HOUSE OF COMMONS

Treasury Sub-Committee on Financial Services Regulations

Oral evidence: Greenwashing: sustainability disclosure requirements, HC 1150

Wednesday 22 February 2023

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Watch the meeting

Members present: Harriett Baldwin (Chair); Rushanara Ali; Dame Angela Eagle; Emma Hardy; Danny Kruger; Andrea Leadsom; Siobhain McDonagh; Anne Marie Morris.

Questions 1 - 91

Witnesses

I: James Alexander, Chief Executive, UK Sustainable Investment and Finance Association (UKSIF); Kate Levick, Associate Director of Sustainable Finance, E3G; and Chris Cummings, Chief Executive, The Investment Association.

II: Sacha Sadan, Director of Environment, Social and Governance, Financial Conduct Authority; Mark Manning, Technical Specialist for Sustainable Finance and Stewardship, Financial Conduct Authority.

Examination of witnesses

Witnesses: James Alexander, Kate Levick and Chris Cummings.

Q1 **Chair:** Welcome to this session of the Treasury Sub-Committee that is looking into the FCA's consultation on sustainability disclosure requirements and investment labels. There is a lot of jargon and a lot of three-letter acronyms in this field, and people watch these proceedings not knowing what they are, so for the benefit of the public, could I ask all our witnesses to speak in retail-friendly language today?

I am going to start by asking you to introduce yourselves.

James Alexander: Good afternoon. I will try to avoid the acronyms. My name is James Alexander. I am the chief executive of UKSIF, which is the UK Sustainable Investment and Finance Association.

Kate Levick: Hello. My name is Kate Levick. I am the associate director for sustainable finance at E3G, which is a climate politics think-tank based in London. I lead their work on finance. I am also the co-chair of the secretariat to the UK's Transition Plan Taskforce.

Chris Cummings: Hello. I am Chris Cummings, the chief executive of the Investment Association, the trade association for UK-based fund managers. Our industry looks after £11 trillion of other people's money, mostly coming from pension schemes, institutional investors and, of course, retail customers up and down the whole of the UK.

Q2 **Chair:** We know that a lot of investors are keen to make sure that their money is invested in our journey to net zero, in other environmentally sustainable approaches and also in good governance. The FCA is proposing to bring in rules that will mean that if a fund wants to describe itself as being sustainable, it will need to choose one of three labels. What does our panel think of this overall approach?

Chris Cummings: We support the FCA's ambition to bring greater clarity to retail investors about where their money is going and ultimately how it gets deployed into the real economy, into high-growth companies or listed organisations, supporting infrastructure and so on. The ambition is absolutely correct.

Of course, this is more than just a labelling exercise, because the funds the labels get attached to then allocate capital across the whole of the economy. It is more than just looking at this from a labelling point of view. We want to make sure retail investors understand where their money is going.

We have engaged with the FCA throughout this exercise, and it has shown itself to be listening to the industry. I do feel that the FCA needs to reconsider some of its proposals. That is because, given where we are today, if the labels were to go ahead unchanged, they would be excluding between 60% and 70% of all retail investment. The FCA proposals do not allow for multi-asset funds, funds of funds or those funds that track an index, to qualify for a label. That is around 60% to 70% of all retail investment. For that reason, if for no other, we would be encouraging the FCA to have another think about it.

The FCA rules would also mean substantially higher costs for the industry. This is adding to complexity because the proposed disclosure requirements discuss whether extra information sheets should be handed over during the sales process. According to the FCA's own figures, only 3% of customers read the literature they get given. Providing further information—

Q3 **Chair:** Would that cost be passed on to consumers?

Chris Cummings: That cost would absolutely be passed on to consumers. The industry would seek to mitigate as much cost as possible. On the idea of handing over pieces of paper in the 21st century, what we are looking for is a digital solution that delivers to potential investors the information they need as and when they need it.

The FCA is also consulting on a new disclosure regime, which we are very happy about. We think there could be better alignment between the various proposals that are on the table at the moment.

We have some other considerations as well, which we set out in our consultation response. Those are particularly around interoperability—the way that the FCA regime would map against what is happening in the European Union and what we see in America. Of the 7,000 funds that UK savers and investors have access to, the majority come from the European Union. They are domiciled in Luxembourg or Dublin. Over 4,000 of them would not qualify for an FCA label. The risk of consumer confusion as a result of these proposals is palpable.

Q4 **Chair:** Kate, what do you think of the overall approach?

Kate Levick: E3G has welcomed the consultation that the FCA put out on its proposed new regime for labelling financial products. We see that in its context as part of a wider suite of moves the UK Government are currently making to look at green financial regulation, to make it consistent, to ensure it supports the UK's net zero transition and the City of London as a green finance leader in the world and to capture some of the post-Brexit opportunities for the UK financial sector at a time of huge growth in green opportunities.

There are constructive comments that we have made to the FCA in our consultation response here and there, but we are very happy overall with the direction of travel. We support the proposals the FCA has put out, not least because they have been through a couple of rounds of consultation already and quite a substantial amount of market testing.

For someone who is sitting as an expert in the profession or in this area, it may be difficult to judge what a label should be called or precisely what its remit should be, but the fact the FCA has gone out and really talked to retail investors and worked out what they want and what will make sense to them gives me a high degree of confidence.

For myself, as one of those rare people who looks to see what is inside their pension wrapper and sometimes moves things around, which is 1% or less of the UK population, I have very rarely invested in something with a sustainable title. When I look at it, I usually find it includes companies that are not ones that belong in a sustainable fund or I do not see a clear objective to the fund.

What the FCA is trying to do with these labels is precisely what the market needs at this point, given the fact that the Competition and Markets Authority has found evidence of greenwashing and confusing claims by firms and that customers are clearly showing lot of demand for this.

Q5 **Chair:** For you, it is a good outcome that two-thirds of firms that currently claim to be sustainable will not be able to obtain one of these sustainable labels.

Kate Levick: That in itself cannot be seen as a good outcome, but it is a good outcome if the firms that are dealing with the kinds of investments that investors want to invest in are clearly labelled so that investors cannot be misled. There will clearly be a market transition as the market adjusts to the new expectations. That will involve changes to the way some funds are composed and marketed.

It is also important to note that different kinds of products may not fit under these labels but may represent some kind of purposeful or sustainable investing opportunity for other reasons. We know there are particular investors who are specifically concerned with not investing in arms, for example. Those kinds of investments will still exist; they will still be needed. They may not fit under these labels, and investors need to be able to find them and find them easily. I think we are agreed on this.

There will be a market transition, but it is a market transition in a direction that we need, which is to incentivise the market to create genuinely credible investment opportunities, to enable retail investment in them, and also to remove the significant amount of greenwashing that is currently in the market.

Q6 **Chair:** James, what do you think about the overall approach? Is it suspicious that the FCA thinks that about a third will fall into each of the three categories they are proposing?

James Alexander: We are similarly supportive of the direction of travel and the approach. To build on Kate's example of her own pension fund, our network brings together fund managers, banks, pension funds, data providers and also wealth managers and financial advisers. One of the things they report back to us is a growing challenge because more and more people want to invest in line with their values, as you mentioned earlier, but even financial advisers and professionals in this space are finding it harder and harder to recommend, hand on heart, products that they think will match the values their clients have said they want to align with through their investing.

That is one of the challenges. Today, if you want to create a fund that draws on the growing demand of consumers for products that have a sustainable impact or are named as sustainable, you can do that without really doing anything. You do not have to do anything specific around that. That is the challenge. We see a real issue for consumers here. That is bringing the whole sustainable finance and sustainable investment market into disrepute. There is a challenge around trust. It has the potential to bring that market into disrepute. We know that we need to build investor and consumer trust in this space. That is what these rules propose to do: to create market confidence, to create integrity in the market and to build the trust of savers.

Q7 **Chair:** If these proposals went through as they are currently outlined, presumably a lot of people who are currently invested in what they think is sustainable are going to be notified, "I am sorry. We are not in one of those three categories. You are no longer in a sustainable investment." Does that build trust?

James Alexander: We are very comfortable with the balance that is being struck in this direction of travel. We think this is a very positive direction of travel, as I said.

Chair: You said that, yes.

James Alexander: The balance that needs to be struck is to create a high bar that is having the positive impact that savers want and expect from a fund that is labelled as sustainable, versus having a long enough lead-in time for the market to adjust and get used to that. We think that balance has been struck.

Most of these rules come in in June 2024. That will give long enough for those funds that want to attain those labels to adjust and adapt—to do that if they need to—and long enough for them to work with their savers otherwise.

Q8 **Chair:** That is very clear. Are you happy that there is enough data to work with for the people who put together these funds to be able to target these three very precise categories?

Chris Cummings: No. The reason for that is quite simple. We absolutely agree with the FCA approach to raise the bar; let that be said. The industry is about nothing if not building trust. We want investors to understand where their money is going. It is their money; we are just looking after it for them.

The data assumptions are built on best endeavours at the moment. The data can only come from investee companies, where we choose to deploy our money. That is in high-growth companies, in life sciences or biotech. These are the companies that are going to be tomorrow's winners. Of course, there are no standards as yet for those companies to report against.

The work of the ISSB, which is the international standards body that is going to set these standards, is ongoing. At the moment we have seen what are called exposure drafts. They are consultations. There is a whole process yet for those drafts to come in, for them to be embedded into the investee companies and for the audit profession to work out how they are going to audit these companies before they can report to us as fund managers on what "good" looks like.

Q9 **Chair:** The industry is basically flying blind into whether or not these three categories are something they can achieve based on the data available.

Chris Cummings: That is what I said. We have mapped out the current fund universe, as has the FCA. Even with the best endeavours, we find that only about a third of funds would meet the requirements as they are set out today.

It is also stopping the industry from using words like "responsible investing" or "ethical investing". Of course, climate change is a massive priority for our industry, but these rules go well beyond climate change. They start to look at areas such as social investing and good governance. On the "E" side—the environmental side—the standards are coming at pace, but they are not there yet. For good governance, there is a clearer and clearer understanding of what good governance means. Societal impact is not as evolved yet.

My great worry about all of this is that, in an industry where over £91 billion has been invested so far, consumers will feel like they have somehow been misled. The regulator has today said, "This is the level playing field. This is what 'good' looks like," but tomorrow it will say, "No, it is only a third of that." This is saying to the industry, "You have 12 months to change," when hundreds of thousands of people and standards across the whole of Europe and internationally are going to have to change. First, that is the FCA imposing its will extraterritorially on jurisdictions outside the UK.

Secondly, this could mean a level of consumer confusion. If these proposals were to go through, a current investor might want to invest in a fund that is assessed as being green—an article 8 fund in the EU. Your financial adviser might want to recommend that to you, but they would then have to give you a disclaimer—a warning statement—saying, "This fund does not conform to the FCA standard, but it does conform to the European Commission standard." I do not see how that builds trust. That will add to confusion.

Q10 **Chair:** Will the slightly confusing picture you are painting do what we would all want it to do, which is to encourage companies seeking investors to be taking steps to become more sustainable and reduce their carbon emissions?

