PRI Principles for Responsible Investment

CONSULTATION RESPONSE

FCA SUSTAINABILITY DISCLOSURE REQUIREMENTS AND INVESTMENT LABELS

25 January 2023

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To inform this briefing, the following investor group has been consulted: PRI Global Policy Reference Group. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing]

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ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the Financial Conduct Authority's (FCA's) consultation on its proposals for Sustainability Disclosure Requirements (SDR) and investment labels.

ABOUT THIS CONSULTATION

The PRI is responding to the FCA's consultation on Sustainability Disclosure Requirements (SDR) and investment labels which is designed to bring regulatory clarity on its approach to greenwashing, whilst also increasing transparency and trust in sustainable investing. The FCA has developed a package of measures, ranging from sustainable investment labels, disclosure requirements, an anti-greenwashing rule, and restrictions on the use of sustainability-related terms in product naming and marketing. The proposals build on earlier views set out in the FCA's DP21/4, published in November 2021.

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INTRODUCTION

The PRI is broadly supportive of the Financial Conduct Authority's (FCA) package of measures (the Proposal or Proposals), which puts beneficiary choice at the core. The FCA's Proposal has built on previous approaches, including the FCA's ESG Strategy, DP21/4 (which set out initial views on disclosure requirements ahead of this consultation), and the Business Plan. The PRI supports a whole-of-industry approach to achieving a sustainable financial system. This approach also necessitates incorporating the future ISSB standards and a sustainable finance taxonomy to provide appropriate tools and standards against which to measure disclosures.

Links with the UK Green Finance approach

The Proposals are framed through the lens of consumer protection and respond to consumers' expectation to understand their products' impact on the broader environment – both positive and negative - by offering clear and consistent investment product labels. Furthermore, the Proposals support implementation of the UK government's first phase of the Greening Finance Roadmap: informing investors and consumers. The UK market has seen delays on all key elements of the roadmap. This delay fails to deliver the necessary framework and policy signals to investors. The prerequisite of a leading green financial centre is a regulatory environment that encourages and enables alignment towards net zero and sustainable economic development. This must be supported by an equally ambitious, whole-of-government approach on the economic transition.

The role of financial regulation in supporting sustainability objectives

To ensure that financial flows support the UK's ambition to make its financial sector sustainable, the UK Government needs to set out a clear delivery plan for the transition of the real economy and financial services, with credible sectoral roadmaps. This approach must be underpinned by the near-term policies, actions and milestones needed to shift financial flows towards net zero, while considering socio-economic issues. The PRI, the Institutional Investors Group on Climate Change (IIGCC), and the UK Sustainable Investment and Finance Association (UKSIF) recently wrote a letter to the UK government to uphold the net zero ambition. Within this letter, we outline that the starting point must be policies that transform the real economy, prioritising sectors whose transition will contribute most to the UK's economic, social and climate goals and sending the right policy signals to investors. This needs to be mirrored by the implementation of the UK's updated Green Finance Strategy and delivering on the COP26 commitment for the UK to become the world's first net zero aligned financial centre.

The UK government is responsible for regulating and reorienting with the real economy towards a sustainable, just transition, including on the role that specific sectors linked with high emissions should have in this process. However, it remains unclear how the FCA's proposals deal with concerns that harmful investments are included in funds that are branded as sustainable. Investments in activities that are not yet sustainable should only be allowed when there is a credible stewardship strategy to address negative outcomes. Through the vantage points of consumer protection and upholding the broader net zero ambition, a mechanism that would discourage the inclusion of investments with negative environmental or social impacts is imperative, similar to the introduction of the "Do No Significant Harm" principle in the EU.

The interconnectedness of sustainable finance policies and disclosure regulations

The FCA's framework for disclosures must be supported by equally ambitious action and policy steers from UK Government to establish a sustainable financial system in the UK. As the demand for sustainable investment has grown rapidly, an integrated framework for decision-useful disclosures across the economy is a natural next step for a sustainable financial system.

As indicated in the PRI's Policy Engagement Handbook, policy reforms relating to sustainable finance and the alignment of financial flows with sustainability goals are becoming mainstream. Sustainable finance policy reform was once treated as an optional consideration. It is now a key objective. Policies addressing corporate disclosures still represent the largest portion, but many sustainable finance policies now govern investor duties and disclosures, taxonomies or broader strategies, including industrial transition in alignment with the Paris Agreement and sector-specific policies. Investors have a clear interest in ensuring that these measures are effective, efficient, support sustainable financial returns and deliver clear social and environmental benefits. Therefore, SDR has a key role in clarifying the cases where the UK's legal framework permits or requires investors to pursue sustainability objectives, to accelerate the transition to a sustainable financial system.

The FCA's proposals are an important step forward for the industry; they create a framework that complements existing ESG investment approaches. The rules should be consistent and usable for investors, and regulators should be able to assess sustainability claims.

KEY RECOMMENDATIONS

The PRI welcomes the FCA's proposals. The FCA's approach marks the first step in progressing the UK Government's Greening Finance: A Roadmap to Sustainable Investing strategy. SDR support the first phase of this strategy: informing investors and consumers. SDR play a crucial role in enabling the flow of comparable and decision-useful information on the extent to which economic activities are sustainable.

SDR are intended to be the main regulatory tool to substantiate sustainability claims and disclosures against evidence and minimum safeguards. The FCA aims to improve how markets function by increasing the accountability of sustainable products and entities, while also reducing risks of greenwashing.

The PRI's key recommendations are listed below.

- All fund managers should **have an obligation to take relevant ESG factors into consideration** in accordance with their legal duties and should **disclose how they integrate ESG factors** in their risk management process.
- In addition, all investors who make specific sustainability-related claims should disclose their objectives, approaches and strategies for each fund, against an evidence-based sustainability performance benchmark to assess sustainability claims, such as **a robust and science-based sustainable finance taxonomy**, as was initially envisaged in the 2021 Greening Finance Roadmap**.**
- Any specific sustainability categorisation through labels should be consistent with the related disclosures and measures against the same benchmark.
- The FCA's proposals need **to better reflect the UK's climate targets,** including the commitment to net zero by 2050, the successive Carbon Budgets, and pathways to limiting global warming to 1.5C in line with the Paris Agreement objectives**.**
- A '**Do No Significant Harm' principle** for all labelled funds should developed **in conjunction with a sustainable finance taxonomy** and incorporated into SDR. Investments which are not aligned with sustainability goals would be acceptable in labelled funds only if the fund has a **credible stewardship strategy** to bring those investments into alignment with sustainability goals over a certain time frame.
- The FCA should undertake work to **provide guidance on relevant key performance indicators (KPIs)** and **develop minimum levels of criteria** to meet.
- **Global alignment** is necessary to ensure market efficiency and comparability across markets and products. Therefore, we recommend the FCA considers future developments in the EU and other capital markets to guide next steps on these regulatory developments.
- Entity-level reporting should be aligned with the **International Sustainability Standards Board** (**ISSB)** soon after SDR comes into force, and product-level reporting should be **updated to include ISSB metrics** once available.
- We support an initial **Taskforce on Climate-Related Financial Disclosure (TCFD) aligned approach** at entity-level, but this should be quickly strengthened through **adoption of ISSB-aligned entity-level reporting requirements** under SDR.

DETAILED RESPONSE

Question 1: 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?

Yes. In addressing disclosure, labelling, and marketing rules, the FCA is taking a holistic approach by establishing categories that relate to the range of ways that investors can contribute to sustainability outcomes. With consistent and clear investment product labels, further supported by an anti-greenwashing rule, the FCA is well positioned to achieve their aims of preventing misleading sustainability claims. As a global organisation, we would encourage the FCA to follow up with proposals related to overseas products at pace.

Question 2: Do you agree with the proposed implementation timeline? If not, what alternative timeline would you prefer, and why?

The climate and socio-economic crises require accelerated action on climate change and sustainable investment. The proposed consultation and finalisation period is sufficient. Giving firms one reporting cycle to implement these rules will help onboarding the new processes. We support the anti-greenwashing rule coming into force as soon as the policy statement is released, which offers an additional layer of security and sets the foundations for a clear direction of travel.

