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

SDR and Labels Policy
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

MACFARLANES

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Macfarlanes LLP response to the FCA Consultation Paper on Sustainability Disclosure Requirements (SDR) and Investment Labels (CP22/20)

We are grateful for the opportunity to respond to the FCA's proposals in CP22/20, with which we largely agree. Our response below details areas where we foresee practical issues that might arise should the regime take effect in its proposed form. Some of these issues concern the applicability of the rules to types of products or asset class.

Macfarlanes is a London-based law firm that is focused on our clients and on delivering excellence in the international legal market. We advise on all types of investment products, from retail funds to private equity, credit, real estate, and hedge funds, closed-ended, open-ended and listed fund structures, and across asset classes and the liquidity spectrum. The practice is distinguishable as the only investment management practice in the City which can credibly transcend both the retail and private market fund environments. We have advised a variety of clients on their compliance with sustainability-related regulations, such as the EU's Sustainable Finance Disclosure Regulation (SFDR) and the FCA's climate-related financial disclosure rules, and in seeking regulatory authorisation for sustainability-related products in the UK and the EU.

Macfarlanes is an affiliate member of the Association of Real Estate Funds, the British Private Equity & Venture Capital Association, the Investment Association, and the European Association for Investors in Non-Listed Real Estate Vehicles. We broadly endorse the conclusions in their respective feedback to the FCA.

The main matters raised in our response are as follows:

- We agree with proposed scope for the SDR disclosures. However, for the benefit of firms in scope of the ESG Sourcebook, we suggest that the FCA explain the rationale for the discrepancy between the scope of product-level reporting under the SDR versus the scope of product-level reporting under the climate-related financial disclosure rules.
- We recommend the treatment of overseas products should be addressed as a priority and, ideally, the treatment of pension and insurance products would also be resolved before the SDR takes effect.
- We agree that intentionality should be a condition for the product labels. However, we consider that the definition of intentionality should be expanded to include not only an explicit sustainability objective, but also robust and demonstrable sustainability criteria (which are typically used instead of an explicit sustainability objective in some asset classes, such as real estate).
- We note the challenges for some strategies in demonstrating both investor contribution and enterprise contribution and recommend that the FCA acknowledge that the balance might fall more towards one or the other contribution, without implying that either contribution is necessarily better.

- We consider that sustainable investment product labels should be available to multi-asset strategies (which may be investing in a range of "Focus/Improvers/Impact" assets).
- In relation to the "Focus" label, we consider that the minimum 70% threshold needs to be applied rationally to different fund structures. For closed-ended funds (which typically have a 'ramp up' period and divestment period), the 70% limit should apply during the fund's holding period (i.e., when the fund is fully invested).
- In relation to "Focus" funds, we suggest that the concept of "stewardship" should be broadened to "engagement"; and that firms should adhere to and disclose membership of robust engagement standards (which may or may not include the FRC's Stewardship Code, depending on its relevance and applicability to the manager and asset class in question).
- The terms "assets", "independently assessed" and "sustainability profile" should be clarified.
- Where it is not possible for a product to identify specific KPIs at the outset of the product lifecycle (as is typically the case for private equity/venture capital funds), it should be permissible for such funds to qualify for a label if they identify *general* KPIs at the outset of a deal and *specific* KPIs at a defined later point.
- We note the potential for ambiguity when classifying strategies that qualify for more than one product label, and suggest the terminology applied to the labels might be clarified to create a greater distinction, particularly between the Improvers and Impact labels.
- We request that the FCA clarifies its intention is to exclude non-UK firms from the entity-level disclosure requirements.
- We consider the marketing rule as currently prescribed is likely to cause significant problems for products with credible sustainability-related characteristics, but which do not meet the qualifying criteria for a label. We consider there is a sufficient framework of existing/incoming rules (including the broadly defined anti-greenwashing rule, and general requirements such as the Consumer Duty), to ensure that managers accurately describe their products and do not overstate their sustainability credentials.

These points, and others, are detailed at length below in response to the questions in CP22/20. We would be happy to discuss our response with the FCA or to provide more information as required.