Chris Cummings: There is a huge opportunity here to green our economy. It is a huge opportunity. As investors, we want to work with the Government on clear transition plans so that all companies and all industries have a really clear idea about what that transition path looks like, with clear milestones. We are not there yet for all the industries, but that is our clarion call. That is absolutely what we need.

We can then overlay the standards from the Task Force on Climate-Related Financial Disclosures, which are supported by this Government and Governments around the world. As they come in, the international standards are a step above those. That is not the work of a year. It does not mean to say we should not start. Of course we should start, but please let us not impose the end state before we have been through the transition.

This is just too important for the FCA to do one discussion paper, one consultation paper and then a set of rules, perhaps recognising they are excluding 60% to 70% of the market. That could lead to such a large dislocation that the FCA might want to reconsult once it has heard from the industry, consumers and other groups. The level of response across the piece may have been either surprising to the FCA or perhaps given them a moment to think, "We should probably go and retest our assumptions before going to final rules." Regulate in haste; repent at leisure.

Chair: We have them in later in the second panel. We will be able to ask them about that.

Q11 **Danny Kruger:** I want to preface my remarks by putting on the record that I very much support the intended direction of travel here. The development of purpose as a theme in business is so important. In fact, I would support a change to the Companies Act to enable firms to designate themselves as purpose-driven companies.

However, I have significant concerns about where we have got to. In a sense, Chris, your remarks have confirmed them. Do you all assume that the intention should be that every firm meets the requirements for an ESG label? Every firm has a "G" in it, even if it is not actively in the environmental or social spaces, though most firms probably are as well. At the moment, only a third would qualify. Is it your intention or expectation that every firm should qualify and therefore meet the criteria? We would have 100% inclusion; is that the ambition from your perspective?

Chris Cummings: From our perspective as investors, we would assess every company we choose to invest in against good governance, their societal impact and their environmental impact, whether they choose to or not.

Q12 **Danny Kruger:** But the ideal regime here is one that all companies should be able to qualify for. As investors, would you only be investing in firms that meet the criteria, or not?

Chris Cummings: As long there was a rating scale. Not every company will get a tick in the box on all three criteria at the highest level. Some, because of their activities, will be on a transition path. That is one of the issues. There is a transition path but no endpoint for some companies.

Q13 **Danny Kruger:** Kate, is your expectation and aspiration for every firm to meet the criteria?

Kate Levick: I find it a surprising question. In a long-term sense yes, but that is definitely not the scenario we have been looking at in the short term and possibly not the medium term.

You are looking particularly at the part of the FCA proposals that is talking about labelling for financial products here and the three labels. There are other aspects to it as well. We have a label that is specifically on sustainable focus. There you would want predominantly investments in companies that are really seen to be future-fit—the companies of the future that are those really good investments, which are already where we need to be. Not all companies are there at that point.

Then we have the label that is effectively looking at transition, "sustainable improvers". These are companies that have credible plans to be on that journey, but they are not there yet. Then, of course, we have the products that are specifically for driving impact, which is a specific type of investment that particular investors often want to focus their investments on.

Each of those is for a different investment purpose. Yes, of course, in terms of the UK's and the world's transition to a resilient, sustainable, net zero carbon world, we want all companies either to have got to the bar or to be on the way to the bar, but it is going to be some time before that happens. In the meantime, we need to be guiding investors as to whether these are companies, funds and so on that are worth investing in and whether they have these investment desires or not.

Q14 **Danny Kruger:** That is understood. James, I want to come to you. I am going to ask the question I was going to put to you all following that. The ambition is clearly to funnel all companies and funds, which we are talking about particularly here, on to this road. The implication of that is that the FCA is basically deciding what a legitimate investment is. As Chris says, these labels are driving capital allocation. We are giving the FCA a significantly greater responsibility for effectively deciding what an appropriate investment is. We are giving it far greater powers than it has had up until now.

James Alexander: No, I do not agree with that. Very simply, this is about saying that there are many people that want to invest in a way that aligns with their values, whether that is environment, social or other things—the things that Chris perhaps said were bad. I think that is a very good thing, because we know that is what a lot of people want to do. These rules are simply saying, "If you are offering a product that says it matches these values, it must do that or it must do something towards that." I do not fully understand why that is such a controversial thing to suggest.

Q15 **Danny Kruger:** It is about the definition. The FCA is determining what that definition is. I agree: you are trying to simplify it. Only 3% of people read the small print anyway. The power of defining is pretty significant, do you not agree?

James Alexander: Over the last year and a half, the FCA has worked very closely with industry in a group with a four-letter acronym, which is the Disclosures and Labels Advisory Group, or DLAG, as it is called. We have all been part of that process, and that has worked very hard across the industry with a group of experts to try to understand this. It has also done a huge amount of consumer research. I am sure you can ask the FCA for more details about that.

That has drawn some conclusions on what people expect to see, particularly in terms of how things should be called, labelled, named and discussed. That is where we have got to. It is based not just on the FCA making things up in "FCA Towers" but on a broad group of the industry coming together and starting to share and think about ideas around how to solve this challenge.

This is not a challenge that should be thrown into the long grass, because right now there is a lack of trust in this industry when it talks about sustainability and things that are sustainable. That is causing consumers to question what they are investing in. When people look underneath their pension fund and they see what it is invested in—the so-called sustainable fund that is full of fossil fuel stocks and other things—people say, "Hang on a minute. What am I investing in? How can I trust this industry to be matching what I have asked it to do?"

That is really what the FCA is saying. That is why this whole thing is not based around the FCA trying to push the economy in a particular direction. This whole thing is based around consumer protection, which is the overarching objective of a financial regulator.

Q16 **Danny Kruger:** It will push the economy in a direction. You are basically deciding on a clean and unclean status for firms. We are going to come on to the question of whether this is driving a bubble in the firms that will qualify for these labels, but I will leave that to Anne Marie.

I have one last question that you might be able to help me with, Kate. Chris identified a challenge, which is that funds of funds or mixed funds do not qualify at the moment. You were presumably hoping they would. What complications or challenges do you see in including these more complex funds in the regime? How much work would be required to get there for those funds?

Kate Levick: There is definitely room for the FCA to have a look at how to make sure the maximum number of funds with the right objectives are going to fit under these labels. I have heard the challenge of mixed funds raised a couple of times. One thing I would say is that the FCA criteria are pretty simple. It is around the objective that the investment product has, which kind of objective it has and whether it is delivering that.

When you have a mixed fund, I suspect in some cases it will be difficult for that fund to have a clear objective and to be clearly demonstrating it, because there is almost a split incentive. It may be that the market may shift and reshape itself a little in response to these proposals, as we were discussing before. I would say it is important not to exclude very valid investment products, but these are edge cases. The overall direction of travel—I completely agree with James—is about being very clear with consumers on what they want.

Can I just say something very briefly about the level playing field issue that Chris raised? It is normal for the playing field to move as things change. As he has rightly said, the area of sustainability is a moving playing field. It is one the UK is very much playing on, helping to set norms and standards.

Chris mentioned a four-letter acronym the ISSB, which is developing the international standard. That has not come out of nowhere. It is being based on a number of existing standards that companies have been using for quite some time. There is quite a lot of data out there and quite a lot of existing practice. He might have slightly overstated the extent to which there was no data or no practice in this area. This is something that has been developing for quite some time.

Chris Cummings: I did not say there was no data; I was saying that there was no robust and internationally agreed data set that we can use. If we think that is the work of but a moment, we would be misleading the Committee.

Could I just pick you up on edge cases, Kate? Multi-asset currently accounts for 17% of retail investments; funds of funds are 12%; and of course index funds are now well over 17%. These are not edge cases. We are talking about the great swell of where people are choosing, with advice, to place their investment.

At the moment there are FCA rules around things being clear, fair and not misleading. If the FCA or any regulator felt that these funds were being mis-advertised or mis-marketed, there are sanctions the FCA could put in place today. The fact is that these funds have been advised on legitimately. The customers who are in them have chosen to do so planfully as part of their wider strategy.

I am a little bit concerned that we may be misleading the Committee as to what has been going on in terms of how people have ended up here. Terms such as "responsible investing" and "ethical investing" have a cachet in the marketplace and have been approved after a rigorous authorisation process that the FCA puts every single fund through, which can take up to six months. It is not an easy process to have a fund—

Q17 **Danny Kruger:** Is it impossible for these more complex funds to comply with a regime around ESG?

Chris Cummings: If I were to take a multi-asset fund, different asset classes could qualify for the three different criteria, which would mean it does not qualify for one. Part of our recommendation was to allow "sustainable focus" and "sustainable improvers" to accommodate mixed multi-asset funds.

It is doable. It just requires a little more thought by the FCA. We have found that the FCA have listened as we have raised concerns. It is just about how we transition the market. That is what we are arguing for. We want higher standards and greater transparency as we transition the market, but be under no illusion: this is going to change the way we invest in this country, and capital allocation as a result of that.

We want to see portfolios that are not only green. It would be very easy to do that. We could green our portfolios tomorrow, but that would mean we would have no transition plans for companies in this country. We have to have a regime that allows for transition plans not just for fossil fuel companies but for old companies, to get them from where they are today to the green economy we want tomorrow. That is the thing we could miss.

James Alexander: That is why the "sustainable improvers" label, which is a real first for the world and something that we are really proud has stayed in the proposals, is so important.

Chris Cummings: Yes, absolutely.

James Alexander: We know that a whole chunk of the economy is not on the pathway towards net zero or wherever it needs to go in the long term. This is about creating and helping to create the market conditions for that to happen, while adding value. This is not detracting from the overarching objective of a fund, which is financial return. This is about adding broader objectives as well.

You talked, Chris, about index funds potentially not being eligible. We think there are lots of opportunities for index funds to fit into this system. We share your concern about multi-asset funds, and we have raised that in our response. Like you, we get a very positive response to our questions and queries from the team at the FCA. We are very confident that these wrinkles can be ironed out as we get closer towards the end of the conversation—towards implementation.

Danny Kruger: That was enjoyable. Thank you.

Q18 **Emma Hardy:** Good afternoon. I just want to say, from the beginning, that the reason why people want to invest in ESG is because they care about ESG. If we do not do something about climate change, it is going to cost us even more in the future. There is a long-term point here about investing in things that are going to help our environment and stop us from all being under a few feet of water.

I want to ask about the risks of a price bubble occurring in the short term. I would just like your comments on whether there is a risk that there could be a short-term price bubble within equities classed as ESG. The number of equities classed as ESG are fewer, so we are going to have more investors chasing fewer assets, which could potentially lead to a price bubble. Will there be a bubble? Do you see it as a short-term or a medium-term issue? To what extent are you happy for that bubble to occur?

Kate Levick: I am always a bit wary about the talk of bubbles. It is very emotive language for what can often be the normal movement of markets and the volatility we see.

