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Harriett Baldwin MP
Chair of the Treasury Committee
Sub-Committee on Financial Services Regulations
House of Commons
London
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23 March 2023

Our Ref: 230309A

Dear Harriett,

RE: Greenwashing - Sustainability Disclosure Requirements and investment labels consultation

Thank you for your letter of 9 March 2023 and for the opportunity for colleagues to give evidence to the Sub-Committee. As I said at our regular hearing on 8 March, I appreciate the time members of the Sub-Committee have devoted to scrutinising our work in this area and see this engagement with the Sub-Committee as a key component of the new accountability framework for financial services regulation. Please find below our response to your questions concerning the FCA's Consultation on Sustainability Disclosure Requirements (SDR) and investment labels.[1]

Greenwashing has been identified as a risk by authorities across the world. We are developing standards for a rapidly evolving market where 'sustainability' might mean different things to different people. There have not previously been specific standards and expectations around what is and is not a sustainable investment. By acting now, to help consumers navigate this market, we will help this market move forward and develop consumer trust. We have proposed a package of measures with consumer needs at the heart of the regime.

As well as tackling greenwashing, our proposals aim to help consumers navigate a complex market for sustainable investment products, provide greater transparency along the investment chain and help consumers make better informed decisions.

A key aim has been to ensure the regime works both in the interests of consumers and for the firms that need to apply the rules. So, we have engaged extensively with industry, and we have undertaken significant research to ensure the regime works for consumers.

We have also sought, as far as possible, to achieve international coherence with other regimes. Our proposals support the Government's ambitions for sustainable finance as set out in the Chancellor's remit letter to us.[2] We need robust standards for the UK to remain at the global forefront of sustainable investment.

[1] CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels (fca.org.uk)
[2] Recommendations for the Financial Conduct Authority: December 2022 - GOV.UK (www.gov.uk)

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

Our regime is intended to empower consumers to give them better information to make informed decisions. We expect that consumers who want to invest in a product that is genuinely seeking sustainability outcomes will want the new information that the labels (and accompanying disclosures) will provide, whether they are new or existing investors. We consider that the benefit of being better equipped to assess the sustainability-related features of products outweighs the costs of implementing these requirements.

Our original cost benefit analysis (CBA) did not calculate the monetary costs for the cohort of consumers who, following the provision of new sustainability information on their products, choose to switch their investment elsewhere – whether to another product with the same firm or to a different one. The proposals give consumers better information, they do not require people to switch. The choice to switch is multi-faceted and will involve the consumer balancing individual preferences, of which sustainability may only be one and the cost of a switch will be another. Our proposals help consumers make this choice. This is not dissimilar to proposals made in other jurisdictions, which the Sub-Committee also probed during evidence sessions, and we note that other jurisdictions to the best of our knowledge have not made estimates of the consumer cost of switching.

We are of course considering comments on our CBA received in response to our consultation, including in relation to direct costs to consumers. This will inform any additional analysis as part of the Policy Statement we publish following the consultation process, as is our standard practice. The consultation process is a vital part of ensuring any final CBA, on which final policy decisions are taken, is as strong as possible. Any additional analysis will be based on the data available and consideration of several scenarios of potential consumer and firm behaviour. As such, it will necessarily be subject to uncertainties and assumptions.

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?

It is important to differentiate between misleading financial products today, which do not comply with current rules, and those that may not comply with the new rules when they come into force after an appropriate transition period. Once the rules are in force, we will have specific requirements that focus on sustainability. We cannot retrospectively apply our new proposed rules and guidance and it would be poor regulatory practice to seek to do so.

We have not to date had specific standards and expectations around what is and is not a sustainable investment in place. In that context, the material used by firms to describe the sustainability-related investment approaches for existing products should be 'clear, fair and not misleading'. Our proposals will set a clear bar for what constitutes a sustainable investment and put additional safeguards in place for sustainability-related claims.

We monitor the market now for signs of misleading sustainability-related claims (or 'greenwashing') in the context of current requirements. For example, in response to products making sustainability-related claims that did not meet our expectations when submitted to us for authorisation, we issued a letter[3] to Chairs of authorised fund managers in July 2021. This included 'Guiding Principles' on the design, delivery and disclosure of sustainable investment funds. We are carrying out a review of how firms are applying the principles. If we find that any firm has issued a misleading promotion about a financial product, based on the existing framework and our expectations in the Guiding Principles, we will take appropriate action.

[3] https://www.fca.org.uk/publication/correspondence/dear-chair-letter-authorised-esg-sustainable-investment-funds.pdf

We expect funds applying for authorisation under the current rules to meet robust standards when using sustainability-related terms.

Once the SDR and labelling rules come into force, we will use all of our tools including supervisory and enforcement action if there is evidence of serious misconduct, for example, if a firm has ignored a requirement to make any disclosures required by the rules; made misleading disclosures or misused a label; or breached our naming and marketing rules. To enable us to identify breaches, we will be undertaking proactive, targeted reviews of compliance.

We are also taking action in related areas to improve standards. Earlier this week we published our findings on where improvements are needed in ESG benchmarks.[4]

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?

Like many financial regulators, we have identified a particular need to set specific standards for sustainable investment products to ensure investors are not misled. That clarity does not exist now. As we set out earlier, sustainability means different things to different people and this market is evolving. So, it would not be correct to suggest that in each case in which a fund fails to qualify for a label that investors have been misled. Following extensive research, our proposals seek to provide common, agreed, and readily understood standards. If we receive evidence of firms failing to meet the expectations in place at the time, we will review it and we have our full regulatory toolkit available to us. However, standards are not retrospective, we have to consider conduct by the contemporary rules.

