Sub-Committee on Financial Services Regulations
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Nikhil Rathi, Chief Executive
Financial Conduct Authority
[via email]

9 March 2023

Dear Nikhil,

Greenwashing - Sustainability Disclosure Requirements and investment labels consultation

As you will be aware, your colleagues Sacha Sadan, Director of Environment, Social and Governance, and Mark Manning, Technical Specialist for Sustainable Finance and Stewardship gave evidence to the Treasury Sub-Committee on Financial Services Regulations.[1] In light of the evidence taken the Committee would like to raise the following issues:

Cost benefit analysis

The cost-benefit analysis (CBA) of proposed new regulations is an important component of assessing their merit. Parliament has given the FCA a legal requirement to provide such CBAs under the section 138I of the Financial Services and Markets Act 2000, as amended by the Financial Services Act 2012. We are concerned that the FCA's CBA of the "Sustainability Disclosure Requirements and investment labels" consultation falls short.

The CBA focusses on the administrative burdens of firms complying with the new regulatory framework such as costs arising from :

- familiarisation with the rules,
- training,
- IT changes,
- change and governance,
- and ongoing costs.[2]

When asked whether the CBA covered the costs to the consumer, Sacha Sadan confirmed it did not.[3] When challenged on potential costs to the consumer, Mark Manning told the Committee the cost "is not going to be zero."[4]

There are three ways in which the CBA does not factor in costs to the consumer:

[1] Treasury Sub-Committee on Financial Services Regulations, Oral evidence: Greenwashing: sustainability disclosure requirements, HC 1150, 22 Feburary 2023

[2] Table 3, Sustainability Disclosure Requirements (SDR) and investment labels, FCA CP22/20
[3] Q52
[4] Q54

- The analysis does not consider additional costs to the consumer of their time spent reconsidering which products they wish to invest in, and which they wish to divest from. It also does not consider the cost to the consumer of having to incur transactions costs from selling investments they are told no longer meet their requirements as ESG investments, and buying new ones which do.

- The CBA makes no attempt to evaluate the costs incurred by consumers through the buy / sell spreads they will be exposed to when their investments are reallocated to different funds. The funds they sell will be sold at the lower selling prices, and the new investments they buy will be at the higher buying prices.

- The CBA also makes no attempt to put a cost on the potential for the proposed new disclosures to change the fundamental prices of the funds themselves. It is possible that at the point when a fund ceases to be able to market itself as "sustainable", it will experience a large-scale simultaneous exit from investors who have mandated their asset managers to only invest their money in "sustainable" funds. In the event of large-scale sell offs, the underyling values of assets within such funds may also be impaired as funds either rebalance or, depending on the nature of the fund, are forced to meet withdrawals. Consumers selling their existing investments in a sellers' market will achieve lower returns, contributing to consumer detriment.

We are concerned that the FCA has failed to take into account the substantial costs to the consumer of the measures included within this consultation. Without even attempting to put a figure on these costs, it is difficult for the Sub-Committee to take a view on whether the design of these proposals has been sufficiently considered.

1. **Will the FCA please provide a new CBA analysis that estimates the monetary and other costs to consumers of its proposals?**

Enforcement against misleading customers

The FCA states in its consultation that "Some firms are making misleading sustainability-related claims about investment products […] Such instances of greenwashing increasingly damages consumer trust in the market for sustainable investment products and causes potential harm such as consumers buying unsuitable products."[5]

When we asked Mark Manning whether the FCA had been clear with firms that consumers should not be misled, he stated that "a fundamental principle in the FCA's rulebook [is] of being fair, clear and not misleading. That is an existing premise within the rulebook." However, when prompted as to whether consumers has been misled by greenwashing, Mr Manning said consumers have not necessarily been misled "because there has not been a clear benchmark as to what is and is not sustainable."[6] This appears to contradict the assetion made in the consultation.

When the Committee asked Sacha Sadan whether the FCA would be investigating cases of mis-selling 'sustainable' funds, he said the FCA would not be doing so, on the basis that it would be "giving the industry time to get the new rules in place."[7] However, when asked specifically whether fines might be issued where a fund manager had described a fund in a way that was not accurate, Mr Sadan said that

[5] Sustainability Disclosure Requirements (SDR) and investment labels, FCA CP22/20, Paragrpah 2.4
[6] Q59
[7] Q82

fines would not be issued retrospectively based on the new rules, "but if it was unfair and misleading, we still have the powers to be doing that anyway."[8]

We are concerned that despite stating in its consultation that consumers are being misled, and that it takes it fundamental principles seriously, it appears the FCA is unwilling to take enforcement action because no specific rules were in place when the misleading took place. Misleading customers is a breach of an FCA principle and should therefore be a cause for enforcement.

2. **Can you set out what enforcement work you will be doing to make sure that where fund managers have been promoting misleading financial products, the FCA will pursue redress for consumers?**
3. **If you do not intend to pursue enforcement action against the funds that you believe have misled customers, as stated in your consultation, can you set out the legal basis for not doing so?**

International divergence or convergence

When we asked whether establishing a strict set of UK disclosure requirements would still allow for UK products to be marketed in the US or EU, Sacha Sadan told us that "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 […] of course there is a caveat that there are some things they might not meet."

4. **Can you set out your assessment of the risks to consumers and to the funds industry, were the FCA requirements to be too onerous for US or EU based funds to meet?**
5. **Is there a risk that non-UK based funds choose not to meet the UK's criteria and as a result the UK consumer has less choice?**
6. **Is there a risk that UK based funds have to spend time and money to become compliant with three separate jurisdictional ESG criteria, resulting in additional management costs that will be passed onto UK consumers?**

In line with the Committee's usual practice, I will be placing this letter and your response in the public domain. I would be grateful for a reply by 23 March.

With best wishes,

Harriett Baldwin MP
Chair of the Treasury Committee

[8] Q83