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FCA – SUSTAINABILITY DISCLOSURE REQUIREMENTS (SDR) AND INVESTMENT LABELS

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E3G is pleased to provide feedback on the FCA’s proposals to introduce Sustainability Disclosure Requirements (SDR) and Investment Labels. This response builds on E3G’s previous reply to the FCA’s consultation on the same subject in January 2022.¹ E3G welcomes the FCA’s commitment to introduce an SDR and Investment Label regime to support investor clarity on green investments. This was a core commitment of HM Government’s 2021 policy document *Greening Finance: A Roadmap to Sustainable Investing*,² and a key recommendation of the January 2023 *Net Zero Review*.³

Summary

If the UK is to leverage the investment required to reach net zero, and if the City of London is to become the world’s first net zero-aligned financial centre, it is vital that the FCA’s SDR regime succeeds in ensuring the integrity of the market for sustainable investment products by increasing transparency, consistency, and credibility in green investment products. Clear, science-based guidance will support market confidence and tackle greenwash. A summary of E3G’s recommendations for the FCA’s updated SDR and Investment Labels can be found below.

Scope of requirements

- > The FCA should extend its proposed regime to funds marketed in the UK by firms domiciled overseas to prevent greenwashing and ensure market consistency.

¹ https://e3g.wpenginepowered.com/wp-content/uploads/FCA-Labels-and-SDR_Response_Press-Release.pdf

² <https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing>

³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1128689/mission-zero-independent-review.pdf



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- > Firms with under £5 billion AUM should be encouraged to report on a voluntary basis and included in the regime within a definite timeframe.

Sustainability labels and metrics

- > FCA Investment labels should define ‘sustainable’ according to a credible, objective and science-based standard, such as the UK’s Green Taxonomy. Any labels should be aligned with the UK Green Taxonomy as soon as it is established.
- > Funds receiving any of the FCA’s three proposed sustainability labels should operate within additional guardrails, including:
 - Alignment with a whole-economy approach to the UK’s net zero targets and an overall 1.5-degree pathway.
 - Clear exclusion criteria for fossil fuel investments. E3G would like to see absolute exclusions on fossil fuel investments for any product receiving one of the FCA’s three labels. If the FCA decides, however, not to mandate exclusions for the ‘Sustainable Improver’ label, then the next best alternative would be to require clear exclusions on coal and oil investments and strict time-bound limitations on gas for this label if it were to be included.
 - Under the ‘Sustainable Improvers’ label, the FCA should clarify which metrics will be used to evaluate transition investments. We also note that the thresholds for what can be classified as a ‘transition’ investment will naturally change over time as the UK’s transition pathway progresses, so we welcome regular reviews of this category. FCA should refer to the work of the Transition Plan Taskforce for guidance on relevant KPIs.⁴ This will also require the development of clear net zero stewardship guidance for firms, perhaps as an update to the Stewardship Code.
 - Provision should be made to ensure that investments with sustainability labels do not negatively impact biodiversity or other natural assets. Protections for nature could be achieved through Do No Significant Harm conditions or alignment with other baseline social and environmental standards.⁵

⁴ <https://transitiontaskforce.net/wp-content/uploads/2022/11/TPT-Disclosure-Framework.pdf>

⁵ <https://www.greenfinanceinstitute.co.uk/wp-content/uploads/2022/10/GTAG-Advice-on-the-development-of-a-UK-Green-Taxonomy.pdf>



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- > The FCA should also explore introducing a label for unsustainable investments, to encourage firms to reorientate their investment portfolios away from polluting assets. Requirements for entities should include Transition Plans and clear stewardship guidance, including clear timelines on fossil fuel phase out.

Interoperability

- > E3G welcomes the FCA's commitment to align its SDR and Labelling regime with the evolving ISSB framework. This should be done as soon as possible for both entity- and product-level disclosures.

Disclosure format

- > To assist firms in disclosure against the proposed investment labels, the FCA could consider introducing a voluntary guidance template for disclosures, to assist data gathering on economy-wide financial flows. To support aggregation companies must generate consistent data points which communicate key information and can be electronically tagged and compared. At the same time there is value in enabling flexible and qualitative disclosures. The Transition Plan Taskforce's guidance could provide a useful reference point as the FCA explores how to ensure that firms strike the correct balance.

