

FCA consults on Sustainability Disclosure Requirements and investment labels

The FCA has published a discussion paper on proposals to introduce a new sustainable disclosures and investment labelling regime.

To coincide with COP 26 Finance Day, the FCA has published a [Discussion Paper](#) (DP 21/4) inviting comment on its proposals to introduce a new sustainable disclosures and investment labelling regime. The proposals follow on from the Government’s Roadmap to Sustainable Investing which was published last month.

The Discussion Paper was published alongside, and forms part of, the FCA’s “Strategy for positive change: our ESG priorities”. Please see our [separate note](#) which summarises this.

The FCA is asking for comments on DP21/4 by **7 January 2022**. It plans to consult on policy proposals in Q2 2022.

1. Overview

The Discussion Paper sets out the FCA’s proposals to establish a three-tiered product labelling and sustainability disclosure regime:

- (i) Product label**
a standardised product classification and labelling system
- (ii) Consumer-facing disclosures**
containing key product-level information in the form of standardised information on the product’s key sustainability attributes
- (iii) Detailed disclosures at product and entity level**
on sustainability risks, opportunities and impacts. This is more granular information intended for institutional investors and other stakeholders

The third limb (entity and product level disclosures) is intended to build on the FCA’s proposals for TCFD-aligned climate-related disclosures requirements, as set out in [CP21/17](#).

Who will be impacted by the proposals?

The Discussion Paper focuses on UK authorised firms involved in asset management and decision-making processes, but the FCA will also in due course explore how to introduce sustainability-related disclosure requirements for financial advisers. In particular, requiring financial advisors to take sustainability matters into account in their investment advice and to understand investors’ preferences on sustainability as part of the suitability assessment.

The FCA is also considering how overseas funds marketing products in the UK should be treated but provides no further detail on that issue at this stage.

2. Sustainable investment labels

The FCA is proposing to introduce a product classification and labelling system to identify a product's sustainability characteristics. This is intended to address the key challenges for investors in light of the interchangeable use of key sustainable finance and ethical terms and lack of commonly agreed definitions.

Key to this appears to be a desire by the FCA not to 'reinvent the wheel' and to ensure alignment with existing internationally recognised standards. The FCA acknowledges that there are already various initiatives focused on establishing labelling or classification systems (for example, the Investment Association's [Responsible Investment Framework](#), the IOSCO [Recommendations](#) for sustainability-related practices, policies, procedures and disclosures, the CFA voluntary [ESG disclosure standards](#) etc), and is seeking views on how best to leverage those as part of its sustainable investment labelling regime.

The FCA views the following as the key design considerations:

- **Objective vs subjective product labels** – the FCA is proposing to base the labels on objective criteria, e.g. referencing the proportion of sustainable investments, rather than using subjective markers, such as traffic lights or medals. The idea being that an objective approach will enable investors to navigate products without imposing a value judgement as to whether a product is 'good' or 'bad'.
- **Investment objectives vs allocation of investments to sustainable projects and activities** – in identifying types of sustainable products, different dimensions could be considered. For example. the sustainability and characteristics, themes or objectives of the product and how the product pursues them, and the proportion of investments allocated to sustainable projects or activities (possibly using the sustainability criteria of the UK Taxonomy).
- **Consistency and compatibility with current market and existing initiatives and flexibility as the market develops** – the FCA highlights the need to use terminology that is already familiar to investors and the industry. The FCA's preference is to build upon existing initiatives to develop a coherent and interoperable system.

The FCA's preference is for a classification and labelling system that applies to all investment products, not just those that make sustainability claims. It is also seeking views on the extent to which UK proposals remain consistent with the European Sustainable Finance Disclosures Regulation ("**SFDR**"), while reflecting the needs of the UK market. As such, it has attempted to map across its proposed labels onto the product types under SFDR, i.e. Article 6, 8 and 9 products.

Its current proposals for a sustainable classification and labelling system are as follows:

	Not promoted as sustainable	Responsible	Transitioning	Aligned	Impact
Description	<p>Sustainability risks have not been integrated into investment decisions.</p> <p>No specific sustainability goals</p>	<p>Impact of material sustainability factors on financial risk and return considered to better manage both risks and opportunities and deliver long-term, sustainable returns.</p> <p>No specific sustainability goals.</p>	<p>Products with sustainability characteristics, themes or objectives that do not yet have a high proportion of underlying assets meeting the sustainability criteria set out in the UK Taxonomy. These products pursue strategies that aim to influence underlying assets towards meeting sustainability criteria over time, for instance through active and targeted investor stewardship.</p>	<p>Products with sustainability characteristics, themes or objectives and a high proportion of underlying assets (measured according to a minimum threshold) that meet the sustainability criteria set out in the UK Taxonomy.</p>	<p>Products with the objective of delivering net positive social and/or environmental impact alongside financial return.</p>
Minimum criteria	N/A	<p>ESG integration, evidence of ESG analytical organisational capabilities and resources, demonstrable stewardship</p>	<p>Evidence of sustainability characteristics, themes or objectives that are reflected fairly and consistently in the investment policy or strategy and may include some combination of:</p> <ul style="list-style-type: none"> • Restrictions to the investible universe • Screening criteria • Application of benchmarks or indices • Stewardship approach 	<p>See Transitioning criteria with the addition of minimum thresholds for asset allocation</p>	<p>Intentionality, theoretical ability to deliver and measure additionality through investment decision-making and investor stewardship, impact measurement and verification.</p>
SFDR mapping	Article 6	Article 8	Article 8	Article 9	Article 9

The above five categories will be underpinned by minimum product-level criteria to meet the “responsible” and “sustainable” categories. The FCA is not yet proposing minimum entity-level criteria but welcomes views on whether this would be appropriate to ensure the firm’s own approach is consistent with the product’s aims (e.g., in relation to systems and controls, governance, ESG integration and stewardship).