The FCA's proposals support the UK government's first phase of the Greening Finance Roadmap, informing investors and consumers. However, we recommend coordination between the FCA and the UK government on the implementation of regulation and disclosure requirements for companies. Careful consideration of sequencing is key to facilitating the flow of information across the investment chain. The FCA's regulation should move in tandem with proposals for a green taxonomy in the UK, which will offer greater transparency on the alignment of economic activities with the UK's climate objectives. A joined-up approach will create a strong framework for a sustainable financial system with aligned policy steers.

In the EU, for example, investors have found it challenging to comply with SFDR reporting obligations in the absence of corresponding obligations for corporate sustainability reporting (under the recently adopted Corporate Sustainability Reporting Directive, which is yet to enter into force). Greater clarity is needed on the expected timing for corporate disclosures required for investors to meet obligations under SDR, in order to avoid the implementation issues that the EU's sequencing approach has caused.

Question 4: 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 are broadly supportive of the FCA's characterisation of what constitutes a sustainable investment. We agree with the FCA's statement that key attributes of a sustainable investment product include an explicit environmental and/or social objective, and a description of how the investments contribute to achieving the objectives (which may reflect both enterprise contribution and the investor's

contribution). We encourage the FCA's proposals to integrate SFDR's explicit definition of sustainable investment; *"an investment in an economic activity that contributes to an environmental objective or an investment in an economic activity that contributes to a social objective."* Under SFDR Article 2.17, a sustainable investment must:

- contribute to an E or S objective;
- do no significant harm to other objectives (according to Principal Adverse Impact (PAI) indicators); and
- follow good governance practices.

We note that these requirements should apply at an asset level, not a fund or product level, as per the definition in SFDR Article 2.17. This is compatible with our recommendation that investments in activities that are not currently sustainable should be allowed if there is a credible stewardship strategy to bring those investments into alignment with sustainability goals. The notion of a credible stewardship strategy is addressed in our response to Q6, however, we would point to the Financial Reporting Council's (FRC) Stewardship Code 2020 as a high, albeit voluntary, standard of stewardship practices among financial actors in the UK which can inform fund-level stewardship practices.

Importantly, many investors and data providers are already starting to build methodologies to assess their investments against SFDR's categorisation. The European Commission is expected to clarify this definition throughout 2023, and we urge the FCA to work with the Commission and ensure alignment with this update.

Question 5: 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 strongly support the fact that any categorisation requires fund managers to go beyond ESG integration and pursue positive sustainability outcomes (outcomes consistent with the social, environmental, economic, and human rights goals suggested by the UN-Sustainable Development Goals).

A clear and effective labelling system will provide the market with welcomed transparency and ultimately, contribute to driving capital towards sustainable business models and economic growth. Emphasis on intentionality will build trust in the market through greater transparency in the intended environmental or social outcomes of sustainable investment products, and the ways in which products seek to achieve their objectives.

The 2021 Legal Framework for Impact report, authored by law firm Freshfields Bruckhaus Deringer and commissioned by the PRI, the Generation Foundation and UNEP-FI, sets out the legal foundation for such actions. Across jurisdictions, investors are generally permitted, and at times required, to consider sustainability outcomes where doing so would support their financial objectives. However, the policy and regulatory landscape does not always provide investors with adequate clarity, guidance or tools to support them in shaping sustainability outcomes. As a result, many investors still do not systematically consider their ability and responsibilities to do so. It lends support to the case for

financial policy and regulatory reforms to overcome this inertia and facilitate a progression from ESG risk management to delivering outcomes.

As highlighted in the report, when designing rules on the disclosure, labelling and classification of sustainable investment products, the FCA should **recognise that all categories of investors must take account of sustainability factors in their decision-making, but they also have to consider pursuing positive sustainability impacts**. Incorporating ESG issues in investment analysis should today be an underlying feature of every investment decision but does not qualify as a sufficient sustainable investment strategy.

In Legal Framework for Impact, we take this further in supporting the shift from ‘how do investors manage the effect of ESG risks/opportunities on their portfolios?’ to also address ‘how can investors ensure portfolios have positive impacts in the world?’

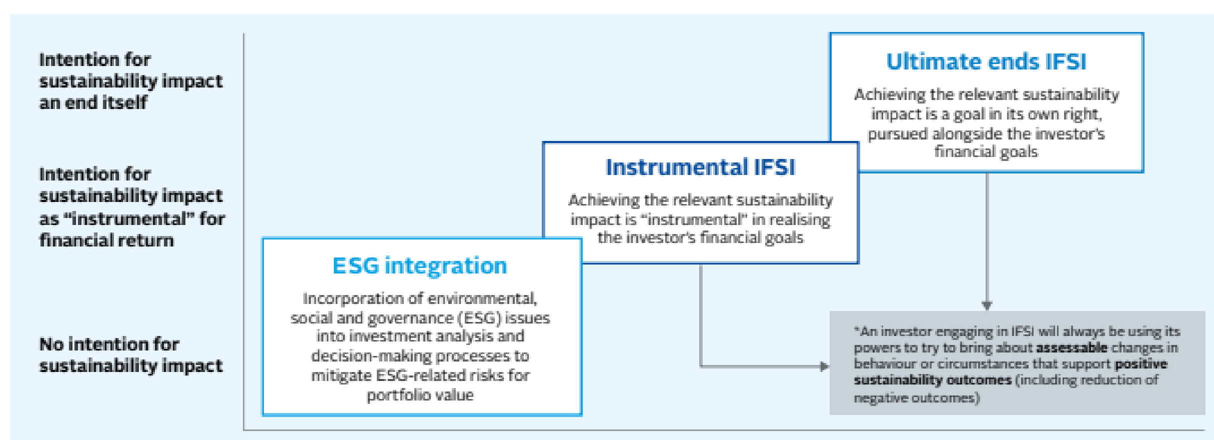

Figure 1: Investing for sustainability impact (IFSI). Source: Adapted from the Legal Framework for Impact report

Our subsequent report, A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry, found that while the UK financial regulatory framework is already broadly permissive with regards to investors’ abilities to pursue positive sustainability impacts, further clarifications will help facilitate and accelerate these practices. Therefore, the FCA are sending a clear signal to the market that investing for sustainability impact is the logical extension of ESG integration.

This latest report includes further proposals for clarification of the UK’s regulatory framework. We highlight that the FCA, amongst other regulatory bodies, should:

- **Clarify that the actions available to investors to pursue positive sustainability impacts** go beyond decisions to acquire or dispose of certain assets. Purpose-related requirements already oblige investors to consider pursuing positive sustainability impacts by using their powers of investment and stewardship.
- **Provide evidence** that systemic risks, including, but not limited to, climate change should no longer be considered so remote or insubstantial to be irrelevant to financial goals, and **provide easily accessible examples of good practice**
- Support and encourage efforts by the investment industry and other stakeholders to develop and endorse their **own examples of good practice or case studies** of how investors can

assess sustainability risks and impacts, and how they can set and pursue sustainability impact goals.

Do No Significant Harm

We propose **the inclusion of a 'Do No Significant Harm' (DNSH) principle** (or mechanism with a similar function, in the absence of a taxonomy-related principle) for all funds using one of the sustainable labels, **except in cases where the fund has a credible stewardship strategy to address negative impacts and bring 'harmful' investments in line with sustainability goals.**

Assessing the effectiveness of label designs with respect to driving capital towards a sustainable economy is less clear-cut than providing transparency in sustainable investment.[1] This is because most labels define the sustainability profiles of funds using the current (rather than the expected) sustainability performance of underlying companies. We would like to draw attention a fossil-fuel related exclusion: the EU Ecolabel (v. 4.0), which sets a number of criteria on which fossil fuel companies could be included, such as based on % of company revenue from carbon intensive activities, the publication of a credible transition plan in line with limiting global warming to 1.5c, dedicated capex and opex expenditures are phased out and there are corresponding investments in clean energy solutions.[2]

DNSH criteria should be developed **in coherence with the defining principles of a sustainable finance taxonomy applicable to the UK market** and incorporated into the SDR at the earliest opportunity. We recommend that the FCA develops a disclosures system on broader ESG integration or stewardship, and consideration of negative impacts for all products.

