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Consultation on Sustainability Disclosure Requirements (SDR) and investment labels

Insight Investment response

January 2023

BNY MELLON | INVESTMENT MANAGEMENT

Introduction

Insight Investment is one of the UK's largest investment managers, managing £654bn in assets, primarily for UK defined benefit pension funds, as well as insurers, sovereign wealth funds and financial institutions[1]. The majority of Insight's assets under management are in risk management solutions and fixed income.

Insight has been a proponent of responsible investment for many years and is a founding signatory of the Principles for Responsible Investment (PRI) in 2006. We welcome the FCA's consultation on sustainability disclosure requirements (SDR) and investment labels, and support its aims to make the UK a trusted centre for sustainable investment, protect consumers and provide a strong foundation for sustainable investment products.

We broadly support the principle of labelling products according to their sustainability objectives to protect retail investors from the risk of greenwashing. We highlight below the key themes in our response to this consultation:

- **The restrictive nature of the proposed labels may lead to the unintended consequences of increasing liquidity risk for these retail funds, and systemic risk in the market overall.** The universe of assets that will be eligible under the sustainable focus and sustainable impact categories for certain asset classes, such as fixed income, could be very narrow and lead to highly concentrated portfolios. This may lead to firms compromising on the liquidity profile of the assets to meet the labelling requirements. Since retail products typically require daily liquidity, this could increase liquidity risk for investors and therefore potentially increase overall systemic risk, working against the FCA's objectives to protect retail investors, and general policymakers' objective to address overall liquidity, financial stability, and systemic risk.
- One approach to address the above concern would be to reconsider the mutual exclusivity nature of the labels. **Three mutually exclusive sustainability labels could introduce significant problems for certain asset classes such as fixed income. One all-encompassing 'sustainable' label, with firms disclosing their allocation to assets currently proposed as eligible for the sustainable focus, impact and improvers categories, would be preferable.** This would allow for a wider universe of assets to be permitted within portfolios, addressing the liquidity risk concerns mentioned above. Furthermore, many currently available fixed income products with sustainability features are a combination of the three proposed approaches and would therefore not bear any label under the current proposals; we believe this would not be desirable for retail investors either.
- **Stewardship, implemented through engagement with issuers, is important – but mandating such activity at asset or product-level is problematic.** Stewardship may not be necessary to achieve sustainability outcomes, and an excessive emphasis on stewardship may lead to engagement as a box-ticking exercise. Perhaps most importantly, the relevance, effectiveness and practicalities of stewardship activity will differ according to market and asset class. We therefore believe an asset manager should have discretion to determine how and when to engage in stewardship activity.
- **The additionality condition for impact funds is unworkable for liquid assets.** The narrow focus on the financing of new projects rules out investments that would otherwise be considered as encouraging a positive impact: for example, green bonds that partially re-finance wind farms. The condition would mostly limit permitted investments to private equity and private debt, which are typically not liquid enough to be suitable for a product sold to retail investors. We question whether any products might qualify for this category as currently proposed.
- **Prohibiting the use of specific words in marketing materials is too prescriptive.** As long as words are used factually and in line with the anti-greenwashing requirements of clear, fair and not misleading manner, we believe they should be permitted. We agree with the proposals regarding fund names, except for the proposed prohibition of the term 'responsible': the term is well recognised with a clear market-standard definition established by the PRI, and

[1] As at 31 December 2022. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. Figures shown in GBP. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Insight Investment International Limited (IIIL), Insight Investment Management (Europe) Limited (IIMEL) and Insight North America LLC (INA), each of which provides asset management services.

there are many products for which the term would be helpful in describing their approach. It is sufficiently different to 'sustainable' that, alongside accurate marketing, it should not introduce confusion for investors.