<u>Responses to consultation questions</u>

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 generally agree with the FCA's proposed approach to the scope of the regime, subject to the following points.

i. <u>Discrepancy between the product-level scoping for product-level reporting under SDR versus climate-related financial disclosure rules.</u> We agree that a threshold of £5bn AUM should apply for the SDR's entity-level disclosure requirements, below which size the entity would be out of scope. This aligns with the threshold given for the FCA's TCFD aligned climate-related disclosure requirements. However, we also note the discrepancy in that the TCFD threshold removes smaller managers from the TCFD product-related disclosure requirements too. We recognise and agree with the FCA's policy rationale to include smaller managers in the scope for the SDR's product-related disclosures to ensure consistency across products and avoid confusing retail investors. But we do believe that managers would appreciate an explanation of the reasons for the different approach.

ii. <u>The treatment of overseas products should be addressed as a priority.</u> We appreciate that the treatment of overseas products will be addressed in a separate consultation. However, we suggest that the matter is clarified in good time before the labelling and disclosure regime takes effect (i.e., before 30 June 2024). Having a functioning SDR and labelling regime which applies to UK managers and products but not overseas products marketed into the UK means that: (i)

overseas managers cannot benefit from using the sustainable investment labels (even if the product meets the relevant qualifying criteria), thereby reducing the attractiveness of the UK as a location for fundraising; and (ii) existing overseas products marketed into the UK will be subject to less stringent requirements around the use of ESG-related terms and references in the product naming and marketing. We are further aware that managers of overseas products seeking recognition into the UK are being asked whether they have considered SDR – this sends mixed messages to offshore managers as to the scope of the new rules, and the potential for conflicts between the SDR and comparable rules in other jurisdictions. The resulting inconsistency of treatment between UK and overseas products could confuse investors and increase the risks of greenwashing. The lack of certainty for overseas products may also have a chilling effect for managers of such products.

iii. The FCA should clarify that UK managers of overseas products established, authorised and marketed in other jurisdictions will not be required to comply with the SDR in respect of those overseas products. Addressing the potential extra-territorial impact of the SDR will reduce the operational risk of UK managers trying to comply with conflicting regimes (SDR versus the rules in other local jurisdictions) when operating on a global basis.

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

We agree with the proposed implementation timeline, subject to the FCA providing clarity about the treatment of overseas products as detailed in our response to Question 1 item iii. Ideally, the treatment of insurance and pension products and providers would also be clarified prior to the introduction of the first stage of the SDR (proposed to be 30 June 2024). This would resolve any disparity between the treatment of products due to their forming part of an insurance product or pension scheme.

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.

Firms directly impacted by SDR are better placed to respond on the cost implications of the regime. Although we acknowledge and agree with the FCA's efforts to reduce the cost burdens on firms where possible; for instance, in deciding to make third-party assurance of managers' disclosures a voluntary matter for the firms involved.

A related matter is the inaccessibility of the relevant data to support key performance indicators ("**KPIs**") for certain asset classes. We address this matter more fully in response to Question 6 on the proposed sustainable investment labels. Suffice to say that managers of private market strategies, such as private equity or venture capital funds, might struggle to access the necessary data. This poses a practical challenge for those firms and potentially has significant cost implications as they rely on expensive data vendors to 'plug gaps' in their reporting.

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?

Yes, we agree with the FCA's proposed approach to defining sustainable investment products and the channels by which investors might influence sustainability outcomes. But there are practical issues that should be considered in respect of the final rules which we set out below:

i. The requirement for an explicit sustainability objective: We note the FCA's definition of intentionality includes an explicit sustainability objective which may not always be present for products that otherwise meet the qualifying criteria for a label. For example, we are aware of numerous private real estate fund strategies that meet or seek to attain high ESG standards,

which are independently verified by organisations such as GRESB, and through compliance with other industry frameworks and benchmarks (EPCs, BREEAM, NABERS, LEED and others). These fund strategies rarely have an express sustainability objective alongside the financial objective so would not qualify for a label (despite otherwise meeting the relevant qualifying criteria for a label). Implementing changes to product terms to introduce an explicit sustainability objective as part of the investment objective is likely to require investor consent or notification and regulatory notifications or approvals, which increases the costs and compliance burden on managers whose products appear to demonstrate intentionality in substance. A solution might be to broaden the definition of intentionality to include robustly defined and measured sustainability characteristics, whether in addition to or instead of an explicit sustainability objective.