Links with climate objectives

We recommend the FCA clarify **how the proposals can support climate objectives**, such as the need to gradually shift away from investments into fossil fuels, lowering greenhouse gas emissions to meet net zero commitments enshrined in UK law.[3] As the purpose of the FCA's proposals are about enabling investor choice and understanding sustainability, some investors raised that this goes beyond the pursuit of net zero.

Nonetheless, as stated in our UK policy recommendations in A Legal Framework for Impact work, the FCA should **provide clarity for investors on how the underlying investments are managed.** This will enable investors to **take account of sustainability factors, to identify, assess and act upon sustainability-related risks/opportunities, and to pursue positive sustainability impacts (including reducing negative impacts).**

Terminology

We consider that the terminology on outcomes and impacts should be clearer. The consultation paper uses the terms "sustainability outcomes," "sustainability profile," and "impact" throughout, without adequately defining each term. The differentiation between each term remains unclear. Subsequently, it is unclear whether the sustainable focus and the sustainable improver categories are required to

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[1] Qontigo, Sustainable investment fund labelling frameworks: An apples-to-apples comparison. February 2022.
[2] Qontigo, Sustainable investment fund labelling frameworks: An apples-to-apples comparison. February 2022.
[3] Including the UK's net zero by 2050 target, the successive Carbon Budgets, and the UK's 2030 Nationally Determined Contribution to the Paris Agreement.

pursue positive sustainability outcomes. Whilst this is implicitly covered in paragraphs 4.24, 4.25 and 4.36, which outline an assumption that products labelled as sustainable go beyond ESG risk/return, it would be helpful for the terminology to match this. Therefore, we propose that the terminology and the categories' descriptions should be better defined to allow for greater clarity and coherency.

In A Legal Framework for Impact, we define sustainability outcomes as outcomes consistent with the social, environmental, economic and human rights goals suggested by the UN-Sustainable Development Goals and the Paris Agreement. We encourage the FCA to also adopt this definition throughout their proposals, as it is currently not adequately defined.

We have further comments on terminology in our response to Question 21.

Question 6: 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?**
>
> **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?**
>
> **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?**

The proposed framework is aligned with the DLAG recommendations and provides distinctive product profiles and strategies for each category. We also welcome the decision to reduce the number of labels compared to those proposed in DP21/4, which will avoid overloading or confusing customers.

The FCA's current proposals are designed in a way that does not propose a hierarchical framework. Each type of product is designed to deliver a different profile of assets, as well as different risk appetites and values to meet different consumer preferences: this approach is welcomed as it supports investor choice. For example, investors might want to distinguish between the following products:

- investment funds investing in companies that are already aligned with net-zero goals (or have an effective transition plan);
- investment funds that aim to improve investee companies' sustainability impacts, e.g., so they become aligned with net-zero goals; and
- investment funds that that a highlight selective approach to investing in companies that generate specific, targeted positive sustainability impacts (traditionally known as impact funds).

The design of the labelling and classification regime may help investors understand the different types of sustainable investment products mentioned above.

All three categories proposed imply taking action on sustainability outcomes, in other words, investing for sustainability impacts. Therefore, they can be considered as equivalent to the EU SFDR Article 8 and 9 funds, and the US SEC's ESG focus and impact funds, but with a different categorisation. This equivalence is important to consider, as stated above, in order to work towards globally aligned and comparable disclosure requirements for investors.

Another consideration is that a mutually exclusive set of labels may risk confusion on the choice of label when an investor is pursuing several objectives (e.g. transition and impact). We recommend the FCA clarify that a choice of a label be based on what is the *main* approach/objective, without this excluding other approaches for all assets. When there is overlap between different categories and approaches, investors should be able to explain the nuance in the disclosures.

It is important to distinguish between labels that are designed for retail markets, and the full disclosures under each category, which are essential for professional investors/intermediaries. There must be a small number of clear labelling categories for retail consumers, whilst investors need detailed information on objectives and strategy. This is because the diversity of products within those categories for professional investors will be far beyond what could be labelled in a simple and clear way for retail investors.

We offer further analysis into the label categories below.

Options	PRI response
The 'Sustainable focus' category, including the 70% threshold for credible standard of environmental and/or social sustainability	**70% threshold** The basis for the 70% threshold is unclear, particularly as it only applies to the sustainable focus category. There must be a stronger methodology or rationale behind this figure, and clarity on whether this figure will remain stagnant or go beyond a minimum of 70% to support a greater urgency of meeting the UK's net zero by 2050 commitment. It is unclear why a quantitative threshold has not been applied to the sustainable improver and sustainable impact category, which adds uncertainty. From our interpretation of the FCA's proposals, we assume that the qualifying criteria of other funds would apply to 100% of the fund holdings. This should be explicitly clarified by the FCA to avoid incorrect assumptions. Nonetheless, "minimum 70%" can be viewed as "well above the majority", which offers credibility to the funds using this label. However, a measure must be in place to ensure that the remaining percentage failing to meet the threshold are not invested in harmful activities – unless the fund has a credible stewardship strategy to address any negative impacts. Otherwise, investments in harmful activities would counteract the positive impact of the "70%" sustainable focus and be at odds with achieving sustainability outcomes. **Do No Significant Harm (DNSH)** The FCA should include a position on the remaining minority percentage or "30%" of holdings within this label, offering guidance on what these holdings should explicitly **not** be invested in. Here, a DNSH criteria based on a sustainable finance taxonomy or equivalent standard would

	be well placed. In this scenario, the fund using the sustainable focus label would need to outline how the remaining 30% of investments does not harm the product's sustainability objective. As outlined in our recommendations, harmful assets for the remaining minority percentage should only be allowed if the fund has a credible stewardship strategy to address these negative impacts. This would also further reduce the risk of greenwashing. **A detailed technical standard** To maximise the usefulness of this category, it should be attached to a more detailed technical standard. Practically, it is difficult to comprehend how one can determine a 'credible standard of environmental or social sustainability' without clear definitions of what such standards could be, as would be provided by a taxonomy. Furthermore, clarity on whether this is assessed at entity-level (i.e., 70% of issuers or investee companies) or activity-level (i.e., 70% of activities funded) is required. The label should also include minimum social safeguards to ensure that the climate transition is not at odds with socio-economic needs, and further consider improvements to social sustainability and broader environmental issues.
The 'Sustainable improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?	**Stewardship considerations** The recommendation for a sustainable improvers category acknowledges the important role of stewardship, and of investee and policy engagement as effective tools for investors to shape positive sustainability outcomes. This category is aligned with a transition approach, recognising investments that are improving their sustainability credentials. It allows investors to support companies and incentivise them to transition. To better reflect the importance of the fund's stewardship strategy for this category, **we recommend more clarity in the wording of its "Sustainability objective" (paragraph 4.37)**. We suggest rewording this as follows: "*Sustainability objective. Alongside its financial risk/return objective, a 'sustainable improvers' product will have an objective to deliver measurable improvements in the sustainability profile of its assets over time,* ***to which the firm will seek to contribute via stewardship influence***." The equivalent amendment is proposed for paragraph 4.32, to read "*Products in this category aim to invest in assets that, while not objectively environmentally or socially sustainable at present, have the potential to deliver measurable improvements in their environmental and/or social sustainability over time,* ***to which the firm will seek to contribute via stewardship activities***." There must be a reasonable opportunity for improvement within a product's environmental and/or social sustainability within a certain period of time. For an investment to be considered as having a 'reasonable opportunity for improvement,' the stewardship strategy must be solid and credible. The stewardship strategy, combined with other market developments, should be strong enough for the fund manager to reasonably expect that the assets will indeed improve their sustainability outcomes in response to it. If this is not the case, the claim that the investee will improve over time would not be credible and thus likely greenwashing. If the sustainability of the fund's investments does not improve in line with its stewardship strategy, the fund manager should be held accountable for the credibility of their stewardship strategy. Stewardship processes can take a long time to deliver improvements – especially if their targets are ambitious –, and any improvements in the fund's assets will not depend solely on the fund manager's stewardship strategy, but also on broader developments in the market.

