

Harriett Baldwin MP
Chair
Treasury Select Committee
House of Commons
SW1A 0AA

9 January 2023

Our ref: C221221B

Dear Harriett,

Re: CP 22/20 - Sustainability Disclosure Requirements (SDR) and investment labels

Thank you for your letter of 20 December 2022. Please find below our response to your questions concerning the FCA's consultation on SDR and investment labels. Our proposals aim to help consumers navigate the market for sustainable investment products and build trust and transparency around it.

With consumer needs at the centre of the regime, the proposals are aligned with the new Consumer Duty requirements that firms are implementing. They also support the Government's ambitions for sustainable finance as set out in the Chancellor's remit letter to us¹. We have taken a collaborative approach to developing our proposals, for example by first issuing a discussion paper in November 2021 and establishing a Disclosures and Labels Advisory Group (DLAG) to advise on our policy development. We welcome any feedback and challenge that will help us shape our next steps.

1. How does the FCA intend to monitor and enforce these new rules? Does the FCA have sufficient expertise in this area?

We will apply our established supervisory and enforcement approaches to identify and respond to compliance issues as they arise. This will include proactively assessing how the rules are being adopted in several ways, such as through:

- firms notifying us when they use a label so that we can see those being used;
- our Fund Authorisation team, which will review and may challenge the categorisation of any new fund submitted for authorisation²;
- post-authorisation, challenging firms as needed on their use of labels and their disclosures, including in response to intelligence we receive;
- carrying out a review of the characteristics of labelled products to assess whether they are meeting our criteria and how they are performing against their commitments, together with a post-implementation review after three years of the regime coming into force.

We will take enforcement action if we see poor behaviour that could harm consumers, market integrity or competition in the interests of consumers. This could include circumstances in which

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1122924/FCA_Remmit_Letter_December_2022_with_cover.pdf

² As noted in our consultation paper, however, this will not entail approval of the label used:
<https://www.fca.org.uk/publication/consultation/cp22-20.pdf>

a firm is found to have failed to make the necessary disclosures; made misleading disclosures or misused a label; or breached our naming and marketing rules.

To ensure we have the right set of capabilities, we recruited a dedicated ESG Director in 2021 and have further sought both to upskill existing colleagues on ESG issues and hire new ones with specialist ESG knowledge. As part of this, we are working to develop and provide training for colleagues across the organisation to ensure we have and continue to develop the right expertise. This builds on our existing expertise in areas such as fund management and financial promotions, to ensure we can identify and act on risks and poor practice related to greenwashing in how products are marketed and provided to customers.

As set out in our ESG Strategy³, we are adapting to ensure consideration of greenwashing and other ESG-related risks are properly taken into account and our regulatory tools are put to work accordingly. This ranges from how we authorise and supervise firms (the questions we ask, the expectations we set) to how we use data and intelligence to identify areas of concern and when/how to deploy our enforcement and competition tools. We are also working actively with our international partners on these matters. For example, we held a TechSprint in October 2021, exploring how technological solutions can help to address challenges relating to monitoring and verifying ESG data and disclosures and bringing together international regulators to share experiences and explore areas for collaboration to serve global markets effectively.

2. How has the FCA sought to balance the benefits of introducing sustainability disclosures and investment labels against the potential risk of reducing consumer choice in this sector?

Our latest Financial Lives Survey (to be published early in 2023) shows that 81% of adults surveyed would like their investments to 'do some good' as well as provide a financial return. However, a recent Boring Money survey,⁴ found that 86% of adults surveyed do not know who to trust in this space.

The market for sustainable investment products has become diverse and complex, with terms such as 'ESG' (environment, social and governance) and 'sustainable' being used interchangeably and a lack of differentiation between 'ethical' and 'ESG' investing. Too many funds claiming to be 'sustainable' are not doing what consumers expect. This undermines the integrity of the market. Consumers find it difficult to navigate the complex landscape and trust has been eroded. In part this is due to growing concerns around greenwashing, which refers to exaggerated, misleading or unsubstantiated claims that may cause consumers to believe that a firm's products are more sustainable or have a greater positive sustainability impact than they actually do.