When you look at ESG investments, ESG has been on a rollercoaster ride for the last few years, as the whole of the financial markets moved to try to integrate sustainability concerns and address sustainability. Global assets under management in ESG grew from $2.2 billion in 2015 to $18.4 billion by 2021. PwC predicts the global market could reach $47.6 billion by 2026.

Within that there have been all sorts of ups and downs, as anyone who has followed the area might know. For example, there was a flight to ESG investments during the Covid pandemic. They were seen as perhaps being in some way countercyclical or outperforming. It was later questioned whether that was a real facet of the market or more because, for various reasons, those stocks were overweight tech, which happened to have a bit of rally for other reasons, some of them pandemic-related.

There is a lot going on in ESG markets. I am sure there would be some effect from there being some funds that now had a label and some that did not have a label, but I find it hard to believe that would be terribly material compared to some of these other very structural changes that are going on. In fact, this is more the FCA trying to rationalise and calm the market, in effect, by making it clear what is or is not a valid and credible ESG objective. Over time, that should help to calm bubbles rather than create them.

I would also say that these measures have been proposed primarily for consumer protection, as James has said. That is in the wider context that the UK is trying to drive different capital allocation. We need significant additional investment into climate change, for example. There is a whole suite of policies and regulations around that, of which this is only one small part. You need to see that in the context of, for example, the UK's net zero strategy or the green finance strategy, which will be published very soon and which will have a whole range of measures in it.

Within that, we need to drive up the amount of capital invested. "Asset bubble" implies that there are going to be no more assets to invest in; actually, there are a great deal of measures to expand this whole market and keep supply coming at the same time as demand.

Q19 **Emma Hardy:** Chris, do you expect there to be a bubble? Or will we instead see the market expanding?

Chris Cummings: The market will expand. I think it will be more like an Aero, in that what we can see is different potential bubbles in different parts of the value chain.

First, if I am an ordinary investor, I use a financial adviser to advise me about my pension and ISAs. If these proposals go through, that financial adviser would let me know that two-thirds of my ESG portfolio now no longer qualifies as a responsible investment. That could then trigger a reaction where the adviser says, "I now have to assess your preferences, and you have told me that ESG is a preference. I am going to have to take you out of those funds and put you into this narrow range of funds." That will cause market movements. There is £91 billion invested. Two-thirds of those investments no longer qualify. That is going to cause some market movement. There will certainly be some bubbles there.

Secondly, if these proposals go through, all funds will have to have third-party validation of whether their approach is correct, rather than relying on their own internal systems. That is going to create a bubble in data providers. That is going to be an extra cost coming into the industry, which we feel is totally unnecessary.

Thirdly, we will then have that wall of money chasing the existing supply of recognised green investments. Across the piece, there are second and third-order consequences that we just need to think through. I do not think any of them will be catastrophic. I really do not. Those might be my famous last words. Touching wood, they are all manageable, but they need to be done in a really planful way.

The FCA decided to exclude financial advisers and the advice they give from its proposals. While the fund industry has to map all of these proposals against our existing fund range and so on, the advice being given by financial advisers is out of scope. It would have made a lot more sense to have done financial advisers, the fund industry and the platforms at the same time. Then we would have had a clearer view of what the potential bubbles would have looked like. For us, that was a bit of an omission.

Industry working together with the regulator to protect consumers—that is what we are here for—should mean this is manageable, but there will be an element of dislocation, yes.

Q20 **Emma Hardy:** Presumably, the FCA will have heard that point. When I ask them about bubbles, they can hopefully address the point you have made.

At the beginning, you mentioned that you thought there would be some expansion in the market—as well as your Aero analogy, which we all love. What will the time difference be between potentially some bubbles being created and the market reacting and expanding the provision?

Chris Cummings: Of course, when we look at the market, we are thinking not just about the UK but internationally as well. Of the £11 trillion that my industry manages, we own about 40% of the FTSE and we invest in infrastructure around the rest of the UK. That number could be higher if there were clearer transition paths and if there were more infrastructure for us to invest in here in the UK.

This could be an opportunity for Government and industry, through schemes such as the long-term asset fund, to help to deploy more of that money into the real economy to finance the green projects that we need. That requires these transition paths; otherwise, my suspicion is that a lot of that new money will be going into other jurisdictions.

The sustainable focus fund will not really be available for retail investors to invest in listed companies. It will all go into private markets and unlisted companies, because of the requirements of this new rule. That is actually increasing the risk because private markets are riskier to invest in than public markets. Investors would need to take a much longer-term view if they were going to do that. That will probably shrink the market for impact investing, which will be a great shame.

Q21 **Emma Hardy:** Do you agree, James?

James Alexander: First of all, it is right to ask this question. At the moment, we do not see any reality to a green asset bubble. Clearly, what we do see is that there is high demand for sustainable investments. There is a lot of capital looking to go into these spaces, but that does not mean investors leave all of their other investing rationale behind and solely invest in something because it is green. People still use the same investment logic and the same analysis and approach to investing as they do with any other investment. If something is overvalued, the market looks at it closely.

There is a key message that the Committee could potentially take back to the Government. There is clearly a lot of capital that can be invested in sustainable projects—in things that will advance the UK's transition to a sustainable future and the net zero rules the UK has. That can be done in a way that brings private capital in. What can Government do to try to find a home for all that private capital that wants to invest in these things? The Skidmore review talked about this. We can talk about decarbonisation road maps and investment road maps for different sectors. The Government can create those and publish those as credible decarbonisation pathways.

We can talk about the need for regulation in the real economy, which we know drives private investment. For example, there is regulation on vehicles in the UK around the 2030 electric vehicle target. That is driving capital into the infrastructure necessary for vehicle electrification, such as plug-in points and all those things. If we could take similar approaches in other industries, could we start to get private capital going in, where people have the confidence and faith in the regulation and in the fact that the transition is happening? Then the capital that we know wants to be in that space can have the confidence to invest.

Again, it is not about investing at all costs just because it is green; it is investing because it is a sensible investment proposition backed by the relevant requirements.

Q22 **Emma Hardy:** So you see this as a really good opportunity to get green investment projects, funded by private capital, that the Government prioritise.

James Alexander: Absolutely, and that is exactly where we are from a fiscal position as well. We need to get private capital into this transition; this is a great opportunity to do so.

Q23 **Dame Angela Eagle:** I know change is difficult, but listening to you, Mr Cummings, I get the impression that you wish it would all go away and it is all too much trouble. It seems like you want the highest percentage possible of investments, including in funds that do not really fit very well in this agenda, to be classified. That seems rather odd to me.

If you want to drive investment into properly green and properly regulated funds that are not lying about their green credentials, surely you have to have standards that allow that to happen. By definition, not all of the currently existing funds are going to be able to fit into that, are they?

Chris Cummings: First of all, let me apologise if that is the impression I gave because that is absolutely not where I am coming from. We welcome the fact the FCA is looking at this market. We completely share the ambition to raise standards. As an international industry, we want to make sure that, across the world, standards continue to increase so that both retail and institutional investors have total transparency about where their money is going.

My comments are about how we can work more effectively with the regulator during this time of transition to make sure we take retail investors with us and that the confidence of the market continues to grow. My worry—this is what I was seeking to express—was about a moment of dislocation where we say to two-thirds—

Q24 **Dame Angela Eagle:** Yes, you have said that 60% to 70% are excluded. They are excluded because they do not currently qualify under the increasingly tough standards.

Chris Cummings: They currently qualify.

Q25 **Dame Angela Eagle:** But they will not qualify under the new standards. You were complaining that they would not qualify, literally.

Chris Cummings: Yes. I was asking whether where the FCA was landing was exactly in the right place.

Q26 **Dame Angela Eagle:** How can you increase standards if you do not increase them and exclude some of the current funds that do not meet them?

Chris Cummings: The challenge is not about whether we exclude or do not exclude funds. It is important that the regulator sets standards that increase customer confidence in the market. As an industry, we have the opportunity to work with the regulator. For funds that wish to move to that new position, that can be done in a seamless transition, being really clear with existing investors as to what is going on and why.

We are in danger of disenfranchising those people who want a more balanced return on their funds, who say, "I want to be a little green," or, "I am going to take a more long-term view of the transition." The standards that are currently being proposed are coming in at pace.

Q27 **Dame Angela Eagle:** We do not really have long left to get this sorted out, do we, since we have dawdled so much in dealing with climate change to begin with? We will have the planet burning by the time we get to the standards you like at the pace you seem to want.

Chris Cummings: So far over £6 trillion managed by my membership has been committed to the Glasgow Financial Alliance for Net Zero. As an industry, we were one of the first to propose transition. My own organisation has insisted that all investee companies have to report against the Task Force on Climate-Related Financial Disclosures framework.

We introduced the world's first taxonomy so that retail investors could assess where their funds were. We introduced that taxonomy before the European Commission and before the FCA. As an industry, if you will forgive me, we have been leading the call for higher standards and making sure there is greater transparency. That is really what we are looking for.

Q28 **Dame Angela Eagle:** If somebody wants to invest in an ESG fund at the moment, they can invest in funds—six have been found—that actively expose you to Shell, for example. If I were a consumer that did not read all the tiny small print, which is deliberately printed in such a tiny way that nobody can read it—human eyesight is virtually incapable of reading most of the small print that goes along with all these proposals—I would not expect my ESG-approved fund to have exposure to Shell or other carbon emitters, but it does at the moment, does it not?

Chris Cummings: You have raised a really important point. As the fund management industry, tomorrow we could invest purely in entirely green companies or we could choose to do the thing that will have the most benefit for the planet, which is to work with all shades of companies on clear transition plans to get them to move from being very brown today—maybe with fossil fuels—to green tomorrow, using clear milestones to hold them to account.

We offer funds that are entirely green for people who want to go down that route, but does that actually solve the problem? If we were to sell out of all brown funds—Shell, BP and the others—who would then own those companies? Would they be as committed to the transition as my industry is, as responsible stewards of the people's money that we are managing?

Q29 **Dame Angela Eagle:** I am thinking about the consumers. You have only mentioned them once in however many minutes we have been taking evidence so far. If I were a consumer investing in an ESG fund, I would not expect it to have exposure to the energy companies as they currently are. For example, Shell wants to increase its extraction of oil by 20% in the next 10-odd years.

Why can we not have a label that says, "This ESG fund is exposed to energy companies," on the front page, not in some tiny little unreadable small print at the back end? Why can we not be more upfront about what these funds contain, so that people can make their own minds up and consumer sentiment can drive the change, rather than what we have at the moment? At the moment, the investment industry themselves—you and all the experts—do it all behind the scenes and hope to have nice little generous connections with these companies and to push them a little bit further, when consumers want to push them more.

Chris Cummings: We have been pushing incredibly hard.

Dame Angela Eagle: "Incredibly hard" is an interesting way of putting it.

Chris Cummings: As you know, as fund managers, we have to publish all the companies we invest in on a regular basis.

Q30 **Dame Angela Eagle:** If an ESG fund had a stamp on the front of it saying, "This has an exposure to Shell," it might benefit a few consumers who do not want to trail through hundreds of pages of small print, might it not? Why can we not just do that?