	Considering this, it is still possible for a stewardship strategy to be credible (i.e., the fund manager could reasonably have expected that it would contribute to sustainability improvements in the future) even when it has not met its original targets and/or timeline. However, the onus should be placed on the fund manager to (i) reassess their stewardship strategy as necessary, and (ii) justify the credibility of their (original or revised) stewardship strategy, as applicable. The key characteristics of a "credible" stewardship strategy are discussed in our response to Question 9. **Language analysis** On the sustainability objective of the sustainable improvers category, in paragraph 4.37, the consultation paper states, *"alongside its financial risk/return objective, a 'sustainable improvers' product will have an objective to deliver measurable improvements in the sustainability profile of its assets over time, including through investor stewardship."* We recommend that **references to 'sustainability profile' be replaced with 'sustainability outcomes.'** This is primarily because 'sustainability profile' is not defined throughout the consultation paper, which could create unnecessary ambiguity. There is further ambiguity in the notion of 'alongside its financial risk/return objective.' This fails to clarify whether, or how, the fund's sustainability objective would be prioritised over its financial risk/return objective in the case of conflict. Regarding the secondary channel for sustainability outcomes within this category, paragraph 4.37 of the consultation paper outlines, *"Portfolio construction and asset selection in 'sustainable improvers' products would be geared towards identifying those **assets that are best placed to improve their sustainability profile over time**. So, a secondary channel would be the market-led channel of influencing asset prices and the relative cost of capital of more **sustainable economic activities/ projects**."* The text in bold could be read as an indication for these funds to pick only assets which are already on track to improve their sustainability practices. This interpretation can reduce the contribution to sustainability outcomes of "sustainable improver" funds since entities with the worst practices may also be the ones where improvements would be most beneficial for people and planet. However, this secondary channel **should require a reasonable expectation of investor contribution to change**. Investors can contribute to improvements via changing cost of capital, but only in certain circumstances - e.g., in start-ups but not in listed equities. The FCA should **set expectations that investors have a reasonable and credible basis** for believing their investments will lead to a change to cost of capital. This could be in the form of **stronger guidance on the qualifying criteria** for the sustainable improvers category, which should also be receptive to emerging changes in stewardship metrics and standards.
The 'Sustainable impact' category, including expectations around the measurement of the product's environmental or social impact? Please consider	It is promising that the FCA's proposals reflect the recent UK policy recommendations in A Legal Framework for Impact, by clarifying that **new rules do not contribute to confusion or increase the risk of investors either believing they are not allowed to pursue positive sustainability impacts, or that their approach to sustainability impacts does not have to be disclosed**. At the same time, new disclosure requirements should not create unreasonable or disproportionate challenges for those investors who are actively investing for sustainability impact.

whether there any other important aspects that we should consider adding.	More guidance is needed on the number of impact metrics that the FCA considers best practice. This guidance should allow for a standardisation of approaches to positive real-world outcomes. Separating impact as a category can be misleading, as funds in the sustainable improvers and focus categories should still be pursuing impact. The FCA should be clearer that the categories are not exclusive of one another, in addition to not being hierarchical. For example, a fund may be labelled under the sustainable impact category, as it provides private market capital to waste and recycling businesses in under-served markets. At the same time, it is also possible that the same fund includes some enterprises which are not yet strongly focused on this objective, but which the investor intends to shift to do so. That being said, an investor should pick a label in accordance with the main approach of the fund, within the three sustainability categories provided by the FCA. This approach would be consistent with the work in other jurisdictions. To avoid confusion, keeping in mind that all three categories aim to 'shape sustainability outcomes,' the sustainable impact label could be renamed 'sustainability solutions.' We urge caution about using the term 'impact' for this category because of its overlap with positive sustainability outcomes and other common terminology used. Furthermore, the current name suggests that this is the only category that seeks positive impact, which is not the case. Impact comes in many forms and could be both pursued and achieved in other labels. Trademarking impact into one label could have negative, unintended repercussions. In addition, the meaning of impact could be interpreted differently by the UK courts, and investors may face new legal risks if this term was used. These names are important as they can affect consumers' decisions on where to allocate assets. As consumer research on using the term 'sustainable solutions' has already been undertaken, the FCA should consider renaming this label.

Social impact measurement considerations

The need for specific indicators is especially urgent considering that there are currently no plans in place to implement a UK social taxonomy. As a minimum, the KPIs and the standards that would be used to assess funds **should explicitly refer to the United Nations Guiding Principles on Business and Human Rights (UNGP) and the OECD Guidelines for Multinational Enterprises**.

With regards to the measurement of social impact, we recognise that the data available on social issues is currently limited. For this reason, we have recently published a report to help investors fill these gaps. Some of the suggestions we make, and that the FCA could support, include achieving more effective disclosures; data tagging; and evolving algorithmic analytic techniques. Improvements will also be needed in terms of data and assurance providers' capacity to source and verify human rights-related information in line with relevant international standards. Data also needs to be better integrated into the investment and stewardship process, for example through **setting clear expectations to fund managers, focusing on high-quality Human Rights Due Diligence (HRDD) and better mapping of a company's value chain**.

In June 2020, the PRI released Investing with SDG outcomes, which sets out guidance to investors seeking to contribute to real-world outcomes aligned with the Sustainable Development Goals. In particular, the report highlights the methodological and data collection challenges related to investor impact measurement. To provide a meaningful assessment of impact, the FCA should provide

guidance on appropriate metrics that are contextualised by explaining their relationship with UK's climate targets, including the commitment to net zero by 2050, the successive Carbon Budgets, and the pathways to limiting global warming to 1.5C in line with the Paris Agreement objectives.

Using a taxonomy would be the best approach to address this, as it provides clear definitions of investments and economic activities that can be considered green and sustainable, with the view of channelling finance into the net zero transition. Given the delays to the implementation of a green taxonomy in the UK, we see scope for the FCA to update and develop requirements, factoring in appropriate metrics for alignment with climate objectives, and potentially considering how other taxonomies (e.g., the EU taxonomy) could fill this gap in the interim, while the UK government settles on its approach to the UK green taxonomy.

On the sustainable impact ("solutions") fund label, impact labelled funds should be required to disclose any key performance indicators or targets yet applying timescales to impact measurement can lead to problems. Research has shown that two thirds of individual investors would like to receive information about the impact and societal benefits of their investments alongside financial reports, which highlights a clear need for this information.[4]

The concept of target-setting is well-established among impact funds and is often aligned with broader societal goals in reference to international norms and agreements. Examples include the International Bill of Rights or the UN Sustainable Development Goals. The FCA should recognise the complexity of target setting, namely that:

> *The nature of targets can vary. For example, GHG emission measurement for the mitigation of climate change lends itself to quantitative target-setting against scientifically quantified thresholds and allocations. By contrast, human rights targets tend to be qualitative and process-based, aimed at reducing the risk of future instances occurring, e.g., 'when applicable, to prevent, mitigate and remedy instances of adverse human rights impacts when they arise or could arise'.*[5]

As a result, rigid timescales are not always applicable for sustainable impact fund labels. The FCA should consider these nuances and **allow funds flexibility in disclosing their targets and progress over time**.

Reporting standards

If investors classify their funds into one of three labels and then satisfy this with a narrative-style report, this will undoubtedly lead to gaps and weaken the potency of the label requirements due to the subjective nature of narrative reports. Therefore, we recommend that the **threshold for label requirements be met with developing ISSB standards, along with specific criteria met for investment policy and strategy, key performance indicators, firm-level attributes, and investor stewardship**.

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[4] Morgan Stanley, Sustainable Signals: Individual Investors and the COVID-19 Pandemic (2021), available at https://www.morganstanley.com/assets/pdfs/2021-Sustainable_Signals_Individual_Investor.pdf, p. 9.
[5] 4 Impact Management Platform (May 26, 2022), Set Targets, available at https://impactmanagementplatform.org/actions/investment-and-finance/set-targets/.

Whilst we support the inclusion of both quantitative and qualitative reporting requirements where appropriate, we advise against requiring quantitative disclosure where such metrics may be unavailable or not used by the fund. Assessing impact often centres on the following concepts:

- Concept of contribution: "a credible narrative, or thesis, which describes how the actions of the investor will help achieve the [impact] goal or how the outcome would not have occurred without the investor's involvement." "This reference to a 'credible' narrative reflects the point made above: it will rarely be possible to attribute the occurrence of a particular sustainability outcome to a single activity or measure the precise difference that the activities of a single investor have made to that outcome. Because of that, the emphasis may often need to be on the basis for and quality of the investor's explanation for the difference it has made."[6]
- Concept of additionality: "outcomes are assessed against the situation that would have prevailed without the relevant intervention (a 'counterfactual') to establish whether there has been an increase in the quantity or quality of the positive sustainability outputs of a given enterprise."[7]

Question 7: 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?