ii. Evidencing enterprise and investor contribution: We note it can be difficult to demonstrate both enterprise contribution and investor contribution in all circumstances. For example, in respect of real estate investments: the UK Green Building Council (UKGBC) states that 80% of buildings that will exist in 2050 have already been built, so a major focus of real estate investors is the decarbonisation of existing stock and the carrying out of "green retrofits", alongside the development of new building stock equipped for net-zero. Evidently, the investor contribution will be significant and possibly predominant in this asset class as typically compared with other asset classes where, as the FCA notes, the enterprise contribution is typically emphasised. There should be regulatory recognition that the relative balance of these factors will vary depending on the asset class. We also detail these challenges later in our response in relation to Impact funds, in which the balance is more greatly weighted towards enterprise contribution, compared with Focus and Improvers funds in which the balance might be closer to investor contribution or be more equally weighed.

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?

Yes, we agree with the focus on intentionality, subject to our comments on the definition set out in the response to Question 4. Given that the rationale of the regime indicates that product labels should be clear and comprehensible signals to retail investors, it makes sense to match the labels to a categorisation of investors' desired outcomes.

Furthermore, having advised extensively on the implementation of the EU's SFDR (which is designed as a disclosure regime and not a product labelling regime), we have observed significant appetite amongst institutional investors for a labelling regime to assist in their investment allocation decisions. Such investors are currently using the EU's SFDR as a 'quasi-labelling' regime. Therefore, we welcome the availability of the sustainable investment labels to products marketed to institutional investors (as well as retail).

Finally, we note two (surmountable) issues that we will explore more fully in response to Question 6 on the proposed sustainable investment labels:

i. Potential hierarchy of labels: We welcome the FCA's intention for the labelling regime not to be treated as a hierarchy, and rather to treat the labels as representing different, non-ranked investor intentions. Nonetheless, there is a risk that the regime might inadvertently be treated as a hierarchical regime, as between the "Sustainable Improvers" and "Sustainable Impact" labels.

ii. Availability of labels for multi-asset strategies: We note concerns in the industry about the availability of labels for multi-asset strategies, for example: (a) products which comprise a range of assets which would be considered sustainable 'Focus', 'Improvers' and/or 'Impact' assets, and (b) fund-of-fund strategies whereby the underlying constituent funds qualify for

different labels. It seems to us that multi-asset strategies should not be prevented from using a sustainable investment label and/or restricted by way of the naming and marketing rules purely owing to being a multi-asset strategy. If the assets underlying the product meet certain qualifying criteria for a sustainable investment strategy, it seems the product should be able to use a label to reflect that the product meets a credible standard of sustainability (albeit across different sustainability strategies).

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?

We agree with the breadth of the "Sustainable Focus" category, and the flexibility given to managers to choose a "credible standard". A principles-based approach will facilitate the development of the UK sustainable investment market better than a more prescriptive standard. We also welcome the clarification that index funds can qualify for the "Sustainable Focus" label if the index achieves the qualifying criteria.

Having said this, rigidity in the application of the 70% threshold for sustainable investments will make this label unfeasible for certain asset classes. In particular:

i. Requiring 70% 'at all times': Having advised extensively on the implementation of the EU's SFDR (which requires disclosures on a fund's minimum environmental/social asset allocation that must be met at all times), we are aware of the issues caused by a minimum threshold that must be met at all times. This issue is particularly acute for private/closed-ended funds or products investing in illiquid assets: such products may make investments which are staggered over a long period (e.g., a four-year investment period), with new deals drastically changing the asset allocation and level of sustainable investments held by the product. For example, the holdings of a private/closed-ended fund or product investing in illiquid assets may not be settled until a few years into the life of the fund. As such, it may not be possible for such products to meet the qualifying criteria for a label until it's fully invested following this initial ramp up period. This could hamper the marketability of such funds versus open-ended funds which are fully invested (and therefore can meet the 70% threshold) in a much shorter period.