Our proposals look to a future in which consumers are better able to differentiate between products that have a genuine objective to seek positive sustainability outcomes from those that do not have such an objective but may nevertheless consider sustainability-related risks and opportunities or exclude certain types of assets. The package of measures that we're proposing – including the labels, disclosures and naming and marketing rules – will better evidence and communicate the sustainability credentials of investment products. This will help consumers to navigate the market, make informed investment decisions and build trust.

Under our current proposals, firms will have a year following introduction of our final rules to decide whether to use the labels or make the necessary changes to their naming and marketing to ensure these are proportionate to the sustainability profile of the product. We are listening to feedback about the length of the transition period. We believe that in the longer-term, more funds will use our labels. We will help them every step of the way.

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?

We need robust regulatory standards that raise the bar, protect consumers, and build a strong foundation for products to ensure the UK remains at the global forefront of sustainable investment.

By building consumers' trust, we expect the market for genuinely sustainable investment funds to grow. Critically if we did nothing, consumers' trust in this market will continue to be eroded, and there is a risk to the industry that investment would flow to other markets with more robust standards.

Any feedback that our approach is onerous compared to other jurisdictions should reflect on ongoing global developments and debate in different jurisdictions. There are tougher standards to tackle greenwashing emerging across the world. For example, since we published our Consultation, the European Securities and Markets Authority released a consultation on fund names using ESG or sustainability-related terms and the French Autorité des Marchés Financiers

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[4] FCA outlines where improvements are needed in ESG benchmarks | FCA

is proposing a targeted review of the Sustainable Finance Disclosure Regulation (SFDR) to include minimum environmental criteria.

We are working with industry to build a world-leading and competitive regime that will help the UK's asset management sector thrive by setting proportionate standards that will help improve consumers' understanding.

There is broad support internationally for the principle that firms should be clear about the sustainability characteristics of their funds, and we are committed to helping firms create a UK market that does so effectively. We are doing this by requiring standardised, reliable, and clear messaging about what different investment products do, and how firms monitor those products and claims.

The requirements build on the existing rules and expectations set out in the Guiding Principles in our Dear Chair letter and are designed to be compatible and complementary with requirements in other jurisdictions. There is a common thread throughout these developing rules, and we are leading efforts through IOSCO to help shape common expectations of regulatory standards.

We have been working carefully through the detailed written feedback to the consultation (around 240 responses). There is broad support for the proposals and direction of travel. We are reflecting on the feedback received on the detail of the proposals to identify where we may need to make changes to the final rules to ensure they are practical for firms while not undermining the outcomes of the regime. We will shortly publish an update on our work on our website.

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?

Our proposed labelling regime will only apply to UK domiciled funds at this stage. Under the current proposals, overseas funds which are permitted to market in the UK will be able to continue naming and marketing their products in the UK using their existing sustainability-related terms. Our proposals will simply require distributors to place a notice on the product to clarify to consumers that the product is not part of the UK labelling and disclosure regime. We therefore do not expect our proposals to impact consumers' choice.

We have started with proposals for UK-domiciled funds and portfolio management. However, we recognise that overseas funds are also an important part of the UK retail funds offering. We think it would be beneficial for consumers to have access to transparent and consistent disclosures that support them in understanding the sustainability credentials of all products marketed in the UK. We will continue to work with the Treasury, who have overall responsibility for the market access regime, to consider options for extending our proposals to overseas funds.

We are also looking closely at the UK market. In our Discussion Paper *Updating and improving the UK regime for asset management* we set out that we want to ensure that the UK remains an internationally attractive hub for asset management.[5] We want our rules to interact effectively with the requirements that firms are subject to in other jurisdictions. We do not want to create unnecessary complexity for firms operating their businesses internationally. We aim to ensure that our rules are consistent with international standards and take account of rules in other jurisdictions and best practice, so that firms can continue to operate efficiently on a global basis.

As noted above, there is a direction of travel towards improved standards in other jurisdictions. Compatibility and interoperability between regimes are, however, key and we are working to ensure that this is reflected in the final rules. It is also the case, however, that under the new regulatory framework in the UK there is an expectation that we determine standards independently in a manner that works for our consumers and markets and that we do not simply copy rules, for example, that have been adopted in the European Union.

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[5] DP23/2: Updating and improving the UK regime for asset management

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?

UK based funds are primarily distributed in the UK. We recognise however that firms are subject to sustainability-related disclosure requirements in other jurisdictions and we have therefore sought to remain compatible and complementary.

Firms will be able to leverage much of their investment for existing SFDR classifications. However, our requirements will in limited areas provide more clarity and robust criteria to complement the SFDR categorisation. With more clarity and robust criteria from the outset, we are seeking to avoid reclassifications further down the line as we have seen with SFDR in the EU.

We provided a mapping of our proposals to EU and US categorisations in our Consultation paper, and we will build on this in the Policy Statement. We are also giving firms time to implement the rules and we will work with industry during the implementation period.

I hope that this is helpful and thank you again for the Sub-Committee's engagement on our consultation.

Yours sincerely,

Nikhil Rathi

Nikhil Rathi
Chief Executive