Whilst we recognise the rationale behind removing a non-sustainable investment product as a signal from the FCA that sustainable investment products should be the norm, all funds should be required to incorporate ESG and disclose how they do so. As well as this, all funds with a sustainability claim should substantiate such claims and use one of the labels. We agree with proposals for labels to be voluntary, and for firms who choose not to use the sustainable investment labels to align with the FCA's naming and marketing rules, including a commitment to more detailed disclosures at product and entity levels for investors.

By only focusing on positive sustainability impacts, a significant portion of investors' portfolios could be out of scope. We urge the FCA to **consider ways to mitigate negative outcomes related to wider portfolios**. Collectively, through the lack of labelling for non-sustainable investment products and the exclusion of DNSH criteria and reporting on adverse impacts, the FCA's proposals fall short of taking effective action on negative outcomes. We recommend that the FCA outline a disclosures system on broader ESG integration or stewardship, and consideration of negative impacts for all products. SFDR Article 7, for example, has a 'comply or explain' requirement for **all products** on whether they consider principal adverse impacts of investment decisions. The FCA would need to clarify whether the rules apply to the principal adverse impacts of investment decisions or investee companies, as this is currently unclear under SFDR. This would allow appropriate consideration for the full range of investment products, not only for products that make sustainability claims.

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[6] Freshfields Bruckhaus Deringer, A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making, available at https://www.unpri.org/download?ac=13902 p. 44-45.
[7] Freshfields Bruckhaus Deringer, A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making, available at https://www.unpri.org/download?ac=13902 p. 44-45.

Question 8: 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**
- **the different components to the criteria (including the implementing guidance in Appendix)**
- **whether they sufficiently delineate the different label categories, and;**
- **whether terms such as 'assets' are understood in this context?**

Yes. We support the FCA's intention to incorporate the outputs of the Transition Plan Taskforce's sector-neutral and sector-specific disclosure frameworks within the KPIs that firms use. This will strengthen the FCA's disclosure expectations whilst promoting the development of high-quality transition plans.

Prescription

A stronger emphasis on prescriptive approaches is welcomed, such as matching qualifying criteria to an environmental performance benchmark to assess sustainability claims, like **a robust and science-based sustainable finance taxonomy.**

The FCA's Dear Chair letter underpins the repercussions of a lack of prescriptive criteria on applications for authorisation of investment funds with an ESG or sustainability focus. To see material improvements in applications, with clear and accurate disclosures, the FCA should move beyond a set of guiding principles on design, delivery, and disclosure, and further align with TCFD recommendations and future ISSB standards. This would provide more clarity on expectations and build trust in the market that disclosures precisely meet regulatory requirements. Furthermore, there is stronger potential for coherence and interoperability with a more prescriptive approach. We recommend that **the FCA offer additional, mandatory guidance on meeting the criteria for each label category**.

Revision of qualifying criteria

As set out in our response to Question 6, we recommend the FCA to revisit the qualifying criteria for each label category, whether this be annually or bi-annually. This is to ensure market developments and industry changes are captured in the labelling regime, and to allow the FCA's regime to remain a tool to assess the sustainability potential of a product.

Specific comments on Principles

On Principle 1 (a Sustainability Objective), the proposal states that 'a sustainable investment product must have an explicit environmental and/or social sustainability objective.' We recommend that this (or another) Principle **should require labelled funds to clarify how they would address any conflict between pursuing financial returns and achieving their sustainability objective**. Currently, the distinguishing features of all fund labels (paragraphs 4.29, 4.37, and 4.43 of the Consultation Paper) are ambiguous through this lens, as they indicate only that the fund's sustainability objective will be pursued 'alongside its financial risk/return objective.'

On Principle 4 (Resources and Governance), we recommend that **the incentive to deliver against the product's sustainability objective should not only be required at the firm level, but also at the fund level**. For example, the fee structure of the fund should be aligned with the prioritisation of its sustainability objective.

Specific mandatory criteria

The PRI is supportive of each label being underpinned by a set of criteria covering investment policy and strategy, key performance indicators, firm-level attributes, and investor stewardship. However, the FCA must provide a mandatory minimum level of criteria to meet and provide guidance on how firms can meet each set of criteria.

It should be clear that a credible stewardship approach, accompanied by KPIs, is required of any fund that relies on stewardship to improve sustainability outcomes, whether it is a sustainable improvers fund or a different labelled fund. Therefore, we recommend that Principle 5, key consideration 2, is reworded to read: *'Where stewardship plays a significant role in its investment policy and strategy for a sustainable investment product, the firm must specify credible, rigorous, and evidence-based KPIs that relate to the contribution of stewardship activities and outcomes to the achievement of the product's sustainability objective* ***in line with the "sustainable improvers" category-specific criteria in Principle 3."***

Updating the qualifying criteria using "additional" criteria

For reference, the PRI's reporting framework sets out a similar minimum and additional criteria for signatories to meet. Following consultations with our signatories in 2019 and 2020, we established the 'CORE' and 'PLUS' model for indicators or questions within the framework, which can provide the FCA with an example of elements to consider for this exercise.[8]

The FCA should adopt a similar approach, setting out mandatory and additional set of criteria for FCA regulated funds to meet the threshold of a fund label, based on investment practice. This mandatory criteria could, for example, include the following:

- a baseline for stewardship activities;
- a minimum threshold (% of total assets) that incorporate sustainability outcomes criteria into investment analysis and decision making; and
- a minimum threshold (% of total assets) for taxonomy alignment.

The FCA should clarify what criteria they deem mandatory, such as the example given above. The suggested additional criteria should then be annually updated, and the FCA should decide whether to update their regulation to incorporate any additional criteria into mandatory requirements. These decisions should be drawn from an analysis of market practices and would enable the FCA to further entrench sustainability considerations in investment decisions and advance the SDR regime.

This is an area that the FCA could develop once an ecosystem is built around the initial framework and the market begins to coalesce around specific KPIs. The PRI would support the FCA to convene

[8] Further information on PRI Reporting and Assessment Framework, which sets out a similar minimum and additional criteria for signatories to meet.

this development, taking into account international developments and the need for alignment on investor disclosure rules.

Question 9: Do you agree with the category-specific criteria for:

- **The 'Sustainable focus' category, including the 70% threshold?**
- **The 'Sustainable improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?**
- **The 'Sustainable impact' category, including expectations around the measurement of the product's environmental or social impact? Please consider whether there any other important aspects that we should consider adding.**

Please see our response to Question 6 for other comments on the specificities of labels, particularly around the need for SDR proposals to better integrate the need for a financial transition to achieve the UK's climate objectives.

In addition, in Principle 2, we suggest rewording the category-specific criteria for the sustainable improvers label to:

> *"The firm must ensure that the product is invested in assets that* ***can be reasonably expected*** *to become* ***aligned with recognised standards of environmental and/or social sustainability within a certain period of time****, including in response to* ***the fund's stewardship strategy.****"*

The rationale behind this change of language is that the fund's stewardship strategy, combined with other market developments, should be strong enough for the fund manager to reasonably expect that the assets will indeed improve their sustainability outcomes in response to it within a specific period of time. If this is not the case, the claim that the investee will improve over time would not be credible and would subsequently be susceptible to greenwashing. This amendment would not require a direct, causal link between the stewardship activity of an individual fund and change in company behaviour and/or real-world outcomes. Rather, it signifies that it is the role of an investor to contribute to change, i.e., a reasonable expectation for a sustainable improvers fund. On the other hand, the previous wording 'become more environmentally and/or socially sustainable' was too vague and could be vulnerable to greenwashing. The proposed amendment would set a stronger objective standard for a strong enough improvement in a fund's sustainability impact.

Sustainable improvers category

Improvement *over time* is an important objective for investors seeking sustainable improvements. However, there is currently very limited, investable quality forward looking data to achieve this. Most ESG and climate corporate disclosures are backward looking. Investors are using Paris-Aligned benchmarks and Climate Transition benchmarks as market-wide improvement methodologies, yet it is challenging to see how SDR label requirements would fit into these benchmarks. The FCA should consider improvement at portfolio-level, rather than asset level, to better align with wider benchmarks. This could be combined with ESG exclusions to remove companies that do not meet certain ESG activity criteria.