- **We do not support mandatory sustainability disclosures for all funds.** It is unlikely to be helpful for investors, could introduce confusion, and would likely lead to increased costs for firms and therefore investors.
- **Defining how sustainability outcomes should be achieved (through the definition of 'primary' and 'secondary' channels) is too prescriptive.** There can be different ways to achieve the sustainability objective of an investment strategy; we believe this should be at the discretion of an asset manager.

Finally, we would note that the rules will operate in parallel with other existing or proposed rules, including the EU's Sustainable Finance Disclosure Regulation (SFDR) and the labelling regime being considered by the European Securities and Markets Authority (ESMA). Alignment between SDR and other such regimes would help to minimise unnecessary costs and potentially increase the impact of such initiatives.

Overarching questions

Q1. Do you agree with the proposed scope of firms, products and distributors under our regime? If not, what alternative scope would you prefer, and why?

We agree with the scope being focused on protecting retail investors.

We note that as the industry implements the labelling and the anti-greenwashing rules, these rules may inadvertently also be applied to strategies managed for institutional investors as distributors and other intermediaries seek to minimise related risks.

We wish to confirm that that non-UK domiciled funds, with portfolio management delegated to the UK, are not in scope of these rules.

We look forward to the further consultation on how these proposals might apply to overseas products, as clarity in this area will be important for many asset managers. Many funds marketed to UK retail investors are domiciled in Europe. We note that ESMA is also consulting on a sustainability label regime for funds. We are concerned about the practicalities of applying two conflicting sustainability labelling regimes to the same funds, and as such we request the FCA be flexible in its approach to the rules on overseas funds in its upcoming consultation.

Q2: Do you agree with the proposed implementation timeline? If not, what alternative timeline would you prefer, and why?

Yes. If the publication of the final rules is delayed, we would call for the deadlines within the proposed rules to be pushed back accordingly.

We also note that it will take time for the International Sustainability Standards Board (ISSB) standards to be finalised and for corporates to adopt them, which could cause data gaps. We believe it is important that the corporate issuer climate disclosures are required before the implementation of the SDR regime.

Q3: Do you agree with the proposed cost-benefit analysis set out in Annex 2. If not, we welcome feedback in relation to the one-off and ongoing costs you expect to incur and the potential benefits you envisage.

No comment.

Q4: Do you agree with our characterisation of what constitutes a sustainable investment, and our description of the channels by which positive sustainability outcomes may be pursued? If not, what alternatives do you suggest and why.

We broadly support the principle of labelling products according to their sustainability objectives.

Potential unintended consequence of increased liquidity risk for retail investors, and systemic risk for the market overall

We understand the high bar set by the FCA for these labels can be appealing, particularly in addressing any risk of greenwashing and protecting retail investors. However, we are concerned this may lead to the unintended consequence of increasing liquidity risk for these funds, and therefore the systemic risk in the market overall.

The universe of assets that will be eligible under the sustainable focus and sustainable impact categories in particular for certain asset classes, such as fixed income, could be very narrow, and lead to highly concentrated portfolios. This may lead to firms compromising on the liquidity profile of the assets to meet the labelling requirements. Since retail products typically require daily liquidity, this could increase liquidity risk for investors, and therefore potentially increase systemic risk in the market overall. This would work against the FCA's objectives to protect retail investors, and general policymakers' objective to address overall liquidity, financial stability, and systemic risk.

Defining primary and secondary channels is too prescriptive

We do not agree with the proposed hierarchy of mechanisms to achieve sustainability outcomes via primary and secondary channels. There can be different ways to achieve the sustainability objective of an investment strategy; we believe this should be at the discretion of an asset manager and not be overly prescribed.

Asset manager discretion is necessary for effective stewardship practices

Under the current proposals, products bearing any of the proposed labels have a requirement to engage in stewardship activity. Products in the 'sustainable improvers' category have stewardship as a primary channel for sustainability outcomes, while products within the 'sustainable focus' and 'sustainable impact' categories have stewardship as a secondary channel.