It is interesting that the FCA is proposing a separate category for “transitioning” products. The purpose of this is to allow products pursuing sustainability characteristics, themes or objectives, but investing in assets that are transitioning, to be labelled as “sustainable”. This aims to recognise the important role in facilitating transition through active stewardship and to avoid discouraging investment in economic activities that are in the process of transitioning.

The FCA is also establishing a Disclosures and Labels Advisory Group (DLAG) made up of industry experts and consumer representatives, to provide feedback, technical advice and constructive challenge.

The FCA is also helpfully seeking views on circumstances in which labels might not be meaningful/feasible. For example, for segregated mandates or where products are not targeted at retail investors.

3. Sustainability Disclosure Requirements (SDR)

The second part of the FCA’s proposals will require listed issuers, asset managers & asset owners to report on sustainability risks, opportunities and impacts. This builds on the FCA’s TCFD aligned climate-related disclosure rules at entity and product level, and, in common with the SFDR, broadens the scope to cover wider sustainability topics beyond climate change.

However, perhaps acknowledging some of the frustrations expressed by the industry on the prescribed form and level of detail required for the SFDR disclosures, the FCA highlights the need to ensure information provided to retail investors is proportionate and comparable and, in contrast to the SFDR, is proposing two layers of disclosures:

(i) Initial consumer-facing disclosures accessible to retail clients.

These are expected to cover the following information:

- investment product labels
- the objective of the product, including any sustainability objectives
- the investment strategy pursued to meet objectives
- the proportion of assets allocated to sustainable investments (based on criteria set out in the UK Taxonomy)
- the approach to investor stewardship
- wider sustainability performance metrics

The FCA is carrying out experiments to test consumer-facing disclosures with consumers to get a better understanding of what consumers understand and what types of information they would find useful. The findings of those experiments will be published next year and will inform the FCA's proposals on the content of consumer-facing disclosures.

The FCA also considering a baseline set of core sustainability metrics to enable consumers to understand sustainable performance over time, e.g. carbon reduction metrics.

In terms of format for the disclosures, the FCA is proposing to develop a baseline level of prescription for disclosures via use of a template or 'ESG factsheet' designed to be read alongside the KIID.

(ii) Detailed disclosures for institutional/sophisticated investors and other stakeholders at both entity and product-level.

The TCFD-aligned product and entity level disclosures will act as the foundation for these disclosures.

Product level

At a product-level, the disclosures are expected to include the following information:

- methodologies used to calculate metrics, including explanations of proxies and assumptions used to fill data gaps
- information on data sources, limitations, data quality etc
- further supporting narrative, contextual and historical information
- further information about UK Taxonomy alignment
- information about benchmarking and performance

Entity level

Entity level disclosures will build on existing entity-level disclosures under the TCFD disclosure requirements. In expanding the scope of disclosure requirements beyond climate change, the FCA is keen to understand whether there are any jurisdiction-specific sustainability-related considerations to take into account.

4. Alignment with other sustainability disclosure initiatives

The FCA is exploring the extent to which the content of disclosure requirements under SFDR is relevant to the UK market.

The global baseline sustainability reporting standards to be developed by the International Sustainability Standards Board ("**ISSB**") will form a core component of the SDR framework and the backbone of its corporate reporting requirement.

The FCA also recognises that some firms that form part of a listed group might disclose against the ISSB sustainability standards, which provide more specificity than TCFD disclosures. The FCA will consult on amending its TCFD-aligned disclosure rules for listed companies to reference the ISSB standard and would ensure a consistent approach for investment firms to ensure flow of information along the investment chain.

5. Other considerations

The FCA is also seeking views on any practical challenges to its approach, in particular ensuring information disclosed is made available along the distribution chain.

The FCA is also intending to explore whether there are market-led mechanisms that might support the proposals. For example, the independent third-party verification of product-level disclosures which might improve the quality of sustainability-related information.

6. Next Steps

The FCA is inviting responses to the 20 questions it has identified in the Discussion Paper, by **7 January 2022**. Responses will inform policy proposals to be issued for consultation in Q2 2022.

Key Contacts for this document



Lucian Firth

Partner

T +44 20 7825 4155

E lucian.firth@simmons-simmons.com



Nick Colston

Partner

T +44 20 7825 4147

E nicholas.colston@simmons-simmons.com



Catherine Weeks

Partner

T +44 20 7825 3940

E catherine.weeks@simmons-simmons.com



Craig Bisson

Partner

T +44 20 7825 4691

E craig.bisson@simmons-simmons.com



Louise Tudor Edwards

Managing Associate

T +44 20 7825 4539

E louise.tudor-edwards@simmons-simmons.com



Tristram Lawton

Managing Associate

T +44 20 7825 3488

E tristram.lawton@simmons-simmons.com



Katherine Tracey

Managing Associate

T +44 20 7825 4820

E katherine.tracey@simmons-simmons.com



James Wallace

Managing Associate

T +44 20 7825 4249

E james.wallace@simmons-simmons.com