CP22/20 Sustainability Disclosure Requirements (SDR) and investment labels

Nest's response

About us

Nest was established in 2010 as part of the auto enrolment programme to help people save for retirement. Unlike any other pension scheme in the UK, Nest has a legal obligation to accept any employer that wishes to use us to discharge their auto enrolment obligations. Over one million employers have signed up to use Nest.

Over the last decade, Nest has grown to be one of the largest pension schemes in the UK, with more than £25bn in assets under management. We are operating at scale as a high-quality, low-cost pension scheme helping over 11 million members save for their retirement. Many are low to moderate earners who may be saving into a pension for the first time. A typical Nest member earns around £20,300 per year and nearly half our members are under 35 years old.

Nest is built around the needs and behaviours of our members, from our approach to responsible investment to our focus on customer service. We now occupy a place in the market as a major Master Trust, helping to drive up standards and best practice across the industry. Nest has great potential for delivering pensions to mass market consumers for many years to come, leveraging our scale to deliver value through the combination of low costs, our market leading investment strategy and modernised services all overseen by strong trustee governance.

Response

We welcome the opportunity to respond to this consultation paper issued by the Financial Conduct Authority. The proposals have evolved significantly since the Discussion Paper published in late 2021, and we believe the direction of travel has been broadly positive.

We see several areas where further work is needed to ensure that the regime delivers on its intended outcomes:

- The current categories have evolved significantly since DP 21/4, but they are not yet sufficiently distinctive, let alone mutually exclusive. There is potential for overlap between the Sustainable Focus and Impact categories, especially in the absence of clear criteria for assessing alignment.
- The Sustainable Improvers category could act as a "catch-all" for funds that do not meet the other criteria and in our view needs more safeguards and a clearer demonstration of improvement to merit the label "sustainable".
- The delay of the UK Taxonomy, and absence of other credible standards to underpin the assessment of alignment leaves considerable uncertainty, particularly with regards to the Sustainable Focus category.

- The disclosures of unexpected investments we believe are too vague and subjective, making them difficult to apply in practice.
- Consideration of overseas and pension products should happen sooner rather than later, to avoid future inconsistency and address any potential challenges before the regime comes into force.

We would of course be delighted to participate in any further discussions with the FCA as they consider responses and develop the final proposals later this year.

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

We broadly agree with the proposed scope but would encourage the FCA to clarify its approach to overseas funds marketed to UK investors and pension products as soon as possible. We would expect that at a minimum, non-UK-domiciled funds marketed in the UK will need to be subject to the same naming and marketing rules to avoid greenwashing risk.

Through our engagement with asset managers and peers, as well as networks such as UKSIF, we are aware that some smaller asset managers fear that they may be disadvantaged by the proposals, and therefore may push for lowering the bar or extending the implementation period for firms below a certain size. We would strongly urge the FCA not to differentiate the labelling and consumer-facing disclosures by size. Nest takes the view that if firms are to invest the resource to develop the product, and to take it through authorisation and launch, they need to set aside the resource to continue to report on its sustainability, for as long as they continue to offer it.

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

We broadly agree with the implementation timeline. However, we have some concerns that the approaches taken by regulators including the Financial Conduct Authority, the Treasury, the Department for Work and Pensions and the Department for Business, Energy and Industrial Strategy are increasingly misaligned. We were disappointed to see the recent announcement that the Green Taxonomy has been delayed once again. This is of particular concern as the Green Taxonomy is highlighted in the Consultation Paper as a key framework for assessing the sustainability characteristics of a portfolio. We further believe that introducing disclosure requirements for financial institutions before real-economy firms is problematic. Investors need clear, consistent and comparable disclosures from investee firms in order to produce sustainability-related information. This includes information on taxonomy alignment of different parts of investee firms' businesses, but also applies to any other raw data which forms the basis of firm disclosures.

We would welcome clarification of the rationale for introducing the anti-greenwashing requirement two years before the first entity-level and performance-related disclosures must be published, and how effectively the FCA expects to be able to assess adherence to the requirement during the implementation period.

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

you expect to incur and the potential benefits you envisage.