There is value in using KPIs for this label, in particular. In cases where investors have utilised all levers, but investees still have not improved as expected, KPIs geared towards monitoring performance are crucial. KPIs would monitor performance in a manner that flows coherently from the objective that the product has set.

We support the approach reflected in the KPIs proposed for this category. We welcome the fact that the KPIs set out for the "sustainable improvers" category focus on the *results* of stewardship activities and how they contribute to progress towards a measurable target. In addition to the KPIs included in the Consultation Paper, to further focus on the results of stewardship activities, the FCA could consider requiring a narrative description of agreements with engaged stakeholders on items proposed by the entity via engagement.

We recommend that the FCA **work with the FRC to keep up to date with emerging common stewardship metrics and standards**, and systematically **update their qualifying criteria annually**. Consideration should also be given to **raising expectations on funds** as the UK transitions to a net zero economy.

Question 10: 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 with FCA's approach at this stage.

We note that there must be a standard before verification can occur. Furthermore, the number and variety of financial products in scope would make a verification scheme highly complex and costly to implement. However, as standards and global alignment emerge, this is an area that the FCA should consider, and we see verification of labelling as an important topic for the FCA to develop.

Question 11: 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?

The PRI broadly agrees with the FCA's proposed approach to disclosures. As noted in our response to DP21/4, there should be a standardised product and labelling system that is underpinned by more detailed product disclosures that are consumer facing, and further granular information beyond that aimed at institutional investors, noting that there will be challenges in translating complex jargon into consumer facing language.

Global alignment

The PRI's position as a global organisation provides us with a unique perspective on investor disclosure regimes in other jurisdictions. In the European Union, for example, conversations with signatories following the implementation of SFDR have revealed confusion surrounding the categorisation of funds according to Article 8 (funds promoting environmental or social characteristics) and Article 9 (funds with sustainable investment as its objective) of the regulation. The wide variation in practices within these disclosure categories (particularly Article 8) can make it difficult for investors

to discern the actual sustainability performance of the funds and underlying investments, as these categories do not guarantee standards for investment practice or sustainability performance. Other stakeholders in the sustainable investment space have pointed to this problem. For example, Eurosif highlights that:

> *"Following the logic of a disclosure-based framework, the product categories in SFDR have a broad scope. They were deliberately left broad to capture as wide a range of products as possible. This is positive when viewed from the perspective of transparency as it ensures disclosures are applied to a wide segment of the market. However, significant risks emerge when a framework designed solely for transparency and disclosure starts being used to classify products.[9]"*

Research by Morningstar has shown the wide variety of fund strategies categorised as Article 8 funds. In their review of the initial implementation of SFDR, Morningstar found that:

> "*Asset managers have taken different interpretations of the definitions, some opting for a softer approach than others. This has resulted in an unexpectedly high number and broad range of products labelled Article 8 and Article 9.*" [10]

Morningstar further highlights that Article 8 funds include a variety of strategies utilised, from exclusion-only strategies to comprehensive thematic approaches.

While the fact that there are a variety of ESG strategies represented in Article 8 and 9 funds is not in itself a problem, it does become problematic when market participants are not able to — or do not feel it necessary to — easily distinguish between funds.

In response to these issues, the European Commission has proposed to develop minimum sustainability criteria for funds that fall under Article 8 of SFDR.[11] Since the first round of product disclosures under SFDR will be due later in 2023, it is difficult to draw further conclusions on the appropriateness and effectiveness of the disclosures required and how they relate to market expectations and interpretations.

Within this current proposed rule, the FCA should **further clarify whether products without a label could disclose their sustainable outcomes or metrics**. We also recommend maintaining **a clear distinction between labelling criteria and disclosures**.

Unexpected disclosures

The principle behind including an 'unexpected' disclosures component is clear, and we see merit in the transparency and trust that this component could build. However, we do not think it goes as far enough, particularly in relation to the sustainable focus label, which risks leaving a significant minority unaccounted for holdings negating the sustainability objective of the majority of holdings. A DNSH principle would address the unaccounted for holdings. The FCA should consider extending 'unexpected' disclosures requirements with a DNSH mechanism, which should be developed in

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[9] Eurosif, EU Sustainable Finance & SFDR: Making the Framework fit for Purpose (June 2022), available at https://www.eurosif.org/wp-content/uploads/2022/06/Eurosif-Report-June-22-SFDR-Policy-Recommendations.pdf.
[10] Morningstar, SFDR: Four Months After Its Introduction Article 8 and 9 Funds in Review, available at https://www.morningstar.co.uk/uk/news/214207/sfdr-four-months-on.aspx, p. 25
[11] 4 European Commission, Strategy for Financing the Transition to a Sustainable Economy, available at https://ec.europa.eu/info/publications/210706-sustainable-finance-strategy_en.

conjunction with a taxonomy and incorporated into SDR. Also, the concept of an 'unexpected' disclosure is inherently subjective and could evolve, differ, and even conflict between investors, consumers, regulators, and fund managers. This could eradicate the trust in the market that the FCA is seeking.

Question 12: 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?

In October 2021, the UK Government announced the adoption of future ISSB standards[12]. This commitment supports building a global baseline of corporate sustainability reporting. Albeit not final, the exposure draft standards published by the ISSB, and recent decisions taken by the ISSB indicate a great level of alignment with TCFD recommendations.

We support an initial **Taskforce on Climate-Related Financial Disclosure (TCFD) aligned approach** at entity-level, but this should be quickly updated through adoption of ISSB-aligned entity-level reporting requirements under SDR. This would limit the risk of duplicative reporting by firms subject to both rules, create an end-to-end reporting system between issuers and SDR-regulated firms, limit market fragmentation, enhance information usability, and lead to more consistent reporting on non-climate sustainability issues.

Therefore, we recommend that **entity-level reporting requirements be aligned with IFRS Sustainability Disclosure Standards** at pace following entry into force of SDR. This would limit fragmentation of sustainability disclosure requirements, enhance information usability, and lead to more consistent reporting on non-climate sustainability issues than the currently proposed requirements [c.f. page 69]. In this regard, **the FCA should publish a timeline for adoption of ISSB requirements under SDR**.

Entity-level reporting is very similar between the TCFD and ISSB, so it makes sense to transition to ISSB at pace given the UK Government's adoption commitment and the benefits this would incur. In this regard, the FCA should publish a timeline for adoption of ISSB requirements under SDR. With product-level reporting, there is scope to deviate slightly from ISSB (but still build on this in the future), since their standards are not designed for reporting on investment products.

Furthermore, we note that the FCA intends to consult on adapting its TCFD-aligned disclosure rules for listed issuers to reference the IFRS Sustainability Disclosure Standards once these are finalised and made available for use in the UK. A speedy adoption of ISSB-aligned entity-level reporting requirements under SDR would limit the risk of duplicative reporting by firms subject to both rules and create an end-to-end reporting system between issuers and SDR-regulated firms.

Given that IFRS Sustainability Disclosure Standards have not been developed with product-level disclosures in mind, we support the proposed approach and timeline to build on product-level disclosure requirements as further ISSB Sustainability Disclosure Standards are developed, with a

[12] https://www.gov.uk/government/publications/international-sustainability-standards-board-issb-exposure-draft-consultations-uk-government-response/letter-from-lord-callanan-to-the-international-sustainability-standards-board-regarding-their-exposure-drafts-ifrs-s1-and-ifrs-s2#:~:text=In%20October%202021%2C%20the%20UK,for%20use%20in%20the%20UK.

focus on sustainability-related metrics. In addition, we recommend that a sufficient level of interconnectivity is provided between product- and entity-level reporting, such that reporting users can clearly assess similarities, differences, and interrelationships between product- and entity-level approaches across firms and their products.

Question 13: 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 welcome the direction of travel to increase transparency through the FCA's expectation that firms must use language that will be familiar and comprehensible to consumers while effectively and accurately describing the strategy in plain English.

Question 14: 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?

Whilst we recognise the value of standardisation and comparability, we caution that any template proposed by the FCA would need to be designed in a way which does not hamper innovation in the market.