Our proposals aim to help rebuild that trust and protect consumers by enabling them to navigate the market and identify and choose products that meet their needs and preferences. The labels will not reduce consumer choice, but rather help investors differentiate between products that aim to deliver a positive, sustainable outcome (i.e. those that qualify for a label), and those that do not (i.e. those that do not qualify for a label).

We have carried out behavioural research on consumer-facing disclosures in several experiments with around 15,000 consumers. We listened to what consumers understand and find helpful to shape our proposals in our consultation. For example, we initially found that consumers often do not understand terminology such as 'stewardship' or 'transitioning'. So, in a later version of the experiments we changed the name of our label from 'Transitioning' to 'Sustainable Improvers', and removed industry-specific terminology from the disclosures, which helped consumer understanding. We also found consumers were better able to understand sustainability information when this was provided in a standalone and accessible sustainability disclosure and, with the benefit of this information, consumers were more likely to select a sustainable product.

³ <https://www.fca.org.uk/publications/corporate-documents/strategy-positive-change-our-esg-priorities>

⁴ <https://www.boringmoneybusiness.co.uk/sustainable-investing-report-2022/>

3. What market distortions does the FCA anticipate could be created as a result of these measures? How will those distortions be mitigated?

We do not expect our proposed measures to give rise to market distortions. As noted in our response to question two above, our aim is to give consumers the information they need to navigate the market effectively and differentiate between those products that are genuinely seeking positive, sustainable outcomes, and those that are not. This information will better enable consumers to choose products that meet their ESG preferences.

The labels we are proposing aim to cover the breadth of potential positive sustainability outcomes. Key to this is our proposal to include a label for 'Sustainable Improvers'. This recognises that investing in sectors that are becoming more sustainable over time can support the transition to a more sustainable future. Investors can play an important role in embedding and accelerating improvements in the sustainability of assets over time, including through their stewardship activities, rather than divesting and losing any potential influence. We received broad support for this category in the discussion paper that we issued in November 2021 to seek early views on a labelling and disclosure regime.⁵

Our proposals also recognise the role alternative investment approaches may play in sustainable investment products and allows for such products to qualify for a label. This approach has been positively received as it enables consumers to invest in a variety of asset classes.

All of the labels will be underpinned by objective criteria which must be met before they can be used. The criteria provide a structured framework against which firms will be able to assess their products. With greater understanding and confidence around regulatory expectations, firms may choose to design new products that meet these expectations and better align with the needs and preferences of consumers.

This may, in future, lead to an increase in the availability of sustainable investment products, encouraging capital inflows into sustainable activities. This would be a desirable long-term evolution in the product landscape. It would also be consistent with the expectation in the Chancellor's recent remit letter to the FCA that we have regard to the Government's ambitions for the provision of sustainable finance and the supply of long-term investment to support UK economic growth.⁶

4. The consultation suggests two thirds of the 450 UK funds currently claiming to operate sustainable funds will change their marketing as a result of these measures. What is the basis for this assumption and how much uncertainty is there around this figure?

In our consultation paper, we clarified that the cost benefit analysis (CBA) is subject to several uncertainties and assumptions. We recognise that many products that are currently marketed as sustainable will not meet all of our proposed qualifying criteria for the use of a label. We expect that many of these will be adapted to meet the qualifying criteria, but some may choose not to do so, and instead change their product names and/or marketing.

We do not yet know what proportion of funds will be adapted to meet the qualifying criteria, and what proportion will choose instead to change their marketing, so for the purposes of the CBA we made assumptions. The 'two thirds' figure in the published CBA was derived by dividing equally between products that a) if adapted, could qualify for and choose to use a label; b) those that could qualify, if adapted, but choose not to use a label; c) those that won't qualify for a label. As we note in the CBA, this is necessarily an assumption, and we welcome views during the consultation on whether it is reasonable.