Chris Cummings: One of the proposals that we agree with the FCA on is what it calls the unexpected investment. That gives us the opportunity, as an industry, to set out why a transition stock might be in an ESG portfolio and all the mitigation or the transition plan that is behind it.

There is a clear choice. There will be funds that simply choose to invest in green stocks and green industries today, and there will be funds that choose to invest more in transition stocks to help those companies that we simply have to get from being brown to green to do that. We can only achieve that by asset allocation and active stewardship to keep pushing them. If they do not meet those milestones, the active part of the industry can simply sell the stock.

Q31 **Dame Angela Eagle:** All I can say is that if consumers feel they are being conned by greenwashing claims—they are at the moment and, unless we get it right, they will in the future—they are going to get very cynical and not invest at all, are they not?

Chris Cummings: I completely agree, which is why, as an industry, we are so upfront and clear on transparency. We want and need to make sure that, for every penny we invest—it is not our money; it is somebody else's—they understand exactly where that money is being deployed. We need to continue to report back to them with value-for-money assessments and publish our fund holdings on a regular basis.

Q32 **Dame Angela Eagle:** Are there any other comments from the other panellists on this greenwashing issue and on being much more transparent and upfront with consumers about what is in some of these funds?

James Alexander: Chris has set out a perfectly good rationale for why the entire SDR regime is necessary and important. It protects consumers from people who are trying to sell something by claiming it is one thing when it is not. Again, we come back to this point: that is what this regime is about. That is what it is doing. It is about building that market confidence, making sure people know what they are getting into and what standards a fund aligns to.

It also creates a whole new system of funds that are labelled as sustainable. That does not mean everything else is bad. It just means it is different. There will be plenty of funds that are not labelled as sustainable. They are specifically not called "unsustainable" because that does not necessarily ring true. They are just a different type of fund. They are not bad; they are not good; they are just a different type of fund. This is not saying that we are not throwing out the entire management—

Q33 **Dame Angela Eagle:** That is why I was surprised that in earlier evidence the view was that we should try to get more of these retail investment funds included and that not enough of them were included. Clearly, as the transition happens, more of them will become included. Why is that a problem?

James Alexander: More will come as consumer demand further increases. We do public polling. We have done it for 15 years with roughly the same questions. Over time, that polling shows that there has been a dramatic increase in the number of people who wish to invest in line with their values and who want to see their financial products matching that. We think that is only going to increase. These products will build that confidence further and allow that to increase further. It is providing the supply of products—

Q34 **Dame Angela Eagle:** So long as the label is genuine. Kate, you wanted to say something.

Kate Levick: Yes, I just wanted to chip in briefly. I am probably the only panellist whose organisation's consultation response did say that we felt fossil fuel companies should be excluded from the sustainable labels.

Dame Angela Eagle: Hear, hear.

Kate Levick: That is one end of a spectrum of views. I suspect that there are a lot of nuances to that, but the primary reason I would advocate that is because of the very question you raise, which is about consumer preferences and the credibility to consumers of that sustainability label.

As I mentioned when I introduced myself, I am involved in the UK's Transition Plan Taskforce. I am absolutely 100% bought into the need to funnel finance into the transition of high-emitting companies. That is a very important goal. I am not sure that is exactly what all of these labels are for, however. The most space for this is clearly in the "sustainable improvers" label, but clearly that label needs to apply to companies that have a credible transition plan and are absolutely seen to be delivering it. Many consumers will currently be sceptical about that with some of the big energy companies.

We also pointed to the possibility, in future, of potentially having something a bit like what you are describing. We could say, "These investment products, possibly due to the companies they are investing in, are on an unsustainable path," and make consumers aware of that. That is not something the FCA has proposed right now. That is not something it has the political space to propose right now, I should not think.

Again, if you look at the bigger policy context, the UK has made additional fossil fuel investments on a short-term basis through the British energy security strategy in response to Russia's invasion of Ukraine. This is not an easy thing to be proposing right now, but it is possible that it may be something that comes further down the line in the future.

Q35 **Andrea Leadsom:** I am sorry to have been late. Chris, 15 years ago most investment managers would have said their duty to their investors was to make them money and that everything else was a matter of the tastes of the time. At the time, you could not really invest easily in an environmentally sustainable fund; you had to really go out of your way to look for one.

What would you say has happened to the mindset of investment management operations to change that? Is it simply that the trend towards sustainability has overtaken everything? To me, the nub of greenwashing is about investment managers saying, "It is inevitable because it has to happen. Therefore, the stocks we own in bad companies are not going to do as well." Is that their approach or is it more enlightened than that?

Chris Cummings: I would be delighted to say it is entirely enlightened, but of course it is not our money that we are managing. It is money from asset owners, be they retail investors or large institutions like pension funds and so on. That money is given to us under a very specific mandate, which can be financial and non-financial, in terms of the objectives we have to achieve. Over recent years, we have seen a much clearer view from asset owners—it is their money—that yes, they need us to achieve a return, but it is not a return at all costs. It has to be a return that takes account of wider considerations.

Of course, as investment managers, we want to invest in long-term sustainable companies. A company is only long-term and sustainable if it is going to take care of its own actions regarding climate change, whether it is a good neighbour to society, whether it has good governance and so on. All the academic and real-world evidence is that companies that manage their reputation, look after their workforce and have an eye on climate make a better return than those that are a flash in the pan and that only worry about profit maximisation. It is driven by our own clients' views about what "good" looks like.

Q36 **Andrea Leadsom:** Just to pick you up on that, there is technical evidence, then, that being a good citizen gets you a better investment return. Again, that was not the case 15 years ago.

Chris Cummings: The academic evidence, the work done by Tomorrow's Company and various studies looking at diversity on boards all point in exactly the same direction now: a better-run company is a better long-term investment.

Q37 **Andrea Leadsom:** Yes, but what does "better run" mean?

Chris Cummings: It means looking at the factors I mentioned in terms of having management that understands its obligations on climate change and has a more diverse board and looks after its employees. We saw it during the pandemic: those companies that have come out best from the pandemic are the ones that looked after their employees and their supply chain. There is certainly evidence that points to that.

I would not underestimate the role of Government and leading politicians in setting the scene as to the direction of travel for the economy as a whole in terms of the net zero challenge and the transition pathways. All of those form the context in which we invest.

If I may also say, it is about the people who work in the industry, who are a lot better sighted on our role as an industry in society. It is other people's money that we manage, which gives us a great responsibility to be good neighbours to the societies we do business in. There is a combination of factors, but specifically it is about the requests and demands of asset owners.

Q38 **Andrea Leadsom:** Would you say that investment managers are taking seriously the risk of stranded assets in terms of investment decisions?

Chris Cummings: Yes. Different houses will have different opinions on what those look like and what the timescales are and so on, but I can say with total confidence that everybody is looking at what that would mean for portfolios.

Q39 **Andrea Leadsom:** I did want to ask a few questions about international comparisons. First of all, Kate, are the UK's proposals, in your opinion, stricter or weaker than those in the US and the EU? Can you highlight the key differences?

Kate Levick: It is difficult to compare because they are not entirely like for like. I would say the UK's proposals build on and take learning from what has been done in the EU. The EU set out some requirements and some instruments with similar goals to what the UK is now doing. It has had some successes with what it has done. The EU has certainly set the international narrative for what leadership in this area might look like, but it has also hit some pitfalls. The FCA has looked very closely at that, learned from what the EU has done and made some different choices, which we think are better choices. It is good to see that learning cycle go on.

The UK and EU approaches, because they have built one on the other, are somewhat comparable. There is a real opportunity here for the UK to effectively put forth a proposal that is a little bit more usable and coherent. It might then help capital and fund formation to flow into the UK and help to strengthen the UK's green finance leadership.

Q40 **Andrea Leadsom:** Very specifically, could the UK see this as an opportunity to lead the world in setting the standard for sustainability?

Kate Levick: The UK definitely has this ambition to maintain what it already has, which is a real leadership profile in the green and sustainable finance area. This is definitely an opportunity to support that. There are not many big jurisdictions that have really gone into this area of sustainable financial product labelling. Some of the issues with what the EU has done are well known. This is an opportunity to set approaches and norms for other jurisdictions and to attract capital flows.

The situation in the US is a little different. ESG has become part of the culture war over in the US. Depending on whether you are looking at federal or state level, all sorts of different things are going on. The big focus is on the climate disclosure rule, which is slowly but surely making its way through the process. That rule deals with climate specifically. It will be very important to the market once passed, but it is comparable to progress that the UK has already made some time ago. It is somewhat equivalent to the TCFD reporting requirement the UK already put into law just before COP26. The UK and the US are not competing like for like in terms of their regulatory approach here.

What does play out, of course, is how big international firms that operate in one or more of these different jurisdictions see this. That battle is playing out on a much bigger playing field than just sustainability product labelling. Again, if the UK can show a clear and coherent approach, backed up by rationale and consumer testing, that will be a helpful contribution to the dynamic.

Q41 **Andrea Leadsom:** Do you see some funds moving between jurisdictions to try to find a more favourable jurisdiction?

Kate Levick: There is always a risk of regulatory arbitrage whenever a regulation is created in this space. The issue has already been raised with what the FCA has consulted on and that this would not immediately apply to overseas funds, although many of those funds would be subject to the EU requirements. Certainly E3G would support the FCA to be able to apply its rules as widely as possible—to overseas funds if possible—to create as much of a level playing field for the UK market as possible.

This needs to be seen in the light of the UK's attempts to build international standards and standardise the process of these things. That includes the ISSB standards that were mentioned before, but there are also a number of other international regulatory forums where the UK is playing a very active role and making that desire to create an international playing field a key part of its strategy on financial regulation.

Q42 **Andrea Leadsom:** James, is it feasible to have a single regulatory environment? Is it desirable?

James Alexander: It is possibly desirable; feasible is perhaps more challenging. I agree with a lot of what Kate just said. Many of us would share the ambition of the UK as the world's leading sustainable finance hub. That is a really positive direction of travel for the UK financial service industry to move. This takes us some way there.

What we would like to see now is the FCA and the Government working internationally to say to other countries, "Look at what we have done. Look at what we have created here. Look at how it is bedding in. Look at the way we have engaged the whole industry, through the Disclosures and Labels Advisory Group, the way that we have created these approaches through intense consumer research and understanding and the way that they are bedding in," and to also, of course, highlight the value of commonality of regulation globally. That is a huge challenge for the industry. Our members talk about that a lot, and rightly so.

The UK can make a really big impact on this—to go overseas, to go to other regulators and to go to other Governments. There is a role at things like the G7 and the UNFCCC process around COPs, to start talking about, "How do we create this sustainable finance regulation landscape globally, which can create this consistent framework that all funds and all financial services firms are engaged in?"