We do not have any feedback regarding the proposed cost-benefit analysis.

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

We are supportive of the direction of travel and the changes that have been made to the proposals. We suggested removing the "responsible" label in our response to DP 21/4 and were pleased to see this has been implemented.

We agree that there is a need for greater focus on investors' contribution to real-world sustainability outcomes, but the current description of the channels is very narrow and not sufficiently nuanced. We have particular reservations about influencing asset prices. As highlighted in box 3, this requires a "sufficient weight of sustainability-focussed investors" making it difficult to attribute the change to individual investors. It also seems to favour investors with a larger shareholding. There are other factors that may influence asset prices and could, in different situations, either reinforce or undermine some of the movement driven by sustainable investors, making it even more difficult to isolate the effect attributable to an individual fund. These factors make such calculations complicated, subjective and assumption-laden, particularly across a diversified portfolio. These concerns also apply to some extent to stewardship and capital allocation decisions where it can also be difficult to attribute outcomes to individual investors. We think that this is one reason why fund managers have focused primarily on enterprise contribution. We note that the FCA acknowledges these challenges through its focus on intentionality, but we have some concerns about the ability to demonstrate this. An unintended consequence of these proposals could be that investors are encouraged to overclaim on their contribution to be able to classify their products, thus exacerbating the issue of greenwashing. We suggest that there should be a greater focus on both investor and enterprise efforts, to provide a more holistic picture.

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

As highlighted in our response to the previous question, we are broadly supportive of the proposed approach. In our response to DP 21/4, we suggested that the "impact" sub-category is retained but removed from the overarching umbrella of "sustainable" and created as a separate "axis" – so that funds may be impact and/or transitioning, or impact and/or aligned, or none of these things. Our view was that an impact fund would seek to fundamentally achieve something different from the other funds, in terms of intentionality. This is no longer the case by making intentionality a key feature of all three categories. Our main concern is that intentionality is difficult to measure and monitor. Our preference would be to base the labelling and classification primarily on the specific outcomes the product seeks to deliver.

Q6: Do you agree with the proposed distinguishing features, and likely product profiles and strategies, for each category? If not, what alternatives do you suggest and why?

We have some reservations about the approach of distinguishing categories by channel of influence while aiming for the categories to be mutually exclusive. We have already set out our concerns about the ability to influence asset prices specifically, but more broadly, we are not convinced that attempting to isolate each channel of influence is likely to bring about the desire sustainability outcomes. In our experience, most sustainable funds employ a combination of channels of influence, and these also tend to vary by asset class. We would urge the FCA to consider the applicability of this approach to asset classes outside of listed equities and assess whether it remains robust.

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?

We are generally supportive of a category that primarily invests in companies that are already aligned with a credible standard. While we are not convinced that it will always be possible to establish a clear link to reducing asset prices, and how consumers could realistically consider this in their decision-making, we believe that the concept of rewarding companies that have leading sustainability practices is a concept that makes sense to retail investors. But in the absence of a credible, consistent standard, we believe there are significant challenges to its implementation concern.

Firstly, in the absence of a UK Taxonomy, we would welcome clarification on whether there are any other existing frameworks (such as the EU taxonomy) that would be considered to be a "credible standard". We expect that many fund managers may seek to use internally developed frameworks and would also welcome clarification as to how they can demonstrate that they are robust and consistent.

Secondly, greater clarification of what "alignment" means at asset level is required. Should this be based on a revenue threshold, and if so, what should this be? We think there is potential for overlap here with the sustainable impact category. We would also be in favour of including a Do No Significant Harm (DNSH) criterion, for example by introducing some baseline exclusionary screens.