⁵<https://www.fca.org.uk/publication/discussion/dp21-4.pdf>

⁶https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1122924/FCA_Remot_Letter_December_2022_with_cover.pdf

It is also important to remember that, given most of our requirements will not come into force until 30 June 2024, firms will have sufficient time to consider their products against our criteria and make any necessary changes to qualify for a label, or choose not to label their products and amend their naming and marketing. We will continue to work closely with the industry and consumer groups through this period and to provide support and guidance that firms need to ensure their products are easier for the consumer to both navigate and trust.

5. To what extent do the two thirds of UK funds, that are not expected to meet the proposed sustainability criteria, currently offer some level of sustainable investing?

a. What does the FCA expect will happen to any sustainable investments currently held by these two thirds of firms? Does the FCA expect the overall level of sustainable investing by these two thirds of firms to decline following the introduction of these rules?

The proposals aim to help consumers differentiate between products and equip them with sufficient information to decide which products meet their needs and preferences. So, with better information, some consumers may find that the products they had invested in do not fully meet their sustainability preferences. These consumers may choose to divest. However, such divestment may not necessarily indicate a lower level of sustainable investment, given it would reflect informed consumers making active decisions based on more accurate information. We expect many who disinvest to opt for products that better meet their needs.

In some cases, a firm may make changes to its products in order to meet the qualifying criteria for a label. In such cases, consistent with existing fund rules, the firm would need to notify existing consumers of any significant changes.

There may be some funds which consider environmental or social matters to some extent in their investment approach, but do not meet the criteria for a label. For example, they may exclude certain types of investments based on ethics or values. There is likely to remain significant demand for such products, and funds such as those will not need a label to continue operating in the UK.

We do not, therefore, expect a decline in sustainable investing following the introduction of our proposed rules. Our proposed rules aim to ensure that consumers have access to the information they need to be able to distinguish between products that are pursuing these strategies and those that are doing more by influencing positive sustainable outcomes. We have had productive discussions with industry with many welcoming the publication of our consultation on SDR and investment labels. Many market participants want guardrails in this space. We have already received much constructive feedback to date, which has been helpful as we consider next steps.

b. In the short and medium term, does the FCA expect the net effect of these proposals will increase or reduce total sustainable investment in the UK?

The aim of the proposed regime is to protect consumers by helping them to navigate the market, tackle greenwashing and increase transparency on sustainability matters. In turn, this will strengthen consumers' trust in sustainable investment products and they will be better able to identify which meet their needs and preferences. We expect that, over time, this will lead to increased provision of sustainable investment products and therefore increased capital flows into sustainable activities in the UK. If we did not take this action, and allow consumer trust in these products in the UK market to remain low, we would expect less investment in those products marketed here as sustainable and a flow of investment to those markets where robust standards are in place.

We have set out examples in our consultation of how existing products may need to do more to meet the criteria. As stated in response to question four above, we also believe firms have sufficient time to consider their products against our criteria and make any necessary changes, given most of our requirements will not come into force until 30 June 2024. We are committed

to helping where we can, and we will continue to engage with the industry through regular dialogue as well as through the use of our convening powers, to help an ecosystem develop around the regime over time that both reflects our commitment to an internationally consistent approach and allows us to keep pace with the speed of evolution in the ESG space.

6. Does the FCA expect that these measures will lead to an increase in fees charged by: (a) funds and (b) distributors of sustainable products? If yes, does the FCA have any concerns that this could reduce the competitiveness of these products?

We sought to ground the proposals in existing rules and expectations to keep costs and burden to firms to a minimum and therefore avoid an increase in fees charged by firms and distributors. For example, the qualifying criteria for our proposed sustainable investment labels build on the Guiding Principles for the design, delivery and disclosure of sustainable investment funds, which set out our expectations for how existing rules apply in the context of sustainable investment funds⁷. For a fund that is meeting the Guiding Principles, the broad thrust of the qualifying criteria should be familiar to firms. We do not, therefore, expect our proposals to entail material additional costs (as described under the 'change and governance' section of our CBA).⁸

Furthermore, while the consumer-facing disclosure requirements will be new for all firms, the detailed product and entity level sustainability disclosures broadly build from existing Task Force on Climate-Related Disclosures (TCFD) product and entity reports. Many firms in the scope of our SDR proposals will already be building processes to produce these. Our proposals for distributors are similar to current expectations to make product-level information available to retail investors.