   A similar issue arose in the context of the Long Term Asset Fund (LTAF) and the requirement for the LTAF to hold a minimum level (at least 50%) of long-term investments. Whilst the LTAF rules do not explicitly provide for a ramp up period, the FCA are conscious that some LTAF's will require a 'ramp up' period before meeting the 50% threshold. Therefore, a similar solution in respect of "Sustainable Focus" labelled funds (which may be the target for LTAFs) would be welcome: ideally, the 70% threshold would be a requirement that applies at the point a product is fully invested, and the ramp up/divestments arrangements are appropriately described to investors. This would ensure that products may continue to utilise the "Sustainable Focus" label during the ramp-up and divestment periods, and avoid counterproductive actions undertaken by managers solely or primarily to maintain the product above the label's threshold.

ii. A credible standard that is "independently assessed": The need for the credible standard to be "independently assessed" could be interpreted to mean that the manager of a Focus product should seek third-party assurance of the credible standard of environmental and social sustainability of the product's assets. Given the FCA's sensible decision to make third-party assurance of disclosures a voluntary matter instead of a requirement, we assume that this requirement means that the credible standard needs to be assessed by the manager of the product (e.g., not slavishly relying on standards prescribed by a third-party organisation which the

product manager has not independently assessed). It would be helpful for the FCA to clarify what is meant by "independently assessed" and whether our interpretation is correct.

(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?

We agree with the overall approach to the "Sustainable Improvers" label. Treating stewardship as a key feature, requiring the disclosure of a theory of change, and a demonstration of change via KPIs are essential elements of a transitional strategy – although below we detail some of the clarifications that might resolve difficulties in relation to stewardship and to KPIs. Finally, we address the ambiguity faced by real asset strategies that could conceivably qualify for either the "Improvers" or "Impact" label.

i. KPIs

As emphasised in our response to previous questions, there is a data challenge in the market, particular for product investing in private market assets. Closed-ended private equity/venture ("**PE/VC**") capital funds operate on a deal-by-deal basis and will need flexibility to determine the KPIs and other tools (including engagement - see below) that are right for the portfolio company in question. Often those KPIs will only become known once the manager becomes more familiar with the company, and after a degree of engagement. Consequently, there should be flexibility in the rules for managers to select and disclose *general KPIs* at the outset of a deal, before defining *specific KPIs* at a suitable stage in the deal. For instance, a "Sustainable Improvers" PE/VC fund might at the outset determine that a portfolio company will achieve a more sustainable use of its water resources and commit the fund at a later stage to define the precise measurement, trajectory, and milestones for this KPI.

ii. Stewardship and engagement

We appreciate the FCA's focus on the stewardship channel to deliver sustainability improvements within the "Sustainable Improvers" label. However, as a matter of terminology and clarity, the regulations should encompass the broader concept of 'engagement'. This concept spans not only the type of voting and shareholder activities common in listed assets, especially equities, but also the wider array of actions undertaken by managers in private markets; for instance, addressing the composition of the board and/or executive management, working with management to set targets and agreeing 100-day plans.

In addition, the FCA's guidance suggests that firms should disclose whether they are signatories of the Financial Reporting Council's ("**FRC**") Stewardship Code. Whilst membership to the FRC's Stewardship Code should be encouraged wherever possible, it will not be appropriate for all managers that have funds which qualify for a label. These could be global managers that adhere to stewardship standards in various other jurisdictions. It might not be feasible or relevant for managers of PE/VC or real asset strategies to become signatories to the FRC Stewardship Code. The guidance should state that managers should disclose relevant and robust stewardship or engagement codes to which they adhere (which may include the FRC Stewardship Code).

iii. Real estate assets

In the context of the real estate sector, there is potential for considerable overlap between the Improvers and Impact labels. This problem is not limited to real estate, but it is to our mind the asset class that is most likely to face this ambiguity and therefore the best illustration.