Thirdly, we believe that a minimum threshold is important, but introducing such a threshold before a credible standard for assessing alignment has been developed is very challenging. Our suggestion in response to DP21/4 was to base the threshold on a multiple of UK Taxonomy-aligned activities across the whole economy, which would also ensure that standards increase over time as the proportion of Taxonomy-aligned activities increases. We also question whether a single threshold is appropriate for all asset classes. We would welcome clarification from the FCA as to how this threshold was established, how it ensures it is both stretching and achievable across different asset classes, and how its proposed timelines may be impacted by the further delay to the UK Taxonomy. In our response to DP 21/4 we also recommended a review of the threshold at least every three years to maintain confidence in the labelling regime and would again encourage the FCA to commit to regular reviews, including whether the threshold should be increased gradually. We think that it is reasonable to expect that despite a significant proportion of aligned assets at inception, the alignment profile of the products should improve over time. We believe that for this category, once the UK Taxonomy is finalised, there

may be a need to reclassify a large number of funds, as has recently been the case with EU Article 8 funds. This could be confusing to retail investors and undermine confidence in the regime, and should be avoided.

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

We can see the rationale for including an Improvers category. If the UK's taxonomy broadly matches the EU's there will be a very low proportion of economic activities which are initially aligned, and considerable potential for a significant tranche of firms who are not currently aligned to become so. But we see this category as fundamentally different to the other two, as at investment, very few if not all assets are not considered sustainable. We are therefore worried that awarding a sustainable label would give the wrong impression to retail customers and ask the FCA to reconsider the appropriate name for this category. We further believe that this category is most at risk of potential greenwashing and free-riding. Specifically, we are concerned that this could become a "catch-all" for all funds that do not fit the two other criteria. This category is based on a theory of change that can be outlined but not demonstrated at inception. Investor claims on stewardship can be subjective and difficult to verify.

Finally, the focus on stewardship suggests that this category lends itself most closely to equity funds. This may not be an issue in itself, but we would encourage the FCA to consider the tools for effective stewardship across different asset classes. There may be other ways that investors could influence companies to improve their practices. Again, we would suggest focusing primarily on the outcomes that the product tries to achieve, without being too narrow about how it should achieve them.

To address some of these concerns, we have some minor suggestions to improve this category:

- Setting some minimum thresholds, for example through minimum threshold for alignment, a DNSH criterion or some exclusionary screens. There may be some activities that are unlikely to become aligned to a sustainable taxonomy framework. Equally, some companies may be able to make improvements but are engaged in such harmful activities that retail consumers would not reasonably expect to see them in any fund labelled "sustainable". We appreciate the FCA's efforts to address this concern through the provisions around "unexpected investments", however we believe these are too vague and subjective, and would favour a stronger of approach of excluding rather than explaining such investments.
- Strengthening the language around setting a "clear and measurable target for improvement", for example by mandating a target improvement for the proportion of assets considered aligned with a credible external framework over a specified time period.
- Setting a minimum expectation for the quantity and quality of stewardship activities. We noted that in Box 7, the example of an index-tracker fund is given, which uses a positive tilt coupled with an engagement approach focusing on the largest companies with poor ESG scores. Such a strategy may well hold between 1000 and 2000 stocks but may only engage with a small subset of 20-30. While we do not encourage quantity over quality, we expect that a fund manager in this category would carry out in-depth engagement with a significant proportion of assets, but question how feasible this is.

With regards to the second part of the question, the distinction between the "improvers" and "impact" categories is clear to us as institutional investors, though it could be argued that both categories aim for impact through real-world outcomes, but through different channels of influence. We are not best positioned to comment on whether this distinction is clear enough to retail investors.

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 term "impact" currently encompasses a range of product and means different things to different people, so we welcome the FCA's efforts to develop clear criteria for this category. In reality, all investors create positive and negative impacts on the environment and society through their investments and some enhance positive impact or reduce negative impacts through stewardship, which we believe makes this category especially challenging to define.

The Global Impact Investing Network ("GIIN") defines impact investments as "investments made with the intention to generate positive, measurable social and environmental impact **alongside a financial return**."[1] The definition is widely endorsed by the market including the Impact Investing Institute and many investment law firms including our own external counsel, Travers. The FCA's proposals however require intentionality for all three categories but focusing on new capital to achieve sustainability goals suggests that the key differentiator to the other two categories is through "additionality". This and the emphasis on solutions and underserved markets suggests a heavy skew to private markets funds. But even in primary markets, investors have no way of knowing whether someone else might have bought the assets at the same price, or at a lower (or higher) price, by how much lower (or higher) making it difficult to demonstrate additionality and we don't think it should be given as much emphasis. As with the sustainable focus category, it is also not clear what the test should be at asset-level, for example whether there should be a revenue threshold. As mentioned previously, we believe that these two categories have a lot of scope for overlap and the distinction between companies that are aligned with a sustainability standard and those that address market failures and support underserved markets may not be clear to retail investors. Given the 70% threshold for the "sustainable focus" category, we would expect to see a large proportion of companies in such funds that provide solutions to a variety of environmental and social challenges. We do not believe that changing the name to "solutions" would overcome this challenge.