Chris Cummings: This is not a race that is just beginning; this is a well-run race. The European Commission introduced a taxonomy with article 6, article 8 and article 9 funds, which all investment managers across Europe had to apply. The FCA is coming rather late to the party. James, I admire your ambition that the UK could do this, but of course nobody has been waiting for the UK to decide what it wants. The US is well down the track. The EU made a landgrab with SFDR. I am afraid the UK is catching up. For us to then say, "Look, here are our standards. They are better than what is going on in the European Commission and what is going on driven by the SEC" is rather presumptive.

What we must get is interoperability between what is going on in the EU and what is going on in the US. A major US member of ours looked at their 70 funds that are currently SFDR article 8 appropriate green funds. One would meet the standard in the UK. Let us understand the business reality here. What that would mean in reality is that companies will have a choice: they will either look to set up a different fund range for the UK, with all the costs that will bring—the higher costs for retail investors—or they will pull out of the UK and only operate in the EU. For us to say our standards are somehow better is a little presumptive. We need to keep pushing.

Chair: I do not agree at all, but you have had your say.

Chris Cummings: We need to keep pushing for interoperability and to make sure that what we can do is influence at an international level. That way we will be able to generate what we should be doing, which is for the UK to help to inform the debates in other jurisdictions.

Q43 **Chair:** Just before we bring this first panel, which has been so interesting, to a close, I am going to drill down on this obvious point of difference between you. Kate, can you point to what were the problems with the EU approach that you alluded to?

Kate Levick: Chris was starting to explain the EU's approach through taxonomy, which of course defines what is and is not a green investment—that is something the UK has said it will also do, but it has not yet completed the process—and how that assigns different types of funds. They could register as one or the other. There have been numerous problems with that.

Chair: There have been problems with that approach.

Kate Levick: Yes. We have had funds that have assigned themselves as effectively green funds and then dropped out, either because it is way too onerous to prove it, in the view of some, or because they cannot prove it because they are not really green, in the view of others. This has really damaged the credibility of the whole regime.

Q44 **Chair:** That is really interesting. Chris, can you give us an example of an investment, preferably an equity investment that we might all be familiar with, that would qualify under the EU taxonomy but would not qualify under this UK approach?

Chris Cummings: Because the UK approach is not finalised yet, I am afraid I cannot give you a specific example. What I can say is that, looking across the fund universe, what we see is that only a fraction—10%—of UK funds under the new regime would qualify both here and also in the EU. Again, that is a market dislocation problem. What we want to see is commonality of approaches so that an investor can have confidence that a fund that they have already been invested in continues to be suitable. If it is not suitable, they can understand the reasons why, and that's fine.

Chair: This has been very interesting. Thank you very much to our first group of panellists. We are now going to hear from the regulators themselves. You are very welcome to stay, but I am going to ask you to move into the Public Gallery. Thank you very much for your time.

Examination of witnesses

Witnesses: Sacha Sadan and Mark Manning.

Q45 **Chair:** Welcome to our second panel for this afternoon, discussing this very interesting topic of how investors can feel confident that what they are investing in has good sustainable credentials. We are joined now by the regulators themselves. Can I ask you to introduce yourselves for the Committee?

Sacha Sadan: I am Sacha Sadan. I have been an asset owner for many, many years. I am now, and have been for 18 months, the director of ESG at the FCA.

Mark Manning: Good afternoon. My name is Mark Manning. I lead on ESG and sustainable finance policy at the FCA, working with Sacha.

Q46 **Chair:** Can I reiterate the point I made with the first panel? Other than "FCA" and "ESG", which we can probably get away with, for the audience could you try to hold back on some of the more complicated acronyms? That would be wonderful.

In your consultation you have proposed a set of standards that, as we understand it, will exclude about 70% of the universe of investable funds. Then for the remaining 30% you think that they are probably going to fall into these three categories that you propose. It seems like a suspiciously round number to us. Can you talk us through your thinking in terms of both the categories and how you came up with the numbers?

Sacha Sadan: Yes, of course. It is such an exciting topic, and everyone has quite strong views on this, which is quite right, too. The first thing we would say is that we have done desktop analysis and we looked at what things people were doing already. There are two things we want to say. That was a static analysis—that was before we had done the consultation and before we make some of the changes. We have had, by the way, 239 responses, so we will have things that we can do to help to refine those assumptions. We think, quite confidently, that more than a third will get there when we get to the period of time—

Q47 **Chair:** Is "desktop analysis" code for pulling numbers out of thin air? Can you talk me through what you mean by that?

Sacha Sadan: No, it is looking through some of the data on the funds that have used their names—the names that we have talked about—and then seeing whether they hit the targets at the moment, and also talking to the industry. We talked to quite a few fund managers about their existing range and how to do it. One of the things that is very important is that it is static. It was conservative, I agree. We are in the middle of the consultation and will refine some of the things that will make more funds able to get there. It is really important that we say that.

The third point is really important. It is okay if a fund does not have this label. They will still exist. They can still be around. If they do not hit the trust criteria for consumers and they are not doing what they say they are doing on the tin, they should not have the label. You have just had the discussion that I will not repeat about SFDR, but that was the discussion about the sustainable finance disclosure regime. Some 40% of the funds that first said they were article 9—the higher standard—have withdrawn to article 8 in the last four months, up to September last year. People are already moving away from some of the claims that they have been making, even before we get to our regime. This market is evolving internationally and we have touched on some of those international things, but this will be a strong standard.

Going back to the reason why we are doing this, we have tested 7,000 consumers. We have done our Financial Lives survey. Consumers feel confused, at the minimum—obviously, there are larger words like "greenwashing" as well—so they want to trust. If we are going to build a world-leading standard, we need to make sure that, first, people say what they do, secondly, that there are products, and thirdly, that we are giving them the chance to pick metrics that they can decide. If they cannot think of the metrics that they can find, why are they selling them as green funds?

Q48 **Chair:** Mark, talk us through why there are these three categories and why you think approximately a third will fall into each.

Mark Manning: Let me start by elaborating a little on some of the points that Sacha made, and then I will answer the specific questions. What I would say in the first instance is that a key aim of this regime is to help consumers to navigate and understand what is quite a complex landscape, and also to give them confidence that when they are investing in a sustainable investment product it is genuinely sustainable.

We said in the consultation paper that there is a very wide range of products out there that are variously using terms in their marketing like "sustainable", "ESG" and "green impact". Some of these terms are used interchangeably and we have a number of examples of products out there that are describing themselves in quite a similar way, despite the fact that they are doing something very different.

As an example, products that are considering environmental, social and governance factors in making financially motivated investment decisions are often described in a very similar way to a product that is purposefully selecting assets that they believe will have a positive real-world impact on the environment or society. They are very different objectives and very different strategies but, because of the confusion around some of the terminology here, they are described often using very similar terms.

What we have tried to do by establishing the labels and the qualifying criteria that sit beneath them is, in the first instance, to draw a clear distinction between products that are purposefully seeking to deliver a positive outcome for the real world alongside a financial return, so they have a sustainability objective, and those that may have some sustainability orientation but are merely considering sustainability factors as part of a purely financially focused set of investment decisions.

The three categories of sustainable investment that we have included within the labelling regime are categories that sit on the side of the boundary where they are purposefully investing in a way that will pursue a sustainability objective. There has been a division between those categories of sustainable investment fund to help consumers to determine whether—

Q49 **Chair:** There was no real rationale behind a third, a third and a third; that was a guesstimate, was it?

Sacha Sadan: No, it was from the analysis that we did before, and also looking at the market at the moment. A lot of the funds are not doing the things that we would expect them to do going forward. It is a static market. You have seen some of the nice responses we have had that would make them get there. It is really important to say that we really want to push the market to go to the levels that they are doing. By the way, if they are selling these products they are probably charging a little bit more for it as well. If someone is selling a product, they should be able to have a metric or a measure to be able to say how they are doing that green measure, and I think they can.

Q50 **Chair:** That brings me to my next line of questioning. You are going to have a lot of consumers who thought they were invested in something that was green and they are going to be told that, as a result of these changes, that is not the case any more. In fact, you estimate 70% of the market is going to be told that. What are going to be the costs to those investors? Presumably, since they have gone to the effort of investing in what they thought was green, they are going to probably have to now switch into something else. Have you worked out what the cost to them is going to be versus the potential benefits?

Sacha Sadan: One of the things that is really important, first of all, is that there is time and the market is moving. Even in the EU, people are moving their funds and reclassifying. Secondly, this is a very wide range, and you talked about it before—there are metrics coming all the time. People are finding ways to do this. That number will be much lower than 70% when we get to the—

Q51 **Chair:** Yes, but it is going to be quite a lot of people who would not be doing it.

Sacha Sadan: Yes, but already for article 9 funds that were moved, people will have had to have told their investors in Europe that in the last three months. When they are told that, it is up to them to decide whether they want to.

I will give you an example. A green income fund will have a decision to make in the next 18 months: to decide whether it is a green income fund and think of a measure that it can show, whether it is a carbon emission reduction or it is taking things out, or it goes to being an income fund. It would then have to explain to its investor whether that is what it should be doing. It has that choice before they have to do anything.

Q52 **Chair:** You have not done any estimate of what the costs are going to be to consumers here.

Sacha Sadan: Yes.

Mark Manning: I just want to clarify one thing before we go on, which is that not every product that fails to meet the qualifying criteria for a label will necessarily want to change. We recognise that there are quite a variety of consumer preferences out there that are met by products that are considering—

Q53 **Chair:** There are going to be quite a lot of people who thought they were investing in something and they are going to be told that they were not. They are going to think about whether they want to make a change, and there is going to be a cost to them. Have you worked out what that cost will be?

Mark Manning: We do not have a figure for that. It is, in many respects, quite a theoretical exercise at this stage.

Q54 **Chair:** It is not going to be zero though, is it?

Mark Manning: It is not going to be zero, but I would say that the funds will have to make a decision as to whether they look to add additional features to their strategy. They will have to make a decision as to whether to include a specific sustainability objective alongside a financial return objective, if they believe that is what their consumers would be looking for. There will be many consumers out there who are looking to invest with, let us say, lighter sustainability preferences. They may be quite happy with a product that is considering sustainability factors but not actively pursuing a sustainability objective.

Q55 **Chair:** However, you acknowledge that there will be some consumers who will be affected and will incur a cost that they were not anticipating, and you have not done any work on what that cost might be.

Sacha Sadan: There are two things on that. First of all, people will be more trusting of the products that do get the label, so that will make them make decisions that they wanted. They may have been in products that they thought were okay.

Chair: I am talking about the people who are in ones that do not make the grade.

Sacha Sadan: Yes, but they thought they were getting something and we are raising the bar to make sure they then get what they want.

Chair: Yes, but they are not getting it. They are going to be told that they are not getting it.

Sacha Sadan: They are getting less of it. Maybe the funds will move. One of the positives that I think will happen is that lots of funds, where they thought they were getting something that they were not, will raise the bar.

Chair: There is going to be a cost, but you have not worked out, estimated or even tried to estimate what the cost is going to be.

Q56 **Rushanara Ali:** Just on the flip side of the cost question, is there is a case for the companies and investors that have, in effect, misled consumers—the 70% or so—to be compensating the investors because they have misled them? They have basically lied to them about what is sustainable. If there are costs for switching, should they be paying for it?