As long-term investors and stewards of our clients' capital, we believe in investing responsibly and engagement is a central pillar of delivering our stewardship responsibilities. It is our most direct way of understanding and influencing the institutions we invest in on behalf of our clients. By ensuring an effective dialogue with issuers we aim to protect and enhance investment returns and seek to help secure the delivery of client outcomes.

We therefore support the importance that the FCA poses on stewardship. However, we note some problems below if stewardship was made into a regulatory requirement, either at an asset, or product level.

- **'Active investor stewardship and engagement' may not be necessary to achieve a sustainability outcome for products in any of the categories.** As stated in the consultation document, this is a channel that "may plausibly contribute" to such an outcome, but the need for stewardship activity to achieve the sustainability objectives may vary. For example, many assets within sustainable focus and sustainable impact categories may meet sustainability objectives, and assets in the sustainable improvers category may show improvement, without the need for engagement.
- **An excessive emphasis on stewardship activity in the rules could lead to engagement as a box-ticking exercise.** This could unnecessarily increase the time and costs of managing these strategies without any increase in the probability of achieving the targeted sustainability outcome.
- **Improvement within such products can be demonstrated by relevant key performance indicators** without having to engage in stewardship activity.
- **The requirements do not reflect that the relevance, effectiveness and practicalities of stewardship activity will differ according to market and asset class.** For example, equity investors can influence an entity's decisions through shareholder voting, a mechanism unavailable to fixed income investors. Also, fixed income portfolios are typically more diversified than equity portfolios, meaning they cover a higher number of entities, potentially including private and sovereign issuers – meaning that engaging in stewardship activity across the portfolio as a whole can be more challenging. Therefore, for fixed income portfolios, stewardship is likely to be targeted for the firms where a manager believes is likely to make the greatest impact, for others there will be a greater reliance on KPIs and the initial selection of issuers and their commitments.

Given the above issues, we would argue that while stewardship is important to encourage overall at an entity level, it should not be mandated at a portfolio level or product level in any of the categories. We believe an asset manager should have discretion to determine when best to engage with entities within its investment universe in pursuit of a sustainability outcome. We also note that most UK asset managers are signatories to the UK Stewardship Code, which already sets a high standard for stewardship at an entity level.

Finally, we would note that it is very difficult to demonstrate a direct causal link between an asset manager's investment activities and a real-world positive outcome; so we believe such links can be drawn on the basis of plausibility, rather than requiring clear evidence of direct causality.

Clarification needed on 'unexpected investments'

We believe 'unexpected investments' should be more clearly defined. It is difficult for asset managers to assess what consumers may consider unexpected and leaving asset managers to determine this independently will create inconsistencies in approach and introduces potential for confusion. A failure to define unexpected investments could lead asset managers to define a large share of holdings as unexpected to guard against accusations of greenwashing.

Q5: Do you agree with the proposed approach to the labelling and classification of sustainable investment products, in particular the emphasis on intentionality? If not, what alternatives do you suggest and why?

We agree with the concept of intentionality within the regime, which helps communicate to clients and consumers that intended social or environmental outcomes may not be guaranteed or certain under all circumstances. Intentionality allows the manager to demonstrate 'best efforts' in attaining these objectives, while the proposed qualifying criteria provide protection against greenwashing.

We do not agree with the concept of primary and secondary channels and the requirement for stewardship activity, as explained in our answer to Question 4.