By way of commercial context, while newly constructed buildings are more energy efficient, the real estate industry is also increasingly aware of the "whole life carbon" impact of a building

and the role of the embodied carbon associated with the construction and refurbishment of real estate in addition to the operational carbon associated with its use. As previously stated, the UKGBC states that 80% of buildings that will exist in 2050 have already been built, so a major focus of real estate investors is the decarbonisation of existing stock and the carrying out of "green retrofits", alongside the development of new building stock equipped for net-zero. Consequently, some of the most "impactful" real estate investment strategies from a sustainability perspective in the coming decades are likely to be transitional real estate strategies, seeking to retrofit existing building stock to meet energy efficiency and net-zero objectives. For such transitional real estate strategies, many could qualify for both the Improvers and the Impact label, as they generally achieve a "*positive, measurable contribution to real world outcomes*", with clear additionality.

While we understand that there is not an intention to create a hierarchy of labels, in the absence of further guidance on the application of the labels where there are areas of overlap, such as the example given above, there is scope for managers to exercise a degree of their own discretion in how a product is labelled, which may result in an informal hierarchy being created.

A partial solution might be for the FCA to clarify that managers should select the label that they deem most helpful to aid investor's understanding of the product's investment strategy. If that proves difficult to do, the FCA might allow managers, by exception, to use combined labels such as 'Improvers-Impact'. However, as the real estate discussion above illustrates, part of the difficulty is the (mis)understanding that might arise in relation to the terminology of 'Impact'. We address these issues in response to the next question.

(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?

For reasons indicated in our response to the question immediately above (6b), the use of "Impact" terminology might result in confusion with the "Improvers" label. For example, we understand that many managers whose products are likely to qualify for the "Improvers" label publish an 'impact report' which sets out (i) the impact of their assets on environmental and social factors, and (ii) the impact achieved by the product by way of improving the sustainability profile of the product's assets over time. In addition, in our view, the strategies underlying the "Improvers" and "Impact" labels both seek to have a positive, measurable 'impact' in terms of enhancing environmental/social sustainability: the distinction is that "Impact" strategies seek to deliver pre-defined, real-world outcomes in relation to an environmental or social outcome (i.e., a specific 'solution' to a real-world problem). Consequently, it might be argued that "Solutions" is a more accurate description of this category. However, the term "impact" is widely used within the market and understood by investors, so introducing new terminology would be disruptive and could lead to confusion, contrary to the FCA's aims for the regime. We therefore suggest retaining the "Impact" label but urge caution around the broader use of the term "impact" and related terms such as "solving real world problems" outside of the "Impact" category. For instance, we suggest "measuring change" is a preferable term to "measuring impact" when referring to KPIs in relation to the "Focus" and "Improvers" labels.

Furthermore, the inclusion of a concept of "additionality" for the "Impact" label does not align with the industry standard for impact strategies. The concept seems to derive from an understandable concern that managers should demonstrate the investor contribution of their investments, rather than the enterprise contribution alone. It is a valid concern, but there must be some acknowledgment that, by their nature, impact strategies seek to target enterprise contribution primarily because those strategies seek out investments that are solutions to sustainability problems. This does not imply a hierarchy of labels, in which investor contribution is superior to enterprise contribution or vice versa, but rather both enterprise contribution and investor contribution are valid means to effect positive sustainability outcomes.

Finally, we have a concern about the expectation that products with an "Impact" label will "typically" invest "new capital". Due to the investment restrictions applicable to UK UCITS and NURS, a "new capital" requirement is likely to prevent, or significantly circumscribe, these types of authorised funds from achieving the "Impact" label. This could give rise to the following risks:

i. regulatory arbitrage risk as compared to other jurisdictions if the conditions for this label are set too narrowly. We also note this risk is compounded by the specific naming and marketing rule regarding use of the word "impact"; and

ii. liquidity risk in retail investor-facing funds, as "new capital" investments are typically significantly less liquid than non-new capital investments.

It would be disappointing if the conditions and criteria for the "Impact" label ultimately led to a chilling effect on the impact investment sector of the UK fund market, particularly as compared to other comparable jurisdictions. Noting that CP22/20 is a starting point for a sustainability regime that will expand and evolve over time, we suggest similarly looking to evolve and expand the array of criteria required for the "Impact" label over time.

