MEMO# 33904

November 16, 2021

UK ESG: FCA Sustainable Investment Labelling

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TO: ICI Global Members
ESG Task Force
Global Regulated Funds Committee SUBJECTS: ESG
International/Global RE: UK ESG: FCA Sustainable Investment Labelling

On 3 November 2021, the UK Financial Conduct Authority (FCA) released a discussion paper (paper) on Sustainability Disclosure Requirements (SDR) and investment labels.[1] The FCA is asking for comments on this paper by 7 January 2022, and intends to use the input they receive to inform policy proposals to be issued for consultation in Q2 2022. The work set out in this paper is consistent with the UK Government Roadmap[2] and follows up on a broader disclosure regime for asset managers as published by the FCA in July 2021.[3]

I. SDR and Sustainable Investment Labels

This paper is intended to complement the UK's planned Sustainability Disclosure Requirements (SDR) to introduce a sustainable investment labelling regime. With SDR, companies, including asset managers and asset owners, will be required to report on their sustainability risks, opportunities, and impacts. These requirements build on measures already taken, or underway, to implement disclosure rules aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD), and will also include disclosure requirements relating to the forthcoming UK Green Taxonomy.

Sustainable investment labels will require certain investment products to display a label reflecting their sustainability characteristics. There are a variety of existing initiatives, both in the UK and internationally, that relate to labeling or classification of sustainable and responsible investment products, but the FCA is looking for views on how they can best leverage these initiatives as they develop their proposal.

II. Why These Initiatives?

With both the SDR and labelling regime, the FCA is hoping to create the right market conditions for market participants to manage risks in a more sustainable economy while ensuring opportunities that benefit consumers. Their aim is to introduce a framework that encourages structured dialogue within firms, and subsequently disclosure, on how these firms identify and manage sustainability-related risks, opportunities, and impacts. The ultimate goal is to help consumers effectively navigate the market for sustainable financial products with enough information to assess which product meets their needs, while holding firms accountable for their sustainability claims.

Sustainable investing is an increasingly diverse market, which can be highly beneficial to consumers, however, the FCA notes that without common standards and clear terminology, there is a risk that consumers can be confused by the array of choices. There are many products that fall within a range of objectives, strategies and characteristics that will be suitable for different consumers with different investment goals and risk appetites.

The paper includes a summary of "building blocks" in ESG investing (Box 1) which is included here:

Box 1: Investment strategies

The Global Sustainable Investment Review 2020 outlines a variety of 'building blocks' in ESG investing and explains that it is not unusual for investment products to combine a variety of investment strategies. These include:

• ESG Integration: The systematic and explicit inclusion by investment managers of ESG factors into financial analysis.

• Corporate engagement and shareholder action: Employing shareholder power to influence corporate behaviour, including through direct corporate engagement (ie communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting guided by comprehensive ESG guidelines.

• Norms-based screening: Screening of investments against minimum standards of business or issuer practice based on international norms such as those issued by the United Nations (UN), International Labour Organization (ILO), Organisation for Economic Co-operation and Development (OECD) and non-governmental organisations (NGOs).

• Negative/exclusionary screening: The exclusion from a fund or portfolio of certain sectors, companies, countries or other issuers based on certain criteria. Exclusion criteria (based on norms and values) can refer, for example, to product categories (eg weapons, tobacco), company practices (eg animal testing, violation of human rights, corruption) or controversies.

• Best in class/positive screening: Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers, and that achieve a rating above a defined threshold.

• Sustainability themed/thematic investing: Investing in assets specifically contributing to sustainable solutions, such as sustainable agriculture or green buildings, or investing in sustainable themes such as low carbon portfolios or portfolios promoting gender equity.

• Impact investing and community investing: Investing to achieve positive social and environmental impacts. This approach involves measuring and reporting against these impacts, demonstrating the intentionality of investor and underlying asset/investee, and demonstrating the investor contribution. Community investing is broader than impact investing and considers other forms of investing and targeted lending activities.

III. Consultation Questions

The specific questions the FCA is requesting comment on can be found throughout the paper and are listed in Appendix 1.

Q1: What are your views on the tiered approach set out in Figure 2? We welcome views on any concerns and/or practical challenges.

Q2: Which firms and products should be in scope of requirements for labels and disclosures? We particularly welcome views on whether labels would be more appropriate for certain types of products than for others, please provide examples.

Q3: Which aspects of these initiatives, or any others, would be particularly useful to consider (for example in defining terms such as responsible, sustainable and impact) and how best should we engage with them?

Q4: Do you agree with the labelling and classification system set out in Figure 3, including the design principles we have considered and mapping to SFDR? We welcome views on further considerations and/or challenges.

Q5: What are your views on 'entry-level' criteria, set at the relevant entity level, before products can be considered 'Responsible' or 'Sustainable'? We welcome views on what the potential criteria could be and whether a higher entity-level standard should be applied for 'Sustainable'products. We also welcome feedback on potential challenges with this approach.

Q6: What do you consider to be the appropriate balance between principles and prescription in defining the criteria for sustainable product classification? We welcome examples of quantifiable, measurable thresholds and criteria.

Q7: Do you agree with these high-level features of impact investing? If not, why not? Please explain, with reference to the following characteristics:

- intentionality
- return expectations
- impact measurement
- additionality
- other characteristics that an impact product should have

Q8: What are your views on our treatment of transitioning assets for:

a. the inclusion of a sub-category of 'Transitioning' funds under the 'Sustainable' label?
b. possible minimum criteria, including minimum allocation thresholds, for 'Sustainable' funds in either sub-category?

Q9: What are your views on potential criteria for 'Responsible' investment products?

Q10: Do you agree that there are types of products for which sustainability factors, objectives and characteristics may not be relevant or considered? If not, why not? How would you describe or label such products?

Q11: How do you consider products tracking Climate Transition and Paris-aligned benchmarks should be classified?

Q12: What do you consider the role of derivatives, short selling and securities lending to be in sustainable investing? Please explain your views.

Q13: What are your views on streamlining disclosure requirements under TCFD and SDR, and are there any jurisdictional or other limitations we should consider?

Q14: What are your views on consumer-facing disclosures, including the content and any considerations on location, format (eg an 'ESG factsheet') and scope?

Q15: What are your views on product-level disclosures, including structure, content, alignment with SFDR and degree of prescription?

Q16: What are your views on building on TCFD entity-level disclosures, including any practical challenges you may face in broadening to sustainability-related disclosures?

Q17: How can we best ensure alignment with requirements in the EU and other jurisdictions, as well as with the forthcoming ISSB standard? Please explain any practical or other considerations.

Q18: What are your views on the roles of other market participants in communicating sustainability-related information along the investment chain?

Q19: Do you consider that there is a role for third-party verification of the proposed approach to disclosures, product classification and labelling, and organizational arrangements of product providers? Do you consider that the role may be clearer for certain types of products than others?

Q20: What approaches would you consider to be most effective in measuring the impact of our measures, including both regulatory and market-led approaches, and should disclosures be provided in a machine-readable format to better enable data collection and analysis?

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endnotes

[1] See full report here: https://www.fca.org.uk/publication/discussion/dp21-4.pdf

[2] See Greening Finance: A Roadmap to Sustainable Investing, October 2021, available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1026224/CCS0821102722-006_Green_Finance_Paper_2021_v5_Bookmarked_48PP.pdf. *Also see* ICI Memorandum No. 33892, available at https://www.ici.org/memo33892.

[3] See ICI Memorandum No. 33703: UK ESG: FCA Consults on Climate-Related Disclosures for Asset Managers, available at https://www.ici.org/memo33703.