While the mutual exclusivity of the labels can be helpful for understanding the labels, it also causes significant issues for the following reasons:

1. Many products with sustainability features, particularly in fixed income, are a combination of the three approaches and would therefore not bear any label under the current proposals.
2. The categories would unduly restrict portfolio construction in fixed income markets likely leading to very high concentration of certain investments and issuers. Many fixed income funds invest in assets that are eligible for a combination of the sustainable focus, sustainable impact and sustainable improvers categories, and this is necessary to ensure the portfolios remain diversified and liquid. Fixed income portfolios that align with only one of the categories are likely to exhibit elevated credit risk due to high concentration in a limited number of issuers, and increased liquidity risk as firms may compromise on the liquidity profile of assets to widen the universe of eligible assets available for investment. This would work against the FCA's objective to protect retail investors, and general policymakers' objective to address overall liquidity, financial stability, and systemic risk.
3. Assets in a 'sustainable improvers' product would not qualify for inclusion in the portfolio once the improvement is complete – leading to a counterintuitive incentive for managers to maintain investments in holdings that are slower to improve.

We propose that funds with a combination of assets currently eligible for the sustainable focus, sustainable impact and sustainable improvers categories should be permitted to receive an all-encompassing 'sustainable' label, so long as the total eligible assets amount to at least 70% of the portfolio. This can be achieved by having one 'sustainable' label, with the requirement to disclose a breakdown of portfolio holdings, highlighting the eligibility of assets according to the sustainable focus, sustainable improvers, or sustainable impact categories. Importantly, this would help address the potential unintended consequences of increased liquidity and systemic risks highlighted in our response.

We note that investors' sustainability preferences are often diverse. Allowing for a degree of flexibility in portfolio construction, while adhering to clearly defined criteria for the three categories, would allow managers to better match a portfolio with a client's specific sustainability preferences – avoiding some of the pitfalls of overly prescriptive/narrow rules, such as those in the EU SFDR.

Q6: Do you agree with the proposed distinguishing features, and likely product profiles and strategies, for each category? If not, what alternatives do you suggest and why? In particular, we welcome your views on:

a. Sustainable Focus: whether at least 70% of a 'sustainable focus' product's assets must meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme?

Comments on threshold for sustainable holdings

We do not have a strong view on the actual percentage required for products with a 'sustainable focus' label providing it is material, however we note that ESMA is also consulting on a sustainable labelling regime in Europe and we are keen that there is alignment in the percentages required between the two regimes. This will be particularly important when the FCA consults on the overseas fund regime.

We note that the ESMA consultation proposes that 50% of the portfolio would need to meet the EU SFDR sustainable investment definition for a fund to receive a sustainable-related label. This is a lower threshold than the 70% put forward in the FCA's SDR consultation.

Practically, we believe that any percentage should be calculated based on the non-cash assets within a portfolio and on a weighted basis.

We question the 90% requirement for portfolio management to qualify for such a label versus 70% requirement for funds. We believe the portfolio management product threshold should also align to the same 70% threshold. Where a portfolio management product invests into a fund with a sustainable label, this could be calculated by looking through to the underlying fund to avoid a dilution in the sustainability of the underlying investments (for example, if a portfolio holds 70% of its assets in sustainable funds which themselves invests in assets that meet the 70% requirement, the result would be a 49% allocation to assets that qualify for the description of that label). Where a firm may not have up to date underlying fund data, then a reasonable assumption should be made for estimating this.

"Credible standard" needs clarification

We are concerned that this category would need at least 70% of assets to meet a "credible standard" of sustainability, or align with a specified environmental and/or social sustainability theme, but there is a lack of clarity around what might qualify as a credible standard in the absence of the UK Green Taxonomy. We believe that until the Taxonomy is ready, there is unlikely to be another credible standard that is "robust, independently assessed, evidence-based and transparent".

Clarification will be needed as to the minimum expectations of such a standard and the treatment of existing market-led standards (e.g. ICMA guidance). It would also be helpful to have examples of credible standards, and case studies to demonstrate how they might be employed in both thematic and non-thematic products. We note that the only examples provided in the consultation were for thematic cases.

b. Sustainable Improvers: the extent to which investor stewardship should be a key feature; and whether you consider the distinction between Sustainable Improvers and Sustainable Impact to be sufficiently clear?

