback from the FCA on what good looks like, as our understanding of sustainability evolves over time. We note that the European Supervisory Authorities (ESAs) are conducting a two-year review before reporting to the Commissions on greenwashing risks and associated mitigants, including substantial industry input.

Enforcement risk: Where a firm makes a genuine disclosure error, we recommend the FCA consider allowing a firm a **"grace" or "correction" period** to rectify the disclosure without triggering an enforcement action by the FCA. This would help bring the anti-greenwashing rule into line with the carve-out under COBS 4.2.1 (right of action under s.138D FSMA), whereby a private individual may not have right of action against a firm if the firm can demonstrate that it took reasonable steps to ensure it complied with the "fair, clear and not misleading" rule.

To avoid any subjective interpretation, we call for clarity on how "**involuntary" greenwashing** (e.g., misstatements due to regulatory/criteria confusion) can be avoided and how the FCA would treat

those cases should they surface. It would be helpful to clarify that a firm should not be considered to have engaged in greenwashing unless there was an element of fault on its part, whether through intentionally making a misrepresentation or negligently doing so. For example, where a firm has not been negligent in using or communicating information which has been provided by a third party, that firm should not be considered to have engaged in greenwashing, so far as this is also in line with expectations under the Consumer Duty.

We call on the FCA to provide firms with extra information on their planned **enforcement approach** and the actions firms should take to avoid being caught off-guard.

Providing evidence and due diligence: The current proposal indicates that "a firm must carry out due diligence on any data, research and analytical resources it relies upon (including when third-party ESG data service providers are used), ensuring that any gaps and shortcomings identified are documented and appropriately mitigated". Caution should be taken not to place a **disproportionate burden on firms using these services by shifting ownership of the validation of ESG data away from data providers**. Shortcomings related to the transparency of methodologies and governance processes of ESG data providers should be addressed at the relevant forums including the International Regulatory Strategy Group (IRSG) ESG ratings and data code of conduct working group, and the upcoming HMT consultations on the regulatory oversight of these firms. This will help strengthen the quality of the data provided and allow firms to safely rely on the information obtained from ESG data providers. Regardless, challenges will persist for the foreseeable future in providing consistent evidence on the degree of 'sustainability' across different products and services. The availability, quality and consistency of data will vary across clients and sectors (e.g., data from SMEs will not be of the same level as that available from publicly listed companies) and therefore the level of due diligence possible across clients will vary. As such, we would welcome further guidance on the expectations for the industry on this point.

Associated cost increases for consumers: We would welcome targeted and constructive guidance on best practice and the FCA's expectations to help providers to comply with the overarching anti-greenwashing rule, noting that it is possible that industry will overcompensate on compliance and **pass on increased costs to consumers**. We believe that targeted guidance on expectations – on an ongoing basis as the regulatory understanding and industry evolve – will ensure that providers can better target their compliance resources thereby minimising a potential negative consumer outcomes (both on cost and product/service availability).

As stated earlier, international interoperability is critical to banking and finance firms. It is therefore of utmost importance to ensure that the anti-greenwashing rule is aligned as much as possible to those in other jurisdictions, for example ESMA's work on "quantitative thresholds".

Please also note our comments on timelines in response to Q2.

Q21: Do you agree with our proposed product naming rule and prohibited terms we have identified? If not, what alternative do you suggest and why?

More guidance should be provided in terms of **terminology, conventions, and definitions**, e.g. green and sustainable. This is potentially an area where the expected UK Green Taxonomy will help once it is developed – but in its absence the FCA will need to set out its own path for addressing this definitional gap.

UK Finance is not responding to questions 22-23.

Q24: Do you agree with our proposals for distributors? If not, what alternatives do you suggest and why?

We do not oppose the proposal to include distributors within the scope of the SDR. However, as indicated above, we have concerns about the disclosure of non-sustainable products.

We would welcome more clarity on the direction of travel in suitability guidelines.

We believe the intention to **leave financial advice suitability requirements to a future consultation creates challenges** to ensuring fair outcomes for retail customers. We recommend that consultation should be accelerated. Assessing the suitability of a fund based on alignment with a client's sustainability preferences is an integral part of the investment process, and the majority of UK retail investors are serviced on an advisory basis. The labelling regime is beneficial but needs to be accompanied with client questionnaires and embedded into the client advisory journey.

Separately, we are concerned that **investment platforms**, whether adviser or direct platforms, are not best placed to determine whether an overseas domiciled fund that is promoted as sustainable would be eligible for a label. In the case of overseas funds, it would be a significant exercise, as implementing the notice for funds that are using prohibited sustainability-related firms and selling to UK retail clients may unintentionally fall foul of the requirements to label funds accordingly.

Distributors need to ensure any product labelling is easily explainable/understandable for retail investors.

In relation to paragraph 7.12, we suggest that, at least during the Temporary Marketing Permissions Regime (TMPR) period until end-2025, **the requirement for a warning notice about overseas funds does not apply to platforms** and is limited to situations where a personal recommendation/advice is given. EU funds in particular (given the volume of Luxembourg and Irish funds still sold in the UK under the TMPR) will have to provide disclosures in line with SFDR rules, which could be considered to adequately protect clients who choose to buy overseas funds on an execution only basis. Platforms could provide generic information on their websites (as part of investment risk disclosures) rather than causing additional friction in a client journey by an additional warning. Where investment advice is being given, the warning can be included readily in a suitability report. A transitional period until end-2025 will allow more time for overseas "sustainable" funds to consider whether to qualify for, and implement, UK sustainability labels on top of meeting the requirements of their local regime, and thereby eliminate the need for such a warning.

UK Finance is not responding to questions 25-30.

Other products (Q31)

Q31: Would the proposals set out in Chapters 4-7 of this CP be appropriate for other investment products marketed to retail investors such as IBIPs and ETPs. In your response, please include the type of product, challenges with the proposals, and suggest an alternative approach.

We consider the inclusion of insurance-based investment products (IBIPs) and exchange traded products (ETPs) to be beneficial.

ENDS