Implementation review

- > E3G welcomes the FCA's proposals for a 3-year implementation review, and for the introduction of enforcement mechanisms to ensure uptake and implementation of these standards is regular, transparent, and robust. The review should include regular consideration of what is classed as green, and as a transition investment, under the Sustainable Improvers label.

Consistent expectations across the fund universe

- > All funds should be required to report on how they integrate ESG considerations into their decision-making process, whether or not they have a sustainability label. This is in line with the FCA's mandate to have 'regard to' net zero.



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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?

- > E3G largely agrees with the FCA's proposals for the scope of firms, products and distributors to be included in the SDR and Investment Label regime. However, we are concerned that overseas funds will not initially be included. This may have negative impacts, including leading to market inconsistency and greenwashing in overseas products marketed in the UK, which would undermine the FCA's objectives. We would therefore like the FCA to set out proposals to include overseas funds in its regime within a definite timeframe. Assessment of alignment of these funds should also be underpinned with the UK Green Taxonomy as soon as possible.
- > E3G would also like to see smaller firms, with under £5 billion in AUM, included in the FCA's framework. Firms with under £5 billion AUM should be included within the regime within a definite timeframe. Including these entities may require offering them increased support and guidance. This could take a staging approach, where large non-listed institutions with 500+ employees are also encouraged to disclose against the labelling scheme.
- > We also recognise that small firms will play an important role in the UK's transition to net zero, so a first step may be to encourage smaller firms to report on a voluntary basis, and then to feedback on their experience.
- > Beyond those eligible for sustainability label criteria, all funds should be required to take ESG considerations into consideration and report on how they integrate them into their decision-making process, whether or not they have a sustainability label. This is in line with the FCA's mandate to have 'regard to' net zero.

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

- > We have some concerns about the proposed sequencing of the FCA's proposals. We note that, at time of writing, there is no clarity from government on either the publication of a UK green taxonomy or on the legislative rollout of Sustainability Disclosure Requirements (SDR). Without a credible, science-based standard of what is green and what is not (i.e. under the Green Taxonomy), the SDR regime may not succeed in



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combating greenwashing. This will have significant knock-on effects for the Net Zero Transition and without a robust corporate disclosure regime backed by legislation firms may not have access to the data they need to comply with the SDR's upcoming requirements.

- > E3G supports the FCA's decision to carry out an implementation review of SDR proposals after three years. This review must evaluate the success of the FCA's enforcement mechanisms and the wider uptake of the standards it proposes.

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?

- > E3G welcomes the FCA's proposal to require a specific sustainability objective for investments classed as 'sustainable'. We note that this represents a significant improvement on the EU's SFDR regime. However, we would prefer the FCA to go further and require that 'sustainable' investments align with a whole-economy approach to decarbonisation, the UK's net zero targets, and a 1.5-degree pathway. We note that this is the approach that the Transition Plan Taskforce has taken in its recommendation for credible transition plans. This should also include strict exclusion criteria on fossil fuel investments.
- > E3G also welcomes the FCA's openness to consider using the UK's Green Taxonomy, when developed, as one possible standard for sustainability. We would encourage the FCA to align with the UK Green Taxonomy as soon as it is possible. In the meantime, we have some concerns that multiple, competing definitions of 'green' may increase market confusion and decrease the effectiveness of reporting.

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?*



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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?

- > E3G welcomes the high numerical threshold for products receiving the ‘Sustainable Focus’ investment label. However, questions remain about the composition of the 30% ‘non-aligned’ portion of the investment. For a product to receive this label, there should be a strict fossil fuel exclusion policy in place, so that no funds investing in fossil fuels are classed as sustainable. This exclusion is necessary to prevent greenwashing.
- > This should also be the case for the ‘Sustainable Impact’ label, where firms investing in new technologies should be subject to clear exclusion criteria for fossil fuel investments, and the ‘Sustainable Improver’ label. However, if the FCA decides against instituting strict exclusion criteria for ‘Sustainable Improver’ products, the next best alternative would be to mandate a strict exclusion for coal and oil investments, and time-bound limitations on investment in gas.
- > Without exclusion criteria, the FCA’s new labels risk muddying the water on what it means to be ‘sustainable’ and will defeat the purpose of a sustainability labelling scheme: providing the market with clarity. For guidance, the FCA might refer to the work of the Powering Past Coal Alliance, which has developed principles on thermal coal phase-out amongst its members. Moreover, on the firm level, reference could be made to Transition Plan Taskforce guidance on supporting fossil fuel phase out.