We support stewardship requirements at a firm level, however we note several problems with a requirement to engage in stewardship activity at a product or asset level as set out in our answer to Question 4.

To reiterate these, we do not think that stewardship should be specifically required or mentioned in the objective for products in this category. While stewardship activity has an important role to play, it may not be required to achieve a stated sustainability objective.

To supplement these points, we would also note the following:

- The composition of a portfolio will change over time as assets are sold and bought, presenting challenges in demonstrating improvements through KPIs over a set reporting period.
- Stewardship activity typically aims to achieve positive outcomes over the long term, and it can therefore be challenging to demonstrate improvements over shorter, set reporting periods such as 12 months; there may even be temporary deterioration over shorter periods before an issuer improves.
- In some circumstances, portfolio-level targets may be more appropriate than issuer-level targets. For example, a targeted reduction in portfolio-level carbon emissions over time could be achieved without all issuers doing so. It can be very difficult to demonstrate a direct causal link between an asset manager's investment activities and a real-world positive outcome; so we believe such links can be drawn on the basis of plausibility, rather than requiring clear evidence of direct causality.

  We would note that a requirement to disclose details on specific stewardship activity and outcomes can create tensions between the issuer and investor. We therefore believe anonymous examples of portfolio-level reporting may be a more appropriate reporting expectation of stewardship activities.

c. Sustainable Impact: whether 'impact' is the right term for this category or whether should we consider others such as 'solutions'; and the extent to which financial additionality should be a key feature?

Proposed additionality could be too restrictive for retail products

We are concerned about the narrow focus on the financing of new projects only. This 'additionality' condition will rule out investments that would otherwise be considered as encouraging a positive impact: for example, green bonds that partially re-finance wind farms.

The additionality condition would also mostly limit permitted investments for products in this category to private equity and private debt, which are typically not liquid enough to be suitable for a product sold to retail investors.

Assets traded on secondary markets, which are typically more liquid and more suitable for products sold to retail investors, are unlikely to be eligible for products in this category as they typically will not meet the additionality condition. As a result, we question whether any products might qualify for this category as currently proposed.

We note that existing international standards on impact investing put together by the Global Impact Investing Network (GIIN) does not limit it to the financing of new projects only. Having different definitions for impact introduces potential for confusion.

Separately, more guidance is needed on how to avoid "unintended negative environmental or social impacts" when selecting assets.

Comments on threshold for sustainable impact category

We believe clarification is required as to the minimum proportion of assets in a portfolio to align with the impact definition for this category. We note that ESMA is consulting on a sustainability labelling regime in Europe; we believe it would be beneficial for the thresholds of the UK and EU regimes to be aligned.

Q7: Do you agree with our proposal to only introduce labels for sustainable investment products (ie to not require a label for 'non-sustainable' investment products)? If not, what alternative do you suggest and why?

We agree that there is no need for a label for 'non-sustainable' products, particularly given the proposed thresholds are high for the proposed sustainability labels. We also believe it could introduce confusion for investors to label products based on what they are not doing. We also support the proposal that there should be no hierarchy between the labels.

We do not believe that the term 'responsible' should be prohibited for products that do not use a sustainability label, as we explain in our response to Question 21.

As explained in our answer to Question 5, we propose that funds with a combination of assets currently eligible for the sustainable focus, sustainable impact and sustainable improvers categories should be permitted to receive an all-encompassing 'sustainable' label, so long as the total eligible assets amount to at least 70% of the portfolio. One way to achieve this would be to have one 'sustainable' label, with the requirement to disclose a breakdown of portfolio holdings, highlighting the eligibility of assets according to the sustainable focus, sustainable improvers, and sustainable impact categories.