At this stage, we agree with the industry-led approach to templates, as long as key components of the required disclosures are provided. Further streamlining and standardisation of disclosures can be developed as global alignment on this topic increases.

Question 15: 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.

The FCA will require more granular information to be included in pre-contractual disclosures than under the SFDR, particularly in relation to the investment policy and strategy to provide greater transparency on the firm's asset selection processes and criteria. We support the FCA's proposals and recommend monitoring SFDR developments to ensure future alignment.

Question 16: 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.

See our response to Question 11 for our views on disclosures.

Question 17: 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.

Question 18: 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.

Yes.

Question 19: 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?

For the reasons outlined in our response to Question 12, we support the FCA's proposals to add more specificity to product- and entity-level requirements, particularly on sustainability issues beyond climate change, as IFRS Sustainability Disclosure Standards are developed [c.f. pages 51, 63 and 69].

In addition, as per our response to Question 12, we recommend that entity-level reporting requirements be aligned with IFRS Sustainability Disclosure Standards at pace following entry into force of SDR and support the proposed approach to build on product-level disclosure requirements as further ISSB Sustainability Disclosure Standards are developed.

Question 20: Do you agree with our proposed general 'anti-greenwashing' rule? If not, what alternative do you suggest and why?

There is a clear discrepancy between firms taking tangible action and doing sustainability work and those using marketing to give the perception that they are doing the same. There is currently no way to distinguish between these approaches, and here is where the anti-greenwashing rule is ideally placed. Funds' advertisements and sales literature should influence the required disclosure and could lead to categorisation as a sustainable focused or a sustainable impact label. Under the FCA's proposals, it is not clear what kind of language signals 'not exaggerated' and would therefore depend upon interpretation. While it might be clear that a labelled fund cannot state that ESG factors play a significant or main consideration in its investment processes, there are a variety of other phrases that could be used in marketing materials. The lack of definition could translate into confusion for retail investors seeking specific funds, and fund managers or advisers downplaying their ESG consideration practices for fear of misstatement. In the European Union, for example, lack of clarity around these issues has caused market confusion, and the European Securities and Markets Authority (ESMA) has

considered it necessary to publish guidance on the matter to provide clarity.[13] The FCA should focus on being as precise as possible with terminology and ensuring that disclosures allow for meaningful assessments of how an investment meets or contributes to sustainability objectives.

The PRI welcomes the FCA's suggestion to 'add a specific rule to the ESG Sourcebook to link this directly to sustainability claims, and to ensure that firms understand that this applies when they are making sustainability claims.'

Asset owners, along with their advisers, must be empowered to challenge investment managers on practice, to uncover greenwashing and to trigger changes in practice across ESG integration and engagement.

Language clarification

However, the FCA's anti-greenwashing rule that would require all regulated firms to ensure that the naming and marketing of financial products is 'clear, fair and not misleading, and consistent with the sustainability profile of the product or service is proportionate and not exaggerated' could be misinterpreted as vague. Importantly, 'not exaggerated' is inherently subjective, and open to a wealth of different definitions. In the absence of specific guidance, this wording is unclear. We envision that the less clear the critical terms in the FCA's proposal are, the more firms will have difficulty in complying with the requirements, or some actors could take advantage of this lack of clarity to be less serious with the requirements.

FCA's approach to greenwashing

Both greenwashing and impact washing have monopolised the sustainable finance agenda and represent a barrier to sustainable investment. They erode trust in the market and are damaging to sustainable investment, due to a false underlying assumption that investing in a sustainable way does not deliver sustainability outcomes. As the UK's Greening Finance: A Roadmap to Sustainable Investing highlights, 60% of ESG investors raise greenwashing as a challenge. Given that investors allocate capital based on sustainability-related information, combatting greenwashing is a matter of investor protection and is needed for effective incorporation of sustainability issues into investment decisions.

With the mainstreaming of ESG, there has been an increase in investor demand for, and the availability of, sustainability-related financial products. Research shows that investors are increasingly looking to select funds and investment products that match their ESG-related investment goals, but only a minority is confident their portfolio is aligned to their values.[14] However, investors have concerns about authenticity and greenwashing as a significant barrier to including sustainable investing in their portfolio.

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[13] 5 European Securities and Markets Authority, Supervisory Briefing: Sustainability Risks and Disclosures in the Area of Investment Management (May 2022), available at https://www.esma.europa.eu/sites/default/files/library/esma34-45-1427_supervisory_briefing_on_sustainability_risks_and_disclosures.pdf

[14] Morgan Stanley, Sustainable Signals: Individual Investors and the COVID-19 Pandemic (2021), available at 2021-Sustainable_Signals_Individual_Investor.pdf (morganstanley.com), p. 8. 5 Capital Preferences, ESG is Personal: 2021/22 Study of Preferences and Advisory Practices (2022), available at 2https://www.capitalpreferences.com/wp-content/uploads/2022/06/2022-ESG-Preferences-Study-Capital-PreferencesConfidential.pdf, p. 5.

The International Organization of Securities Commissions (IOSCO) states that, alongside requirements relating to product naming, labelling, classification, and marketing materials, 'requirements about investment objective disclosure can help prevent greenwashing by providing transparency about the nature and extent of a product's sustainability-related investment objectives.' With this in mind, **a required disclosure that all FCA-regulated funds are meeting their sustainability objective would inform, and be compared to, related marketing materials to ensure accuracy and prevent overstatement.** This would boost the FCA's oversight in preventing greenwashing.

Question 21: Do you agree with our proposed product naming rule and prohibited terms we have identified? If not, what alternative do you suggest and why?

Prohibited terms

The FCA clearly recognises that responsible investment terminology in a fund name would be materially deceptive and misleading unless a fund prioritises those considerations that their names suggest, as contrasted to funds that analyse responsible investment factors only as part of a broader investment selection process. We agree that the proposed product naming and marketing rules will curtail greenwashing risks.

We also agree that a fund should not be permitted to use '*sustainable, ESG, impact, responsible, green, SDG, Paris aligned'* or any sustainability-related term in its name if it does not comply with its respective investment objectives and strategies or responsible investment inputs are merely one factor among many driving an investment decision, as this could mislead investors.

Definitions

It is important to note that wording and terminology evolve rapidly. If the FCA is proposing to control the language used to describe funds, it needs to be prepared to factor in evolution of terminology into their rules, particularly in a fast-moving industry. Otherwise, this could risk undermining the FCA's rules should similar wording emerge that the FCA hasn't had sight over. It is important for the FCA to **define components and propose frameworks to implement concepts** of '*sustainable, ESG, impact, responsible, green, SDG, Paris aligned'* or any sustainability-related term that the FCA is proposing to regulate. Precision on these terms is fundamental, and there are inherent risks when using normative words as technical definitions.

Here, the risk of miscommunication is high, and judgement should be exercised when using technical language. In fact, any terminology that one can attach a normative definition to can be problematic. The FCA should **strive to reconcile definitions of sustainable, impact, and green,** for these terms bear the strongest correlation to normative language. Importantly, this must be understood by all investors (and not only those actively pursuing sustainable practices). A discrepancy has formed between those using data with a clear understanding, and those using the data for marketing purposes having a less clear understanding. This undoubtedly creates a fertile ground for greenwashing to occur yet begs the question of what is misleading in the absence of definitive definitions. Here is where the FCA is best placed to act and harmonise responsible investment terminology within sustainable fund labels.

When outlining the category descriptions and rationale for investment labels, the FCA describes products that 'aim to invest in assets that a reasonable investor would regard as being environmentally and/or socially sustainable.'[15] The notion of a 'reasonable investor' is inherently subjective and this could be construed as a loophole. We would recommend that if such terminology is going to be used, the FCA should provide a definition of what they deem to be a 'reasonable investor' to then inform the product categories.

On product-level disclosures, these tend to vary across different types of what is often referred to as 'sustainable products,' meaning investors are unable to effectively compare them. Requirements should be clear, consistent, and substantive to allow for comparability. This would reduce the scope for greenwashing.