More broadly, our proposals align with the New Consumer Duty and are seeking similar outcomes, particularly with respect to consumer understanding. Firms should already be taking steps to act in good faith and to provide consumers with information that enables them to make informed, effective decisions, as well as ensuring their products and services provide fair value for consumers.

Nonetheless, we have encouraged challenge to our thinking – we want our proposals to be helpful and we want to get the balance right. We established a Disclosures and Labels Advisory Group (DLAG), made up of industry experts and consumer representatives, to provide advice and feedback as we developed our proposals. This engagement has generated useful insights which have informed the proposals set out in our consultation, and we continue to encourage feedback from stakeholders during the consultation process. We will continue to engage actively with the industry to ensure that we continue to listen, learn and challenge our assumptions as we play our part in supporting the development of a vibrant sector and the UK's leadership in this area.

7. What can the FCA do with its proposed 'anti-greenwashing' rule that it could not previously do with its existing financial promotions rules? Are there circumstances where this new rule would apply but existing rules would not?

Firms are subject to existing rules that require communications to be clear, fair and not misleading. There are nevertheless growing concerns that some sustainability-related claims may be potentially misleading, exaggerated or unsubstantiated.

We took initial steps to address this in the funds space, where we found some products making sustainability claims submitted to us for authorisation did not meet our expectations. We published a set of Guiding Principles in July 2021 (as referenced in our response to question six) reiterating our existing rules and expectations for the design, delivery and disclosure of ESG and sustainable funds. And our proposals in CP22/20 introduce further regulatory requirements to address these concerns.

⁷ <https://www.fca.org.uk/publication/correspondence/dear-chair-letter-authorised-esg-sustainable-investment-funds.pdf>

⁸ <https://www.fca.org.uk/publication/consultation/cp22-20.pdf>

As an initial step in addressing potential greenwashing concerns in other areas, we consider it necessary to add a specific rule to the ESG Sourcebook to link the 'clear, fair and not misleading' principle directly to sustainability claims, so that all firms understand that it applies when making sustainability claims about their products and services. We take the opportunity to further clarify that those claims must be consistent with the sustainability profile of the product or service: claims must be proportionate and not exaggerated.

This proposal will give us an explicit rule against which we can challenge any firm that we consider may be greenwashing its products or services and take enforcement action against them as appropriate. There are already other places in the Handbook that add to the 'clear, fair, and not misleading' requirement to elaborate on what it means in specific contexts. For example, COBS 4.2.4G adds further prescription around financial promotions and CONC 3.3 adds detail in respect of consumer credit.

We will continue to monitor potential greenwashing concerns in respect of other products and services and assess the case for further requirements as needed.

a. Are there any additional powers, outside of the FCA's current remit, that would be helpful for reducing misleading sustainable promotions?

Our proposals aim to advance the FCA's operational objectives to protect consumers, to protect and enhance market integrity, and to promote effective competition in the interests of consumers. As noted above, they also support the Government's expectation that we have regard to its ambitions for the provision of sustainable finance.

While the proposals in CP22/20 focus on UK fund products and portfolio management, we have been clear that we want retail investors to be able to trust *all* products offered in our market, including overseas retail investment products marketed in the UK. We would therefore welcome additional powers to apply our proposed labelling and disclosure rules to overseas products so as to avoid confusion to UK consumers. We are currently working with the Treasury to consider options for how to treat these products and intend to follow with a separate consultation in due course.

8. How will the FCA treat funds that meet sustainable labelling and investment disclosure requirements in the EU, US or other jurisdictions?