Sacha Sadan: If we start from the beginning, this is an industry that has grown very fast. Someone mentioned that 15 years ago it was very hard to find a fund and now the biggest area of growth is ESG.

Rushanara Ali: That is because they have misled people. That is because it is misleading.

Sacha Sadan: The market has grown and therefore now we have to put the guardrails in place. Other areas are doing the same. Other markets internationally are starting.

Q57 **Rushanara Ali:** You do not have any plans to do anything about penalising financially. For instance, in terms of changing investments, if you are trying to change your pension fund from one to another, there are transaction costs anyway.

Sacha Sadan: There are from any investment to any investment.

Q58 **Rushanara Ali:** Yes, exactly, but if you are making this transaction because you were misled and you were given the wrong information about what is sustainable, clearly that is what you are trying to address in terms of what has happened so far. Some 70% of the investors are in that category. Say that for half of them things have not improved, they have to move and they wish to move. There is a cost. What I would ask you to take away is whether there should be a calculation of what that cost might be, and also whether the companies that have basically lied to people should be bearing some of those transaction costs.

Mark Manning: We need to be a little bit cautious of suggesting that, in each case in which a fund fails to qualify for a label, consumers have been misled. This is a very fast-evolving space, as Sacha and others have said. We have not to this point had very clear standards and expectations around what is and is not a sustainable investment, and nor has there been a clear distinction between different types of sustainable investments.

Q59 **Rushanara Ali:** You and the Government have not said in the past that you must not greenwash and you must not mislead the public because that is going to breed distrust.

Mark Manning: We certainly have as a fundamental principle in the FCA's rulebook this notion of being fair, clear and not misleading. That is an existing premise within the rulebook.

Q60 **Rushanara Ali:** Given that is the case, they have been misled. Consumers have been misled.

Mark Manning: As I say, they have not necessarily, because there has not been a clear benchmark as to what is and is not sustainable.

Q61 **Rushanara Ali:** Out of the 70%, some of them would have consciously misled investors in the process of greenwashing.

Sacha Sadan: We are saying that the market is evolving and even the metrics are coming into place now. What we are trying to do is make sure that there is confidence going forward. Our rules are world-leading and therefore that is stronger, but we have seen this in Europe as well. Funds have moved already. We are not the first place to have seen this happen.

Q62 **Rushanara Ali:** According to WWF in 2021, the UK banks and asset managers were responsible for financing 805 million tonnes of CO_2 in 2019, which would make the City of London the ninth biggest emitter in the world, if it were a country. Just looking at the bigger picture, how far do you think we will be able to bear down on those numbers, which I have a real concern about, because a lot of that investment is often in other countries in the global south that are much more climate vulnerable here and now? We cannot wait for time to elapse before things get resolved. How far do you think these reforms will help in trying to bring down those numbers?

Sacha Sadan: It is a big question. One of the things I would say is that it is not just about labelling. It is very important, as you said. Kate and I are on the steer group of the Transition Plan Taskforce. We have our big event next Monday. We are making sure that the UK is leading on not just saying, "I am signing up to net zero"; what are you doing if you are going to sign up to net zero? It is industry led, so we are making sure we are working with industry. Mark is working tirelessly in the sandbox. We are a safe harbour for companies to actually to practise these transitions now.

We are seeing other international regulators looking at this and wanting to take our standards and use them. That will help them, to your point, with disclosures for now going forward. People can then see, "Is that company actually transitioning and does it have a credible plan, or does it not?"

Then, back to the specifics on labelling, there will be more information so that labels going forward will be able to say, "I can buy a product that has bought funds or companies"—whether it is bonds, equity or real assets, it does not matter—"that are linked to the plan and I believe in it." At the moment, they are still not there and we are world-leading on that.

Q63 **Rushanara Ali:** Of the 70% you were talking about earlier, some of which should be able to qualify in due course, do you have a sense of what percentage you are hoping will be able to join the 30% that do qualify? Within what sort of timeframe do you think they might get there?

Sacha Sadan: My personal opinion is that the most important thing is to encourage the market. People want to buy these products. Remember that. People are buying them already. If we can help to make some guardrails, as has happened in other industries such as with food labelling and other things, if we can help then we will, absolutely. We will also have guidance and do webinars. There is also the fact that they are charging. We think they can make that happen.

There are two other points that I would like to make. First of all, we are not telling them what the metrics are. We are not being too rigid. An asset manager who is selling a product should be able to come up with some metrics that show a consumer what they are doing with their money.

Q64 **Rushanara Ali:** They need to be honest and transparent. Can we also make a plea, please? If there is anything the regulators can do to make sure that the small print is not the small print—it is just so frustrating. You can be highly educated and financially literate, and it is a challenge to people's sight.

Sacha Sadan: I agree, but Mark can answer.

Rushanara Ali: I have raised this many times with the FCA, continuously. This is an issue across the board in terms of financial products. I do not know how people are expected to read the small print.

Mark Manning: Yes, absolutely. This has been front and centre in the design of the regime. The regime operates at multiple levels. The labels sit at the top, as the top-line navigation tool, but there are then two layers of disclosure beneath that, the first layer being specifically designed to be consumer accessible. We are saying a one or two-pager that sets out very clearly what the product is seeking to achieve, how it is going about it and how the product is travelling against its objectives over time.

Q65 **Rushanara Ali:** Are there any investment activities that you think would be completely incompatible with a sustainable label? We talked about fossil fuels earlier; are there any like that?

Sacha Sadan: It would depend on the label.

Mark Manning: It does. That is exactly the point: it depends on the label. One of the three categories is a sustainable focus fund, where the aim is to invest in assets that are already sustainable against a credible standard. In a product of that nature, you would expect, in an environmentally focused fund, that those assets that it is holding are, to the reasonable investor, considered to be environmentally sound in their profile.

Then the other 30% of the fund—if it is at the minimum of the 70%—should not be invested in anything that is in conflict with that objective. That is where this question of unexpected investments comes in, which is one of the fields in the consumer-facing disclosure that should draw to the attention of the consumer anything that they might reasonably balk at.

Q66 **Rushanara Ali:** Do you think consumers will read the unexpected investments disclosures? Will it be clear what that means and what that entails?

Mark Manning: Our aim is that it will indeed be very clear to the consumer. The idea of the consumer-facing disclosure is to be written in very accessible terms, in plain English.

Q67 **Rushanara Ali:** Has that been tested with consumers?

Mark Manning: It has. That was part of the consumer experiments. Sacha mentioned the 7,000 participants in those experiments. We were testing exactly that: does this improve consumer comprehension around the sustainability profile of a fund?

Q68 **Rushanara Ali:** On mixed labels, has the FCA considered a mixed label to reflect funds that are pursuing a combination of sustainable investment strategies that may not fit neatly into one that you propose but still would legitimately be seen as green? Is that what you were getting at earlier when you were making that point?

Sacha Sadan: We are looking at that, but obviously if it is a majority in one, that is the label it should do because otherwise that would confuse the consumer. We have some comments back from that.

Secondly, in the two-pager—again, it is only up to two pages—if there is a stock that was in there, such as the oil and gas company someone mentioned, you would have to put that in the document and say why that would be in a fund where people would not expect it, what you are doing and why it is in there, in language and, hopefully, fonts that people would be able to read.

Q69 **Rushanara Ali:** How does this fit with generational shifts in terms of the demand for sustainable products? Can you see the market actually wanting to rush ahead and fix this problem? Or is this market frustrated that you have spotted an issue that you are trying to correct now? Do they want you to just get off their backs and let them get on with it? Do they see the opportunities, especially in terms of future investors and the younger generation? Do you that the sector is fearful enough of what you are trying to do that they will get their act together, or are you going softly-softly?

Sacha Sadan: There are a few questions there. I will take the first one first. It is really important that, first of all, the market has been moving: hundreds of billions have been going into this area. It is already happening. It is not just future generations.

Rushanara Ali: They can see that there are benefits, returns and so on.

Sacha Sadan: Capital flows are moving this way, whether we are involved or not. That is one thing. It has been happening globally.

Secondly, in terms of future generations, I talk to all the corporates. Employees want to work for firms that they believe in, so they are asking that. That is why even oil and gas companies are spending a lot of time trying to explain that. That is happening.

On the other question, there is definitely demand internationally. We have mentioned once the International Sustainability Standards Board. We are going to get one set of metrics. I cannot wait to be able to say who pays their suppliers in time. I could then have new products—innovative products with proper metrics—that could then be sold to consumers with the right labels.

Mark Manning: It is important to say that the evidence we are seeing from our own Financial Lives survey is that more than 80% of consumers want their investments to do good as well as to make a financial return. If that is the case, you should see more funds coming—

Q70 **Rushanara Ali:** Neither of you has answered my question about whether they are scared enough of the regulator to act if necessary. That is really important, certainly to me, because if they think you are going to be softly-softly and not penalise where it is needed, you are going to get lots of excuses.

Chair: We will leave that question hanging.

Rushanara Ali: Is it yes or no?

Mark Manning: I will be super-quick. The critical point on that relates to your earlier question around being fair, clear and not misleading. Now that we are able to establish some standards and some reference points for what that actually means in the context of sustainable investment, that gives us a much stronger basis to engage with firms in our supervisory activity and take enforcement action if we see egregious bad behaviour.

Chair: It is a really important question that Rushanara asks. Are consumers who find themselves in funds that actually turn out not to meet your criteria going to have a mis-selling claim?

Q71 **Emma Hardy:** I was going to ask you the same question as I asked the first panel, which is about an asset price bubble and whether you think there possibly could be one now that the criteria have become more honest. I also wanted you to pick up on the comments made by Mr Cummings about your decision to exclude financial advisers. Would you like to comment first on whether there is a risk of an asset price bubble?

Mark Manning: It is a really important question and it is one that we have thought about in developing this regime. We have thought about whether there is potential for market dislocation arising from some of the decisions we have taken.

First of all, the risk is reduced by the fact that we are not specifying the standard for what actually constitutes a sustainable activity. We are categorising funds in terms of the intention they have, but we are allowing the firm themselves to determine what benchmark they are using for sustainability. It has to be a credible standard. It has to be robust, evidence based and transparent, but we are not the arbiter of, "This is a sustainable activity and that is not." We believe there will be quite a wide variety of different credible standards used by firms when describing their sustainability objective and to guide their investment activity. The fact that it is not a single one should mitigate the risk of bubbles emerging.

We also have the "improver" category. This "improver" category is investing in assets that may not be sustainable today but are on a credible path to becoming more sustainable over time. We may see quite a broad scope of assets in those funds and, as a result, quite a lot of investment opportunities among funds in the "improver" category.

The other point that was raised, which you alluded to, is that financial advice is not part of the initial proposal. We have been very clear, in setting a road map to how we intend to build on this foundation, that we will include financial advisers over time, with a particular focus on how financial advisers assess the suitability of their advice for the needs and preferences of the retail consumer.