See also our response to question 9 for further reflections on the FCA’s proposed investment label criteria.

Question 7: Do you agree with our proposal to only introduce labels for sustainable investment products (i.e., to not require a label for ‘non-sustainable’ investment products)? If not, what alternative do you suggest and why?

- > We propose that the FCA includes a label for unsustainable investments, in addition to the three sustainability labels included in the consultation. This would provide consumers wishing to avoid unsustainable products with the easily accessible information that they would need. We recognise that few firms are likely to apply the ‘unsustainable’ label to their own investments, and that the FCA may have to propose some penalties for

firms not using the 'unsustainable' label in the marketing of unsustainable products.

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

- a. The 'Sustainable Focus' category, including the 70% threshold?*
 - b. The 'Sustainable Improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?*
 - c. The 'Sustainable Impact' category, including expectations around the measurement of the product's environmental or social impact?*
- > Funds receiving any of the three sustainability labels should operate within additional guardrails. All should be aligned with an overall 1.5-degree emissions pathway for the UK, and a whole-economy approach to meeting the UK's net zero emissions target.
 - > In addition, steps should be taken to prevent funds adversely impacting nature and biodiversity from receiving any of the FCA's three sustainability labels. If this guarantee is not achieved through "Do No Significant Harm" (DNSH) requirements, then the FCA must propose robust baseline conditions to ensure protections for the natural environment.
 - > For the Sustainable Improvers category, we have some concerns about the lack of credible standards and KPIs currently available to define transition investments, which may increase the risk of greenwashing. The FCA should offer further guidance on what a good 'Sustainable Improver' looks like and should refer to the work of the Transition Plan Taskforce in doing this. This guidance should be regularly updated as the UK's transition progresses.
 - > The 'Sustainable Improver' label will also require clear stewardship guidance for firms, which should align with any updates to the Stewardship Code to account of the UK's net zero target.

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?

- > We strongly support the FCA's decision to update its disclosure requirements in line with evolving ISSB standards. This should be done as soon as possible, for both product- and entity-level disclosures.



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- > Aligning FCA labels with ISSB will support international coherence of disclosures and support multinational companies in disclosing across their portfolios in different jurisdictions.

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?

- > While we understand the practical issues that surround mandating use of a template at this stage, E3G also notes the benefits that would arise if firms were required to disclose consistent data points that communicate key information and could be electronically tagged. This would increase comprehensibility and comparability for consumers and facilitate economy-wide tracking of financial progress to net zero. This is especially significant, given the Net Zero Review's openness to a 'Net Zero investment Plan',⁶ supported by the investment industry,⁷ which would require widespread mapping of public and private financial flows. One solution may be to encourage voluntary reporting according to a template. To facilitate adoption and implementation, any template or guidance on disclosure implementation should take note of the flexible approach used by the Transition Plan Taskforce, which allows firms to disclose qualitative considerations in support of their transition pathway.

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

- > While E3G agrees with the principle of an 'anti-greenwashing' rule, we believe that any such rule, to be effective, must be based on a central, science-based definition of green. We would urge the FCA to align their greenwashing rule with best practice science-based guidance, and the UK's Green Taxonomy when finalised, into its proposals as soon as possible.
- > Any 'anti-greenwashing' rule must also be backed up by sufficient enforcement capacity on the part of the regulator, to ensure that firm penalties exist for firms found to be misleading the public about the sustainability profiles of their products.

⁶ <https://www.gov.uk/government/publications/net-zero-review-final-report>

⁷ <https://www.e3g.org/news/investors-managing-3-trillion-in-assets-call-on-uk-government-to-deliver-net-zero-investment-plan/>



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Question 25: What are your views on how labels should be applied to pension products? What would be an appropriate threshold for the overarching product to qualify for a label and why? How should we treat changes in the composition of the product over time?

- > E3G recognises the significant role that pension products play in the UK's financial system, and the important relationship they have with consumers. We would therefore encourage the FCA to expand its labelling regime to pension products as soon as possible, to help consumers choose financial services which accurately reflect their own sustainability preferences.
- > The FCA should also encourage providers of pension products to adopt net zero-aligned transition plans to help consumers and regulators track their progress on sustainability-related metrics, and encourage them to report against the UK's Green Taxonomy as soon as this becomes possible.

For any questions on E3G's response, please contact Heather.mckay@e3g.org.

About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics, and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

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