We recognise that firms will be subject to sustainability disclosure requirements in other jurisdictions, such as the EU and US. We have therefore sought, as far as possible, to remain compatible and complementary. However, we note that in the context of this consultation on labelling the starting point for our regime is different: our proposals aim to categorise products with consumers' trust and information needs as our primary concern. Both the EU and US regimes aim to categorise products in order to determine which disclosure requirements should apply.

With the EU's regime already in place, we have an opportunity to learn from challenges in its implementation, including concerns market participants and consumer groups have raised through our engagement about the lack of clarity in the EU's requirements. For example, a Morningstar analyst found that almost a quarter of funds classified under the EU regime's 'Article 8' (i.e. those that promote environmental or social characteristics) do not appear to have the sustainability credentials they claim to have⁹. Moreover, many funds classified as 'Article 9' (i.e. those that have sustainable investment as their objective) have already downgraded due to concerns that they were not sufficiently invested in sustainable assets. This exacerbates greenwashing and trust concerns and argues in favour of introducing clear, objective qualifying criteria for our classifications and labels on the lines we have proposed. We also note the clear

⁹ <https://news.bloomberglaw.com/securities-law/esg-stripped-from-23-of-eu-sustainable-funds-in-fresh-review><https://news.bloomberglaw.com/securities-law/esg-stripped-from-23-of-eu-sustainable-funds-in-fresh-review>

intention of the Government and Parliament through the Future Regulatory Framework that the UK should adapt its regulations so that they are internationally consistent but also work for the UK consumers and markets. It would not therefore be appropriate or consistent with our objectives to simply replicate in detail other jurisdictions' regulations.

In Annex 1 of CP22/20, we have provided mapping from both the EU and (proposed) US regimes to help firms determine how products categorised under those regimes would be classified under our proposals, provided that they meet the qualifying criteria.¹⁰ We are also giving firms time to implement the rules as mentioned above – with the majority not coming into force until at least 30 June 2024. We will continue to work closely with the industry during this period to ensure they have the support and clarity they need through our regular engagement.

We remain committed to an internationally consistent approach and intend to evolve our regime in line with the International Sustainability Standards Board's (ISSB) standards, which did not exist when the EU regime was created. And beyond this regime specifically, we continue to play a leadership role internationally, helping to drive progress towards global solutions in ESG. For example, we are vice-chair of the International Organization of Securities Commissions' (IOSCO) Sustainable Finance Taskforce and co-lead its workstream on corporate sustainability-related reporting, through which we continue to promote the common global baseline of sustainability reporting standards developed by the ISSB.

9. Will these proposals limit UK investors' ability to invest in funds managed outside of the UK?

Our proposals will not affect UK investors' ability to invest in funds managed outside of the UK. As our proposals apply to UK fund products and portfolio management, we expect consumers to be better able to navigate and make informed decisions about those products. We want the UK to be a trusted centre for sustainable investment and our proposals aim to do this by setting robust regulatory standards to protect consumers. We believe this will underpin competitiveness of UK markets.

As noted, we want retail investors in the UK to be able to trust all products in our market, including those marketed into the UK from overseas. We therefore intend to follow with a separate consultation in due course on how the proposals may be applied in respect of overseas funds.

We are also seeing a direction of travel towards tackling greenwashing and providing greater clarity on sustainability features of funds based in other jurisdictions. For example, ESMA recently issued a consultation on fund names using ESG or sustainability-related terms and the US SEC also proposed restrictions around sustainability-related terminology in fund names. We are already working with international regulators to promote consistency in our approaches to addressing greenwashing matters. For example, as mentioned above, we held a TechSprint in October 2021, which included two international regulatory roundtable sessions bringing together 59 regulators from 36 jurisdictions and fostering conversations around international collaboration in this regard. We also hope our proposals and criteria can be useful for other jurisdictions looking to strengthen requirements to protect consumers going forward.

I hope that these responses are helpful.

Yours sincerely,



Nikhil Rathi
Chief Executive

¹⁰ <https://www.fca.org.uk/publication/consultation/cp22-20.pdf>