Global alignment

Given that the SEC, the European Commission, and the FCA all propose rules on fund names, we see the greatest scope for **global alignment on fund names**. In the EU, ESMA have proposed guidelines whereby a fund will only be able to use sustainability-related claims if 80% of investments meet the applicable criteria. As they currently stand, ESMA guidelines apply to both retail and institutional-only funds, whereas the FCA's proposals are confined to the retail market. In the US, the SEC proposed an extension to the fund names rule to require 80% of fund to meet the applicable criteria. The three approaches taken by the SEC, European Commission and the FCA are underpinned by a clear reference to the **investment objective**, and we support an effort to ensure alignment with the SEC and European Commission's approach.

Question 22: Do you agree with the proposed marketing rule? If not, what alternative do you suggest and why?

We support the FCA's recognition of the key role that marketing plays in investors' understanding of the product's features. As IOSCO outlines, asset-manager greenwashing can occur through marketing communications that do not accurately reflect the level and/or extent of the asset manager's consideration of sustainability-related risks and opportunities.[16] As the FCA is aware, these forms of marketing may lead investors to invest in products based on an incorrect understanding of the products sustainability-related investment objectives or how the product will achieve those objectives.

To ensure transparency and provide investors with the information needed to make informed decisions, fund level disclosure should reflect investment practices and align with marketing materials. In particular, the qualifying language ('*sustainable, ESG, impact, responsible, green, SDG, Paris aligned, climate, sustainability, net-zero')* is suitable, and at this stage, provides appropriate guidance on what kind of language in marketing triggers a breach. Nonetheless, as stated in our response to Question 21, the FCA should **factor in emerging language in their rules.**

[15] https://www.fca.org.uk/publication/consultation/cp22-20.pdf p.32
[16] IOSCO, Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management. Final Report. November 2021.

The FCA's proposal allows that firms will be able to use such qualifying terms, provided that 90% or more of the total value of the products in which the relevant portfolio invests qualify for a sustainability label, and that terms are not used in a misleading way. However, it is unclear how the FCA will consider whether the terms are being used in a "misleading way." We recommend the FCA place **greater emphasis on the stated intentionality** to define misleading language more clearly. The threshold of 90% is a high bar to meet, and a requirement for sustainable funds to meet a higher threshold than non-sustainable funds for naming rules would be counterintuitive.

In EU member countries, marketing communications are prohibited from contradicting information set out in any of the requirements under the SFDR. There is scope FCA extend SFDR's determinations of contradictory information to prohibit 'materially misleading' information, which sets a necessary higher bar than contradictory information.

The proposal further prohibits qualifying sustainable focus and sustainable improvers products from using the term 'impact' in the naming and marketing of products. While we understand the rationale behind this proposal in practice, this would prevent the sustainable focus and sustainable improvers products from addressing impact in any way. This is contrary to PRI's understanding of the categories (and of the range of approaches to investing that can improve sustainability impacts): each of the 3 categories can accommodate investment approaches that involve setting objectives to improve real world sustainability outcomes/impact - albeit distinct approaches. It would be counterproductive for the term 'impact' to be associated only with the "sustainable impact" category, which describes a distinct set of impact strategies, rather than capturing all types of products and strategies that may entail investing for sustainability impact.

To mitigate this effect on non-impact products, the FCA should clarify that this prohibition only applies to fund names, while also clarifying that the above marketing provisions apply to all funds. This clarification would ensure that other funds can discuss their considerations of impact, as long as this is not done in a non-misleading way that overemphasises that focus.

Question 23: Are there additional approaches to marketing not covered by our proposals that could lead to greenwashing if unaddressed?

Financial education programmes

As noted above, definitions and language evolve rapidly, especially in the responsible investment field. As such, there is a need to educate investors about climate-related financial risks and how they can incorporate sustainability considerations in their decision-making. A recent survey conducted by IOSCO concluded that financial investor education is an instrumental tool that can help support sustainable finance and protect investors against greenwashing and sustainability-related risks.[17] More than half of the jurisdictions included in the IOSCO survey have implemented at least one financial educational programme in relation to sustainability-related risks, and several other jurisdictions intend to undertake such initiatives in the future. Once the FCA's SDR and investment

[17] 2 International Organization of Securities Commissions (November 2021), Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management (p.54-p.55)

labels regime have been implemented, we recommend that the FCA develop their regime to offer investor education.

Data quality

Data quality issues create an avenue for greenwashing by entities to occur, addressing data quality is therefore an important part of the solution. We support efforts made by the ISSB to **build a global baseline on corporate sustainability reporting**, and further recommend that the FCA embed these in guidance. To avoid greenwashing and provide useful information to the market, any sustainability claim must be verified with reference to an objective benchmark or standard. This creates a role for taxonomies of sustainable activities, which set a common language between investors, issuers, and policy makers, and helps to increase investments that are consistent with sustainability goals. While sustainable taxonomies are becoming increasingly common, it is crucial that these are harmonised across jurisdictions, and currently there is a lack of comparability on terms, thresholds, and sector classifications, leaving room for greenwashing.

Global alignment

Financial markets are increasingly interconnected, with asset owners and managers working across multiple jurisdictions. At the same time, the number of investment-related ESG reporting requirements on asset owners and investment managers to tackle greenwashing, both mandatory and voluntary, is rising. This is creating a complex and fragmented environment for firms to navigate. Divergence among jurisdictions is concerning for investors, especially those that face requirements in multiple jurisdictions or rely on comparable reporting from investment managers in different jurisdictions. In the Institute of International Finance (IIF) - European Banking Federation Global Climate Finance Survey of 70 financial institutions, 65% of institutions reported that 'green' regulatory market fragmentation was a major obstacle and would have a material impact on the market for sustainable finance.[18]

The FCA's mapping of SDR proposals against SFDR requirements and SEC proposals is welcomed, and we would like to highlight that the FCA's regime must adapt and respond to changes in global standards. We strongly support the FCA's efforts in working with other global regulators, both bilaterally and through IOSCO, to promote international coherent solutions wherever possible.

The FCA has tailored its proposals with the intention of acting as a bridge between regimes and intending to strike greater global convergence. The FCA's commitment to global regulatory alignment will benefit UK investors and global investors looking to invest in products in the UK, through the broad level of alignment between the proposed SDR, the SFDR and the US SEC's proposals on sustainable investment products (as shown in Annex 1 of the Consultation Paper). For instance, all three contain entity- and product-level reporting.

However, we recognise there are some key differences. For example, SDR would require firm-specific indicators, as opposed to a mandated minimum set of metrics under the SFDR.

While we acknowledge relevant nuances in the scope and objectives of SDR, we strongly encourage the FCA to continue to work closely with other regulators to align approaches to the extent possible, aim for interoperability, share best practices, and avoid market fragmentation. As the FCA is aware,

[18] The Institute of International Finance (IIF) and European Banking Federation (January 28, 2020), Global Climate Finance Survey: A Look At How Financial Firms Are Approaching Climate Risk Analysis, Measurement, and Disclosure.

global developments surrounding ESG-related disclosure are evolving rapidly, and numerous regulatory efforts have emerged to address market fragmentation in the use of ESG names and standards in various jurisdictions and regions.

As outlined in PRI's Policy Engagement Handbook, if sustainable finance and investment policies are to realise their full potential (i.e., driving capital towards sustainable, inclusive and zero-carbon activities), global alignment of their scope, requirements, and purpose will become an increasingly important feature.

Question 27: 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?

Occupational Pension Scheme (OPS) firms are the in-house investment management arms of occupational pension schemes and have their own FCA-regulated firm category. Typically, an OPS firm has one client only (the trustee of the relevant pension fund) and therefore an OPS firm owes regulatory obligations to its sole client. Within the Consultation Paper, it is not clear whether SDR proposals apply to OPS firms, as the paper refers to 'providers of pension products' rather than 'pension schemes' themselves.

There are cases where pensions schemes are or will be subject to DWP's regulations on ESG reporting and disclosures, but at present, the respective investment subsidiaries *may be* in scope for the SDR requirements. In this case, OPS firms could be subject to regulatory duplication, confusion, and unnecessary complexity. We recommend that the FCA works with DWP to ensure that if there is a requirement for pension schemes to provide SDR-type data to their members, such requirements are delivered via pension fund regulation rather than fund manager regulation.

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to further support the work of FCA in the development of disclosures and labelling regime in the UK.

Please send any questions or comments to policy@unpri.org.

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