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?

Yes, we agree for the reasons outlined by the FCA.

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?**

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.**

Yes, we agree with the qualifying criteria, subject to our comments in response to Question 6. We appreciate the balance between principles and prescription which we consider facilitates future developments in the UK asset management industry around sustainability practices and tools.

In addition to our comments in response to Question 6, we also note the following:

i. <u>Definition of "assets"</u>: We recommend the FCA clarifies what it means by "assets", particularly given the FCA Handbook already includes a definition of "assets" which is not used in CP22/20 (and is defined by reference to the Regulated Covered Bond sourcebook). Such clarity would be welcomed in particular by managers of private fund strategies.

ii. Definition of "sustainability profile": We recommend the FCA clarifies what it means by "sustainability profile", given this is imperative to determining whether a product meets the qualifying criteria for the "Improvers" label.

iii. Ability of SFDR Article 8 funds to qualify for a label: We note that, according to the FCA's indicative mapping of the labels to the EU's SFDR, some Article 8 SFDR product will not qualify for a sustainable investment label in the UK. This creates a conflict in the way that managers describe the same product in different jurisdictions, and potentially leads to issues in respect of treating customers fairly. We believe that these issues can be addressed via the naming and marketing rules, discussed in our response to Question 22.

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?

While third-party verification is desirable where possible, and we anticipate that investors will welcome the assurance offered by such independent verification, we agree that it should not be a requirement at this stage. The successful introduction of a verification process will require both the availability of specialist auditor/assurance services (with appropriate expertise in the relevant asset class and sustainability profile) and further internal compliance resource within managers themselves. We therefore feel that a voluntary verification regime (initially – noting the FCA's acknowledgement that CP22/20 is a starting point for a regime that will expand and evolve over time) is a balanced approach which prevents burdening smaller firms and products with additional costs.

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?

We agree with the FCA's approach to disclosures, including tiering.

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, although the specifics of the ISSB standard and its integration into the SDR will need to be properly considered once the IFRS S1 standard is final and complete.

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

Yes, we agree with the FCA's proposals.

We note that the FCA does not intend to set any KID-specific requirements, beyond the expectation that the relevant sustainability-related information, such as the product's investment strategy, is copied over to the relevant sections of the KID. Given the Government's intention to revoke the PRIIPs Regulation and the UCITS disclosure requirements, and the FCA's intention to design a new retail disclosure regime, we hope that the new requirements can readily fit with the SDR requirements given the implementation time and costs that firms will face to comply with the SDR.

In relation to a product having unexpected investments, we support the requirement to disclose and explain those investments, rather than a prescriptive rule that seeks to prescribe any investments that might be deemed questionable relative to the product's investment strategy.

Q14: Do you agree 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?

Yes, we agree that the regulator should not mandate a reporting template at this stage. It might be that sectors of the industry develop templates that are most suitable for their strategy/product types and target market, which should be a priority at this stage rather than prematurely seeking standardisation in reporting in a diverse market. We note the standardised templates for disclosing/reporting in accordance with the EU's SFDR/Taxonomy Regulation are proving difficult for managers operating in a diverse market but disclosing under a 'one size fits all' approach (which can lead to odd outcomes). We anticipate that managers will welcome to ability to design their materials (which can include their own branding and 'style') and present the information in way which they consider to be most useful to their target market and based on the product's investment strategy.

Q15: Do you agree with our proposal 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 with the FCA's proposals. As noted in relation to unintended investments in response to Question 13, we believe that the requirement to disclose trade-offs is more practical and helpful than a prescriptive 'Do No Significant Harm' rule (as is imposed by the EU's SFDR).

Q16: Do you agree with our proposal 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.

Yes, we agree with the proposals.

Q17: Do you agree with our proposal 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?

Yes, and this is consistent with much market practice.

Q18: Do you agree with our proposal 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.