There are a number of things that we are doing and that we have in the road map that ought to mitigate against the potential for bubbles to emerge.

Sacha Sadan: Just very briefly, the consumer testing shows that labels plus a consumer disclosure will give them the information they need. Secondly, we are making sure that financial advisers then have these labels. That will help.

This market is moving very fast, not just here, as I am trying to say. People are moving their money and people are moving these products already, as they have been doing in the EU and the US.

Q72 **Emma Hardy:** Just going back to the point about bubbles, as you introduce the new clearer and more honest criteria, how are you going to be assessing to see if there are any bubbles? Are you going to assess to see whether there are any bubbles? What are you going to be looking at in particular? If something looks like it is starting to occur, what actions would you take?

Sacha Sadan: That is a really good question. The first thing is that we have learned from the EU. They did a great job with SFDR—version 1.0—but it was meant to be a disclosure regime, and you heard that there were some problems with that, which have been addressed by all the industry. The industry tells us that, and that is why our version hopefully learns from that, as we should do. It was mainly exclusionary and therefore people were just excluding. That could be not doing positive things and it was not using our world-leading stewardship abilities and corporate governance, which is important. That is one part of it.

Secondly, it is really important to say that the most important part of the market is that it is now evolving. We will review this. The ISSB, which I apologise for mentioning for a third time, is the international standard for everything on sustainability globally: one standard for gender, diversity, supply chain and carbon emissions. That will come out in 2024. That will help the standards to come through, and we can use that and review to see if that is working. We will be doing not just tests; we will be deeply looking at this.

I have set up an ESG advisory committee of people from outside of the FCA. One of them is someone who has been involved in some whistleblowing cases and been involved in greenwashing. We have a lawyer involved. We have people actively involved who will be helping us to monitor this. We have a great team, and we have this DLAG, which was mentioned—the Disclosures and Labels Advisory Group—where the industry will tell us what is working and not. As you have seen from the industry, they are not shy about telling us quite quickly, so we will not have any problems knowing if there are some potential things on the horizon. We will know.

Emma Hardy: You will be watching it very closely to see if bubbles are occurring.

Sacha Sadan: Yes, absolutely.

Q73 **Emma Hardy:** Some of the comments we heard previously were saying that what you are proposing for the UK is stricter and harsher than what is happening at the moment in terms of ESG classification for the US and the EU. Do you agree with that? Do you see that as a positive or negative?

Sacha Sadan: It is a bit. The "improver" label means that we can allow companies that are trying. I do really want real-world industries to be able to move. It is the same thing that we have done many times as investors, when we have worked on diversity and things like that. We do not just buy companies that were doing well on diversity. We pushed to improve diversity. We are now nearly at 40% in the FTSE 100 in terms of diversity. It is really important that we do that. The "improver" label will be slightly different from harsh exclusionary terms, but in terms of having definitions it will be harsher.

Emma Hardy: Do you see that as a positive or a negative?

Sacha Sadan: It is absolutely a positive, because why are we doing this? This is for consumers, and consumers need to trust.

Emma Hardy: And the planet.

Sacha Sadan: The consumers make the choices. We are not telling them to make them, but they are buying these products in droves. If they are buying them, they expect those products to do something for them. If we then make those products credible, they will buy more of them and there will be foundations for these products. Internationally, these things will be used by other organisations, but it does get you to that credibility. It is not us telling the consumers that they have to buy these.

Emma Hardy: You are just giving that honest label for them to make their own decisions.

Mark Manning: Yes, absolutely, to make their own decisions.

Just going back to some of the discussion earlier around some of the challenges that have been observed since the introduction of the EU regime, one of the reasons for the reclassifications that have occurred, and for some of the confusion that has arisen in the implementation of that regime, is the fact that there were not clear and objective criteria sitting beneath the categories. We believe that, having set out some qualifying criteria that are clear and objective and specify where the bar should be set, that is what will ultimately give consumers confidence that, when they see a labelled product, it is genuinely pursuing a positive real-world outcome for the environment or society.

Q74 **Emma Hardy:** One of the other challenges we heard about from the previous panel was that if the UK has higher standards, people will move money away from investing in the UK to invest where there are lower standards, in the EU and the USA. Do you agree with that?

Mark Manning: No, we do not agree with that. At the end of the day, if that is the type of product a retail investor wants, they want to have confidence and assurance that they know what they are getting. As I said before, it is perfectly reasonable, and we absolutely expect, that many consumers will have lighter environmental or social preferences for their investments. They may only want to invest in a product that has a limited number of exclusions. They may only want to invest in a product that is managed against a benchmark that is only slightly tilted towards certain ESG characteristics. That is completely fine. Those products will still exist. They just will not have the label because they will not be actively and positively pursuing an environmental and social outcome.

Sacha Sadan: Just remember, this is the direction of travel everywhere. It is different speeds. I am on the international securities regulator. I am the vice-chair of the sustainability taskforce. They want to know what we are doing. People are looking in other regions. This is where it is going, because those consumers want exactly the same things, so it would not go very well.

By the way, one of the reasons they are moving their labels is they are getting reputational risk. That reputational risk will not just come from being scared of a regulator; it will come from the media and from people who will have a backlash if that product is not good. They will not move to other markets. They will learn to build products that are credible.

Q75 **Emma Hardy:** Finally, James said at the end of his evidence that there is an opportunity for the Government to get private investment for green projects. Do you agree with that?

Sacha Sadan: Yes, absolutely. I was at the Energy Efficiency Taskforce meeting, where Dame Alison Rose was announced yesterday, with 100 leaders in green and everything else. There is a huge opportunity here. One of the things that came up was that finance is confusing at the moment: "Is it ethical? Is that counted as green?" People were saying, "We want better definitions."

The FCA has put together the long-term asset fund, where defined contribution schemes can put up to 10% of the money—they are long-term pension schemes; I have been involved in them for a long time—in illiquid schemes that are in green innovative projects, which could then be helpful for the communities, helpful for all of the other things, but also make a better return than buying certain sovereign bonds. Yes, absolutely, but they do need credibility to do that. That is something we are trying to help with, not just in the UK. That is why we are members of IOSCO and the ISSB, which we have talked about, to try to drive this globally, because there is huge demand for these products.

Mark Manning: Can I just add to that very quickly? It is important to stress again the fact that we are doing this in the funds market as part of a wider set of sustainable finance-oriented regulatory reforms. It is all of the pieces coming together that are going to deliver on the potential here. We have talked a number of times about the International Sustainability Standards Board getting the right information flowing from investee companies, and the Transition Plan Taskforce getting good forward-looking information on companies' plans and strategies to navigate the transition, to respond to and contribute to that transition.

Then there is another important aspect, which is ESG data and ratings. Data was talked about a number of times. Ultimately, even if we get better information flowing in corporate reports from companies in the real economy, having the data services, the analytics and the ESG ratings delivered in a credible way that commands trust in the market is really important. To that end, we have convened a code of conduct working group to help to build trust in the market for ESG data and rating services.

With all of this, there is the need to ensure that companies have the right governance arrangements, the right capabilities and the right incentive structures to be able to deliver on their potential in sustainable finance. For that, we have recently published a discussion paper that is starting the conversation around the transformational change that is likely to need to take place within firms in each of those areas to make sure that they are well equipped to deliver on this agenda.

Q76 **Siobhain McDonagh:** There is a slight overlap in some of my questions, so I hope you will forgive me. They look again at consumer trust and consumer choice. The FCA's letter to the Committee of 9 January said that a survey found that 86% of adults surveyed do not know who to trust in the sustainable investment sector. The letter made the assertion that consumers find it difficult to navigate the complex landscape, and trust has been eroded. It has become clear that this survey finding related to a different statistic regarding general trust in opening a new investment product. How did this statistic make its way into your letter?

Sacha Sadan: Thank you for finding that. We corrected it immediately. The trust issue is still a very big issue and other surveys have said very similar things, but that was why we made that statement and change. Credibility and trust is something that, first, we know has been eroded. Secondly, the industry has written to us and said it wants guardrails to build trust.

Q77 **Siobhain McDonagh:** Do you think consumers think they are being lied to specifically about sustainable investing, or is it a reflection of a simple lack of consumer trust in all financial products?

Sacha Sadan: As I have said before, this is a market that has grown very quickly. We had this in other things, such as whether it was organic: it took time for organic to get to credible standards. People did that, and people did it with all the best intentions. It is more that than anything. We are now getting standards. We are getting metrics, so this will build the credibility in the market in that sense.

Q78 **Siobhain McDonagh:** We are talking about this particular area. Do you think people are distrustful of all financial products, or are we specifically talking about here?

Sacha Sadan: No, we are specifically talking about here. One of the things that was mentioned before is that people are confused about a green fund that might own an oil and gas company. It might be okay, because if they are trying to move that oil and gas company to reduce their carbon emissions by 50% that will actually make more difference to greening the world than by just ignoring it, but it has to be explained. Therefore, there is confusion in the market, which it is our job to try to address.

Q79 **Siobhain McDonagh:** Are you concerned that if sustainable disclosure requirements are introduced, a considerable number of funds will have to close, which could lead to a significant reduction in choice for investors who are not interested in ESG investing?

Sacha Sadan: No, absolutely not. As I have mentioned before, there are funds out there that maybe five years ago thought that they were at the vanguard of ESG, which are not now, and they certainly will not be by 2024. They will have the chance to evolve and refine but, if not, they can still carry on selling their funds, just not with those terms. They will not have to close. Then it will be consumers' choice to decide whether they are happy with what they are doing or whether they want to move to a more evolved fund, and that is what happens in capitalist money markets. People will move that. No, I do not think that will be the case.

Mark Manning: We are currently working through these 239 consultation responses, many of which were very rich and included a lot of good examples and good detail. We have had quite a lot of feedback around the naming and marketing restrictions that might apply to products that do not qualify for one of the sustainable investment labels, and some suggestions of how we might be able to refine those criteria so that products that do not meet the grade but nevertheless may meet lighter sustainability preferences among consumers can still be found easily. That is an important aspect that we are going to need to consider.

Q80 **Siobhain McDonagh:** You made particular reference to having had 269 responses. Is that a big response for one of your consultations?

Sacha Sadan: It is 239. The answer is yes, but that is not surprising, because we have been really engaging. A proactive regulator talks to the industry. We had that group, the DLAG—I apologise for mentioning it again—which has had all of the industry telling us what works and what does not. We have done the testing of 7,000 consumers. We are not surprised. We also know how much passion there is in this area, so it is very important. The great news is that we know some of the areas where we think we have done a really good job but we think could be tweaked, and we will. It is a consultation, and we are absolutely in listening mode. That is really important in this stage of events.

Mark Manning: We have already started to think about a lot of the points that Chris Cummings made in the earlier session, having heard quite a lot of feedback during the consultation process. We were out talking to stakeholders daily during the consultation period. We have started to think about a number of those points around the naming and marketing, the impact label and the definition of it, the balance between asset allocation and stewardship in the "improvers" category. We are making sure that we are going to be positioned to deliver something at the end of the process that is going to be fit for purpose and meet the needs of the market.