Q8: Do you agree with our proposed qualifying criteria? If not, what alternatives do you suggest and why? In your response, please consider:

• whether the criteria strike the right balance between principles and prescription

There can be different ways to achieve the sustainability objective of an investment strategy, and we believe this should be at the discretion of an asset manager and not be overly prescribed. As explained in our response to Question 4, we do not agree with the proposed hierarchy of mechanisms to achieve sustainability outcomes via 'primary' and 'secondary' channels; there are challenges in particular with prescribing stewardship activity, as we also explain in our response to Question 4.

• the different components to the criteria (including the implementing guidance in Appendix 2)

1 Sustainability objective

No comment.

2 Investment policy and strategy

No comment.

3 KPIs

Using KPIs to measure progress against a sustainability objective can be appropriate, but we would note that more KPIs are available for measuring progress relative to environmental objectives than for social objectives – meaning such a requirement is likely to encourage more products focused on the former. Also, for portfolios with higher turnover, KPIs can become less relevant.

4 Resource and governance

There are data gaps in many markets and asset classes beyond large-cap equities. Addressing these gaps may present challenges for asset managers, especially those with limited resources, and could in turn lead to increased costs for investors.

5 Investor stewardship

As noted in our response to Question 4, we support a broad expectation for asset managers to have robust stewardship policies at a firm-wide level. We would also note that it is very difficult to demonstrate a direct causal link between an asset manager's investment activities and a real-world positive outcome; so we believe such links can be drawn on the basis of plausibility, rather than requiring clear evidence of direct causality.

• whether they sufficiently delineate the different label categories, and;

No comment.

• whether terms such as 'assets' are understood in this context?

No comment.

Q9: Do you agree with the category-specific criteria for:

• The 'Sustainable focus' category, including the 70% threshold?

Please see refer to our response to question 6(a) above.

• The 'Sustainable improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?

Please refer to our response to question 6(b) above.

• The 'Sustainable impact' category, including expectations around the measurement of the product's environmental or social impact?

Please refer to our response to question 6(c) above.

Please consider whether there any other important aspects that we should consider adding.

No comment.

Q10: Does our approach to firm requirements around categorisation and displaying labels, including not requiring independent verification at this stage, seem appropriate? If not, what alternative do you suggest and why?

We agree that independent verification should not be required; we note that this would increase costs, which would ultimately be borne by investors.

Internal compliance processes, along with the supervisory powers of the FCA, should be sufficient to ensure labels are implemented as required. Firms can choose to adopt third-party verification on a voluntary basis, should they choose.

We support the requirement for asset managers to use the relevant graphics created by the FCA for the labels.

Q11: Do you agree with our proposed approach to disclosures, including the tiered structure and the division of information to be disclosed in the consumer-facing and detailed disclosures as set out in Figure 7?

We do not support the requirement to produce consumer-facing disclosures for all funds regardless of whether they have a sustainability label.

Where possible, we would like to encourage alignment with SFDR requirements on pre-contractual and post-contractual information, as asset managers will have typically already established systems and processes for overseas funds that could be adapted for UK funds.

Q12: Do you agree with our proposal to build from our TCFD-aligned disclosure rules in the first instance, evolving the disclosure requirements over time in line with the development of future ISSB standards?

Yes. We broadly support alignment with international standards, including the ISSB standards.

Q13: Do you agree with our proposals for consumer-facing disclosures, including location, scope, content and frequency of disclosure and updates? If not, what alternatives do you suggest and why?

We do not support the proposal that an additional document should be created that applies to all funds outlining whether the fund has a sustainability label, sustainable goals, metrics and approaches and unexpected investments.

The majority of funds will not a receive a label and most would put ‘not applicable’ against these categories. This is not useful information for investors but would lead to increased costs for asset managers.

We believe ‘unexpected investments’ should be more clearly defined. It is difficult for asset managers to assess what consumers may consider unexpected, and leaving asset managers to determine this independently will create inconsistencies in approach and introduces potential for confusion. A failure to define unexpected investments could lead asset managers to define a large share of holdings as unexpected to guard against accusations of greenwashing.

