

Insights

FCA DISCUSSION PAPER ON ENTITY & PRODUCT LEVEL SUSTAINABILITY DISCLOSURE REQUIREMENTS

AND THE PROPOSED SUSTAINABLE INVESTMENT LABELLING REGIME FOR THE UK INVESTMENT MANAGEMENT SECTOR

5 November 2021

SUMMARY

On 3 November 2021 the FCA published a [discussion paper](#) (DP) seeking views on how best to introduce Sustainability Disclosure Requirements (SDR) for certain asset managers and FCA-regulated asset owners, as well as a sustainable investment labelling regime for the investment products they offer. These initiatives form part of the Government's October 2021 [Roadmap to Sustainable Investing](#). The DP was published alongside the FCA's '[Strategy for positive change: our ESG priorities](#)' to coincide with COP26 'Finance Day' announcements. The FCA's key aims, to be achieved by collaborating both internationally and domestically, are to promote transparency through high-quality sustainability disclosures, promote trust in investment products and protect consumers from misleading claims about their sustainability characteristics. The FCA will use the DP feedback (open until 7 January 2022) to inform its policy proposals, which are to be consulted on in Spring 2022.

The proposals in the DP are consistent with those set out in the Roadmap, built on, but broadening, the Task Force for Climate-related Financial Disclosures (TCFD) recommendations. We would highlight a few of the discussion points raised in the DP.

The FCA proposes a three-tiered and standardised approach to disclosures and labelling, as set out below, to ensure consistency and comparability.

- An investment product label.
- A consumer-facing product-level 'ESG factsheet' to provide standardised information on a product's key sustainability attributes.

- More detailed supplemental disclosures (aimed at more sophisticated or institutional investors and other stakeholders) at product and entity level on sustainability risks, opportunities and impacts. The FCA proposes the following as types of product-level information for this detailed layer of disclosure: on data sources, limitations and data quality; further supporting narrative, contextual and historical information; further information about UK Taxonomy alignment; and on benchmarking and performance.

The DP sets out a classification and labelling system that complements SDR and covers the full range of investment products available to retail consumers (not only 'sustainable' products). A baseline level of prescription would need to be set to evidence suitability for the 'Responsible' and 'Sustainability' labels.

In designing a labelling and classification system to reflect a product's sustainability characteristics, the FCA proposes some key design principles.

- First, using objective criteria and descriptive labels, referencing for instance the proportion of sustainable investments, or the nature of the product's objectives or strategy. This should allow for clear product categorisation and more effective supervision by the FCA.
- Secondly, by identifying a product's objectives and strategies - its sustainability characteristics, themes or objectives and how it is pursuing them. This could include assessing the proportion of its investments allocated to sustainable activities, by using the sustainability criteria as developed in the UK Taxonomy.
- Thirdly, adopting a familiar and market-based approach that is consistent and compatible with current classification systems, whilst accommodating flexibility as the market develops and innovates.

The suggested approach preferred by the FCA maps products into four categories, each to be supported by clear definitions and criteria, and which the FCA states could potentially integrate with the EU's Sustainable Finance Disclosure Regulation (SFDR) product classification regime, as set out below.

- Not promoted as sustainable: sustainability risks have not been integrated into investment decisions and the product has no specific sustainability goals. Equates to 'Other' products under Article 6 SFDR.
- Captures two product types, which both equate to Article 8 products under SFDR:
 - 'Responsible': the impact of material sustainability factors on financial risk and return is considered, in order to better manage both risks and opportunities and deliver long-term, sustainable returns; but no specific sustainability goals.

- 'Sustainable Transitioning': sustainable characteristics, themes or objectives, but which do not yet have a high proportion of underlying assets meeting the sustainability criteria set out in the UK Taxonomy (or that are established as verifiably sustainable where a taxonomy is not yet available). In recognition of the important role in facilitating transition through active targeted investor stewardship, these products will pursue strategies that aim to influence underlying assets towards meeting sustainability criteria over time.
- 'Sustainable Aligned': sustainable characteristics, themes or objectives and a high proportion of underlying assets (measured according to a minimum threshold) that meet the sustainability criteria in the UK Taxonomy (or that are established as verifiably sustainable where a taxonomy is not yet available). Equates to Article 9 products under SFDR.
- 'Sustainable Impact': objective of delivering net positive social and/or environmental impact alongside a financial return. This would be a sub-set of Article 9 SFDR products.

As well as engaging with bodies such as the FCA and PRA's Climate Financial Risk Form, the FCA has established a Disclosures and Labels Advisory Group to support implementation.

The FCA requests feedback on a broad range of issues around policy design raised in the DP. We have set out those of key interest below.

- The types of firms and products that should be in scope of the requirements. The FCA asks for any specific examples where labels may not be meaningful, suitable or feasible – for instance where portfolio management services are provided on the basis of segregated mandates or where products are not targeted at retail consumers.
- How to design the labelling and classification system, including how best to leverage existing systems and work in this area, and any quantifiable, measurable thresholds and criteria that could be applied to evidence suitability for obtaining each of the 'Responsible' and 'Sustainable' labels.
- Views on any approach to entry-level criteria, including a higher threshold for 'sustainable' products, for the firm responsible for delivering the product and managing the investment products (including any delegate) – for example, matters relating to systems and controls, governance, ESG integration and stewardship.
- How best to ensure alignment with:
 - the requirements of the EU and other jurisdictions, including how products that are already classified under the EU regime could map across to the UK classification system and the extent to which the content of the disclosure requirements under SFDR is relevant for the UK market and should therefore be captured under SDR;

- the TCFD-aligned disclosure rules for listed issuers and proposed rules for firms; and
- the forthcoming standards being developed for corporate reporting by the International Financial Reporting Standards (IFRS) Foundation's International Sustainability Standards Board (ISSB).
- Views on the role of derivatives, short-selling and securities lending in sustainable investing.
- Practical considerations, such as scope and operation of the system – including if there should be independent third-party verification of product classifications, labelling and disclosures.

Developments in designing and embedding ESG considerations are fast-paced and dynamic. The FCA will also consider how to apply the rules both to overseas funds marketing into the UK and the best approach to bring financial advisers in scope. More imminent is the FCA's policy statements and final rules, expected by the end of 2021, following its Consultation Papers (CP 21/17 and CP21/18) on proposals for TCFD-aligned climate-related disclosures by a wider scope of corporates as well as asset managers, insurers and FCA-regulated pension providers, both coming into effect from 1 January 2022.

This DP is an important juncture to engage with the FCA, via industry bodies or directly; to take the opportunity to provide feedback to help shape UK policy for sustainable investment labels and consumer-facing and entity and product level disclosures. The final rules will, in due course, impact beyond asset managers and owners, creators of investment products and those giving investment advice - to corporates and the economy more broadly. The FCA's stated preference is to build upon existing domestic and international initiatives and frameworks to develop a coherent and interoperable system – in particular, to be consistent with the sustainable finance initiatives that are being pursued within the EU. This will be of great help to firms navigating the rules and proposals and operating in both the UK and the EEA.

For more background and detail on the Roadmap you may be interested in our recent briefing [Roadmap to Sustainable Investing: UK Government proposals for a green finance rulebook – with an industry call to action to help cement the UK as the global leader in green investment.](#)

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Matthew Baker

Co-Author, London

matthew.baker@bclplaw.com

[+44 \(0\) 20 3400 4902](tel:+442034004902)

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