Sacha Sadan: Just to be clear—this is a very important point—our focus is to protect consumers, align their interests and help integrity in the market to drive really strong competition. There is a lot of money out there that wants to be involved in this, and if we help to build the foundations right, I think we will get there.

Q81 **Siobhain McDonagh:** Sustainability is part of the whole values-driven investment idea. I would like to raise a particular case related to human rights. In 2021, I learned that the pension fund for MPs had investments in Chinese companies that had been accused of being complicit in human rights violation and the ongoing problems with the Uyghurs. The Parliamentary Contributory Pension Fund has now disinvested from these companies, but the Legal & General pension for the staff of MPs still holds similar investments. The FCA has made it clear that there should be more transparency for consumers when they invest in sustainable funds; do you think there should also be transparency about funds that invest in countries that abuse human rights?

Sacha Sadan: To start with, as you know, the world is moving quite quickly in different areas. I have had this debate many times on things like defence. I have been very conscious of saying that it is up to people to decide if they want to own certain regions or areas, and defence is a perfect example. Defence is now seen as quite a strong area, whereas before it was seen as bad. It is more important that it is transparent, and then people make their decisions.

Mark Manning: I alluded to this in an earlier response. It is ultimately not for the regulator to make the judgment as to what is good and what is bad. What is absolutely critical is, first of all, that there is transparency around where a fund will and will not invest, and that there is transparency around what it is seeking to achieve and how it is planning to go about that. Ultimately, transparency is a critical part of the solution to the sorts of issues you are describing.

Chair: That is very interesting. I should declare I am a trustee of the Parliamentary Contributory Pension Fund. The issue you have just raised would be a really good issue to raise with the Speaker's Committee for the Independent Parliamentary Standards Authority.

Q82 **Andrea Leadsom:** Just going back to a question raised earlier about mis-selling, when your rules are finalised is there likely to be a mis-selling claim? Or is it going to be a case of wiping the slate clean and then, moving forward, people disinvesting if they are invested?

Sacha Sadan: We are giving the industry time to get the new rules in place. These rules are innovative everywhere, so we are going to make sure that the market has time, but after that we will be making sure that funds are complying with that. That is why we want these rules—to make sure that they cannot use those names—and whether we supervise or use enforcement techniques, yes, we will do.

Q83 **Andrea Leadsom:** There will, in effect, be a clean slate. They will not be retrospectively held responsible for not properly meeting the requirements of that category.

Sacha Sadan: If I am being fair, in one sense there has not been a rule and therefore there has not been an involvement. The market has moved significantly, even in the last five years. The discussion on human rights is a perfect example of something that, when we were investing a long time ago, would not have been something that people thought about. They would have just said, "Is it making me a good return?" This is evolving, so we have to make sure that we are fair to the industry in what we are doing.

The industry's response is that they think we are being quite tight and raising the bar, but we think that is a good thing. We would rather the whole industry do that than just find someone who did something that we thought might not be so—

Q84 **Andrea Leadsom:** Just to be clear, it is not your intention to fine an investment manager who had described a fund in a particular way that was no longer accurate. You would not be allowing them to be accused of mis-selling.

Sacha Sadan: No, not because of these rules, but if it was unfair and misleading, we still have the powers to be doing that anyway.

Q85 **Andrea Leadsom:** Going back to what Mr Cummings said about the UK doing too little too late, us being behind the curve and that the world is going to end—I have known him for a very long time, and his approach—do you agree with that? Do you think that the UK is behind the curve and that we cannot be a global leader as a result?

Sacha Sadan: It is very difficult for me to say what people think of us, but when we go to IOSCO we are asked to be the chairs and the co-chairs. People think we are. There was the ISSB launch at COP26, and the things that we are doing—the Transition Plan Taskforce is world-leading. I have many examples of where we are seen by everyone to be doing great things, and we can absolutely lead in this area. Innovative regulation and learning from others is exactly what we should be doing.

ESG ratings is a perfect example. We are using the Japanese code of conduct as a base, and working really fast to do that. We are really trying to be there. Whether we are world leaders or second or third, I do not know, but we are absolutely working in this area. By the way, from what we have read, most of the 239 responses have said, "What you are doing is great, but can you do this a bit different?" Of course, I am afraid in any industry when a regulator acts or legislation happens, everyone wants it, but not that way; they want it in their own personal way. That is the balance that we have to play at the FCA.

Q86 **Andrea Leadsom:** Could you set out the key differences between the EU, the US and the UK proposals?

Sacha Sadan: I will start. Mark has been in the detail, and actually in Montreal helping to set up the ISSB standards only last week. He has been a key person in that. The first one is that the SFDR was meant to be a disclosure regime, not a label, but everyone used the article 6, article 8 and article 9—quite rightly, in commercial terms—as a badge, and it became the term. Of course, of 6, 8 and 9, what do commercial firms want? They all want a 9, so the market moved more to 9 very aggressively. As I have said, 307 funds moved from 9 to 8 in the last six months or so.

Q87 **Chair:** I honestly do not think people listening will know what is in 6, 8 and 9 and how they map to your three categories. Perhaps you could elaborate on that.

Sacha Sadan: Yes, of course. The first thing is that it was more exclusionary: because it was not consumer-tested, it was exclusionary. It would take out things but it was not worried about what you were doing with the money that you had invested in the old stewardship and corporate governance. That would be the difference, whereas we are saying, "Tell us what you are doing with the money that you have invested on behalf of consumers."

Mark Manning: Just to clarify, article 6 is funds that are not either promoting sustainability or have a sustainable objective. Article 8 is funds that are promoting sustainability. Article 9 is funds with a sustainable objective. They are slicing the universe in a somewhat different way. The other important aspect is that they are generally focusing more firmly on the composition of the assets in the portfolio rather than on the intention of the asset manager and the objective of the portfolio in the sustainability space.

We have taken an approach that is very much focused on intentionality. What is the fund seeking to achieve? What is its purpose? What is its objective? That way, a retail investor can immediately make a decision as to whether this is the type of product they want to invest in, whether they want to be investing in a fund that is primarily focusing on investing in already sustainable assets or they are looking to invest in assets where the sustainability is expected to improve over time. That is an important distinction.

The other important distinction between our regime and the EU regime is the fact that it is consumer focused at the heart. It is not purely a disclosure regime; it helps consumers to navigate. The fact that the labels are supported by the consumer-facing disclosures that we were describing earlier is another key feature.

The fact that we have these qualifying criteria sitting beneath the categories is another key distinction. What we are seeing in the EU, because of the confusion, is that there has been a bit more consideration of whether some qualifying criteria need to be introduced beneath those labels.

Sacha Sadan: We worked very closely with the EU. They went first. It was groundbreaking. It was good. It did what it was meant to do. That is why the market has evolved and that is why it is a different market. They are looking at moving towards what we are doing in different ways. This is the direction of travel everywhere. We are seeing it in Singapore and Japan. Everywhere is thinking about it. They are all struggling with the word "greenwashing" and how to adapt to that, because it is new. We are working with other regulators all the time to try to work it out, including by surveying and working out supervisory techniques.

Q88 **Andrea Leadsom:** I would like to get your assessment of the US versus UK as well, but the next follow-on question is about whether it makes sense to have an internationally co-ordinated set of definitions. Perhaps you could just address the US question first?

Mark Manning: The US is doing two main things in this area. Kate talked about the climate disclosure rule, which is corporate reporting. Very similar to the climate disclosure rules that we introduced, it is aligned with the recommendations of the International Task Force on Climate-Related Financial Disclosures.

That is the corporate reporting piece, but they have also been consulting on a classification regime for sustainable investment as well, taking a more similar approach to the EU, because it is based on disclosure as opposed to labelling. It is classifying products on the basis of the disclosures that they need to make, rather than providing a labelling regime to help consumers to navigate. Again, that is a slightly different approach, but what we have done in our consultation is to map between the regimes to show where there is an additional step in our regime—for example, to assess a fund against the qualifying criteria and to determine a label.

We have also looked at the disclosure requirements under each of the regimes to see where there is commonality and where there are differences. We are very focused on the fact that we need to make the regimes as interoperable as possible. What we have tried to ensure is that a significant proportion of the investment in processes and systems that a firm would need to make in order to comply with either the US regime or the EU regime could be leveraged, but then to also have an add-on to do the additional piece that we believe is necessary to give the right information to consumers to make informed decisions.

Sacha Sadan: Australia, Japan and Singapore are doing similar things as well.

Q89 **Andrea Leadsom:** I am not completely clear if you are saying that there is merit in a globally co-ordinated system or not. Is UK difference a good thing or a bad thing? Or is it UK leadership globally that we are striving for?

Sacha Sadan: A lot of the regulators have different mandates. Some are not consumer regulators as much, so there is already a difference. That makes it hard to map, but we are doing so. At IOSCO we are all working on—SEC, Japan, Singapore, ESMA, us—and thinking of how we can use common definitions. One of them will be having the ISSB metrics so that we can all use consistent standards.

The other one, which we have touched on, is ESG ratings. That is what a lot of funds are using to make decisions. We are trying to make sure there is a global standard or code of conduct on ESG ratings so that it drives convergence, but I cannot say it will go to complete convergence because of the differences in markets and other things. We are absolutely moving that way, and that is why it is quite important to say that the direction of travel is this way. Consumers want this and the regulators are on to this. They are trying to help to define this and create a guardrail so that people can then use their choices to invest in products that do what they want them to do.

Mark Manning: In direct response to your question, it is fair to say that international convergence, as much as possible, is desirable. That is why we have been so supportive of the international corporate reporting standards in this space. We would absolutely like to see as much convergence around different terminology, classification and labelling as possible going forward. We will use our position in the sustainable finance taskforce at IOSCO—the International Organisation of Securities Commissions—to promote and encourage convergence where that is feasible.

Q90 **Chair:** This is such an important question. If, for example, industry were to follow your approach, would that approach then work for EU-marketed products and for US-marketed products? Is it going to be such a high standard that it will therefore fall within all those other parameters?

Sacha Sadan: It is moving that way. Obviously we have not even finished our standards, because we are going to tweak them from the rules we get, but our aim is to help other regulators to look at this. We have done so much extensive work with consumers.

Q91 **Chair:** If industry here in this country aimed to meet your standards, they would feel confident they were going to meet other major international regulations as well.

Sacha Sadan: Yes, but of course there is a caveat that there are some things they might not meet. They would meet the majority of things and be moving in the right direction, absolutely, and much more than it is at the moment.

Chair: That is great. We appreciate your time today. This has been an eye-opening session for the Committee. We have certainly learned a lot. I particularly express shock that you had not thought about the cost, either for industry or for the consumer, in terms of any of the communication, and also some of these important questions around enforcement and a clear answer on the international standards. We will follow up with you on some of those questions. That was not a question for today; these are just my concluding observations. We really appreciate your time giving us this evidence and allowing us to ask you in-depth questions. Thank you very much for coming.