Q14: Do you agree with the proposal that we should not mandate use of a template at this stage, but that industry may develop one if useful? If not, what alternative do you suggest and why?

Yes. Given that a template has already been mandated by SFDR, asset managers may wish to use this as a starting point and adapt it to align with the final SDR rules.

Q15: Do you agree with our proposals for pre-contractual disclosures? If not, what alternatives do you suggest and why. Please comment specifically on the scope, format, location, content and frequency of disclosure and updates.

Yes, we are broadly in agreement with these proposals.

Q16: Do you agree with our proposals for ongoing sustainability-related performance disclosures in the sustainability product report? If not, what alternative do you suggest and why? In your response, please comment on our proposed scope, location, format, content and frequency of disclosure updates.

We support this being built on the TCFD product report.

We support the reporting of sustainability-related disclosures for products using a sustainability label. However, we are concerned about the FCA's longer-term goal to require this for all products: it is unlikely to be helpful for investors, could introduce confusion, and would likely lead to significant increased costs for asset managers and therefore investors.

Q17: Do you agree with our proposals for an 'on demand' regime, including the types of products that would be subject to this regime? If not, what alternative do you suggest and why?

Yes, we support this proposal for on-demand disclosure requirements from clients once a year. To avoid undue complexity in responding to requests from different clients at different times through the year, we believe it would be beneficial to align this with one of the current periodic reports currently provided under FCA's COBS rules.

It would also be beneficial for allowance to be made for single-client funds to be treated in a similar manner.

Q18: Do you agree with our proposals for sustainability entity report disclosures? If not, what alternatives do you suggest and why? In your response, please comment on our proposed scope, location, format, content, frequency of disclosures and updates.

We support the entity-level reports being built on the TCFD entity-level disclosures. We also support the FCA's proposal that it does not adopt a regime similar to the principal adverse impact regime under SFDR.

Q19: Do you agree with how our proposals reflect the ISSB's standards, including referencing UK-adopted IFRS S1 in our Handbook Guidance once finalised? If not, please explain why?

No comment.

Q20: Do you agree with our proposed general 'anti-greenwashing' rule? If not, what alternative do you suggest and why?

Yes. However, we note that the anti-greenwashing rules would come into effect immediately, before the sustainability labels regime. We would welcome clarification from the FCA that the labelling regime does not inadvertently come into effect earlier than intended as a result of the anti-greenwashing rules.

Q21: Do you agree with our proposed product naming rule and prohibited terms we have identified? If not, what alternative do you suggest and why?

We believe the term 'responsible' should not be prohibited from being used in a product name. There are many products that do more than simple integration of ESG risks and characteristics in their approach (as acknowledged in the consultation paper – see section 2.3), but these would not meet the high bar required for the proposed sustainability labels. An example of this is products that include strategies that invest in 'best-in-class' entities, as measured by ESG ratings.

We believe the term 'responsible' would be helpful in describing some of these products, and is sufficiently different to 'sustainable' that it would not introduce confusion for investors. We note that the term 'responsible' is widely adopted and there is pre-existing guidance (e.g. from the PRI). We therefore believe it would not be in investors' interests to restrict the ability of asset managers to use this term.

Q22: Do you agree with the proposed marketing rule? If not, what alternative do you suggest and why?

We agree with the proposals regarding fund names, with the exception of the proposed prohibition of the term 'responsible', as explained in our response to Question 21.

However, we do not think any words should be prohibited from use in marketing and other product literature. Restricting the use of specific words may hinder asset managers' ability to communicate effectively to investors. As long as words are used in a clear, fair and not misleading manner we believe they should be permitted. Many words are already widely used in product literature without any association with sustainability, such as the word 'impact'; and as all investment products have governance rules and processes in place, the term 'governance' would be difficult to avoid.