Yes, but we suggest clarity in two areas:

i. Application to non-UK firms: We interpret the rules to mean that non-UK management companies are out of scope for the entity-level reporting requirement but would appreciate that interpretation being clarified.

ii. Sub-£5bn threshold firms: As detailed in our response to Question 1 on the scope of the regime, it would be helpful if the FCA could clarify the reasons for the discrepancy in scoping for the product-level reporting requirements as between the SDR and the UK's Climate-Related Financial Disclosure Rules).

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?

Yes, it is desirable to build on the UK's Climate-Related Financial Disclosure Rules and to consider the ISSB as a baseline for global comparability. This will help underpin the UK's status as a global investment hub. However, as previously stated, full judgement on the integration of the IFRS S1 into the SDR will need to be reserved until the final standard is complete and published.

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

Yes, while the rule reflects existing regulatory requirements and is consistent with those rules and principles, it is expected to help focus the minds of FCA-regulated firms on their regulatory expectations in relation to sustainability-related matters. Indeed, we suggest that the anti-greenwashing rule should have a greater prominence in the SDR regime, as discussed in our response to the marketing rules in Question 22 below.

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?

We agree with the proposed product naming rule and its application only to products marketed to retail. However, to avoid confusion in the market and inadvertent greenwashing, we recommend that the FCA provide a broader, albeit not necessarily exhaustive, definition of prohibited terms.

The naming rule could give rise to further issues for overseas products, particularly products in jurisdictions such as the EU, that are or will be subject to local naming requirements. We note the starting point is for firms to publish a notice including a prescribed statement that the overseas product is not in scope of the SDR. However, we urge that these cross-border issues are resolved before the SDR takes effect.

Q22: Do you agree with the proposed marketing rule? If not, what alternative do you suggest and why?

No, we do not agree with the proposed marketing rule. We consider this is overly restrictive for products that do not qualify for a label, but which may wish to use proportionate sustainability-related terms in their marketing. Given the (generally welcome) high bar to qualify for a label, there will be many products that have sustainability-related characteristics or features, or managers that are undertaking sustainability-related actions, which cannot be adequately described to investors. Examples are a fund that considers and manages sustainability-related risks with financial implications (so-called "ESG integrated" funds), and perhaps certain risks that are material to the asset class, such as physical risks like flooding to infrastructure; or a manager that adheres to certain globally recognized ESG standards. It is important, and material to investors, that a manager can adequately and fully describe the sustainability-related characteristics and features that are relevant to the investor, regardless of the intentionality captured in a qualifying label.

The blunt prescriptiveness of the marketing rule undermines the ability of managers to make disclosures that are fair, clear, and not misleading. Perversely, it could result in a 'white-washing' of what are fundamentally sensible management actions and investment strategies (if done genuinely), and disincentivising managers to undertake good sustainability-related actions outside of products in the narrower labelling regime.

The solution appears readily available. The FCA's existing marketing requirements and upcoming Consumer Duty rules require firms to make investor disclosures that are clear, fair, and not misleading, and to ensure consumer understanding and good consumer outcomes. Underpinned by the new anti-greenwashing rule, firms should be able to make use of sustainability-related terms in a way that is proportionate and accurate. Indeed, it should provoke firms with a product that does not qualify for a label to describe what terms like "integration" mean in practice to an investor. Consequently, we propose that the marketing rule be dropped or modified, and greater emphasis be given to the anti-greenwashing rule and general communication requirements.

Alternatively, should the marketing rule be retained, clear Handbook guidance regarding "proportionate" use of sustainability-related terms will be necessary to ensure FCA expectations are

met and to avoid the risk of ‘whitewashing’. Ultimately, investors must be able to make informed decisions, and the current formulation of the marketing rule puts that at risk.

Q23: Are there additional approaches to marketing not covered by our proposals that could lead to greenwashing if unaddressed?

Only to note, as we did in response to the scope in Question 1, that addressing pension products is important because it addresses a distribution channel for investments that are in-scope for the regime.

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

Yes, we support consistency in the application of the SDRs along the distribution chain. In addition, the application of a disclaimer to overseas funds is an interim solution, although it would be preferable to resolve the treatment of those funds before the regime takes effect.

Q25-31 re: pensions

We have not considered these questions at this time.