As noted in our response to Question 21, there will be funds that do not qualify for sustainability labels but that do more than simple ESG integration (as acknowledged in the consultation paper, section 2.3). Asset managers should be able to explain these funds in a factual manner and prohibiting the use of certain words in marketing and product literature could impede this. Firms will already be subject to the anti-greenwashing rules which will require any description to be clear, fair and not misleading.

Removing the prohibition of words to be used in marketing materials will bring this in line with the ESMA consultation on sustainability fund labelling regime.

Finally, it would be helpful to have a definition for 'marketing materials'.

Q23: Are there additional approaches to marketing not covered by our proposals that could lead to greenwashing if unaddressed?

No comment.

Q24: Do you agree with our proposals for distributors? If not, what alternatives do you suggest and why?

We agree with the proposals and acknowledge that they build on existing requirements in the FCA's Product Intervention and Product Governance Sourcebook (PROD) rules.

We would like to stress the need for distributors to make timely disclosures to asset managers on the ability of different client types to access the relevant products.

Q25: What are your views on how labels should be applied to pension products? What would be an appropriate threshold for the overarching product to qualify for a label and why? How should we treat changes in the composition of the product over time?

As explained in our answer to Question 5, while the mutual exclusivity of the labels can be helpful for understanding the labels, it also causes significant issues.

We propose that funds with a combination of assets currently eligible for the sustainable focus, sustainable impact and sustainable improvers categories should be permitted to receive an all-encompassing 'sustainable' label, so long as the total eligible assets amount to at least 70% of the portfolio. One way to achieve this would be to have one 'sustainable' label, with the requirement to disclose a breakdown of portfolio holdings, highlighting the eligibility of assets according to the sustainable focus, sustainable improvers, and sustainable impact categories.

A 90% requirement for a portfolio management arrangement may be appropriate if the underlying investments are themselves sustainable funds rather than direct investments; this is to avoid a dilution in the sustainability of the underlying investments (for example, if a portfolio holds 70% of its assets in sustainable funds which themselves invests in assets that meet the 70% requirement, the result would be a 49% allocation to assets that qualify for the description of that label) .

We believe products that do not meet the 90% threshold, and therefore do not qualify for a sustainability label, should still be permitted to publicise their percentage allocation to sustainable portfolios and/or investments.

Changes over time should be treated by allowing to apply an average of quarterly allocations over a certain period, such as one year.

Q26: Do you consider the proposed naming and marketing rules set out in Chapter 6 to be appropriate for pension products (subject to a potentially lower threshold of constituent funds qualifying for a label). If not, why? What would be an appropriate threshold for the naming and marketing exemption to apply?

Please refer to our response to Question 22.

Q27: Are there challenges or practical considerations that we should take into account in developing a coherent regime for pension products, irrespective of whether they are offered by providers subject to our or DWP's requirements?

We believe the regulation should take account of the fact that sub-funds may only periodically publish details on sustainable holdings, leading to a potential time lag.

Q28: To what extent would the disclosures outlined in Chapter 5 be appropriate for pension providers ie do you foresee any challenges or concerns in making consumer-facing disclosures, pre-contractual disclosures and building from the TCFD product and entity-level reports?

Please refer to our responses to Questions 16 and 18.

Q29: Do you agree that the approach under our TCFD-aligned product-level disclosure rules should not apply to products qualifying for a sustainable investment label and accompanying disclosures? Would it be appropriate to introduce this approach for disclosure of a baseline of sustainability-related metrics for all products in time?

No comment.

Q30: What other considerations or practical challenges should we take into account when expanding the labelling and disclosures regime to pension products?

As noted in our response to Question 27, we believe the regulation should take account of the fact that sub-funds may only periodically publish details on sustainable holdings, leading to a potential time lag.

Q31: Would the proposals set out in Chapters 4-7 of this CP be appropriate for other investment products marketed to retail investors such as IBIPs and ETPs. In your response, please include the type of product, challenges with the proposals, and suggest an alternative approach.

No comment.

Contact

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