Q7: 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 agree with the proposal. We expect all fund managers to carry out ESG integration and stewardship activities as part of their risk management activities. We therefore do not believe that these activities should merit a label. While we acknowledge that the extent of these activities varies, we believe that the bar for sustainable investment product should remain high. We are not convinced that the Sustainable Improvers category currently is distinctive enough from general ESG integration and stewardship activities to merit a separate label. We would therefore suggest strengthening the criteria for the label as outlined in our response to question 6b or removing the category.

[1] https://thegiin.org/impact-investing/need-to-know/#characteristics-of-impact-investing

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

- **whether the criteria strike the right balance between principles and prescription**
- **the different components to the criteria (including the implementing guidance in Appendix 2)**
- **whether they sufficiently delineate the different label categories, and;**
- **whether terms such as 'assets' are understood in this context?**

We welcome the FCA's proposals on the qualifying criteria, and the efforts made to ensure the criteria are sufficiently clear. Overall, we believe they strike an appropriate balance between being clear without being overly prescriptive. Our main concern, as mentioned in our responses to questions 4-7, is that the three categories, in particular the sustainable focus and sustainable impact categories, are not distinctive enough to ensure that they are fully mutually exclusive.

On Principle 1, we welcome the inclusion of considerations of adverse impacts. However, we believe that this is currently too weak. We do not think that retail investors would expect a sustainable investment product to lead to significant environmental or social trade-offs. We would therefore suggest strengthening the requirement to minimise adverse impacts and any trade-offs that may arise.

We also have reservations about the distinction between "direct" and "indirect" influence. We are unconvinced that any of the channels can reliably exert direct influence in bringing about a sustainability objective. We would therefore suggest removing this distinction but clarifying that any influence that investors may exert on their portfolio assets may be limited.

On Principle 2, while we appreciate the efforts made to identify "unexpected investments", we believe that there are practical challenges with this. There is a significant degree of subjectivity, and it is not clear what the view of a "reasonable investor" may be or how fund managers should ascertain this view (for example, should they sample existing retail investors through surveys or focus groups?). To ensure that they meet the requirement, firms may try to play it safe by providing an explanation of each asset held in the fund. We believe that a balance needs to be struck between comprehensive and detailed disclosures and accessibility for a retail investor audience. In a worst-case scenario, excessive "legalese" to justify each holding may undermine investors' confidence in the product.

We believe that Principle 3 is currently missing wording to ensure that the product remains fit for purpose, and that the sustainability objective remains worth pursuing.

Q9: 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.

On Principle 2, as highlighted in response to question 6, we believe that the criteria for the Sustainable Improvers category could be strengthened. We would like to see a Theory of Change included in this category too, outlining how the fund manager anticipates that the potential of the holdings to contribute to the objective will be realised.

We would also welcome clarification of the unexpected investment provision for the sustainable focus category in particular. We believe there could be two types of "misaligned investments":

a. Investments that might seem unexpected to a retail investor, but actually meet the standard the alignment is based on
b. Investments that seem unexpected and don't meet the standard, but in aggregate do not make up more than 30% of the total portfolio

We believe it would be helpful to distinguish between these categories. For the other two products, our understanding is that all assets are expected to meet the criteria and therefore there would only be one type of unexpected asset.

For the Sustainable Focus category, the Implementing Guidance suggests that a proprietary standard may be chosen as long as it is robust, consistent and credible, yet this seems to be at odds with the description of the categories in Chapter 4 which suggests that it must be independently assessed. We would welcome further detail on how a proprietary standard, which likely involves a significant element of intellectual property, can be demonstrated to be robust and credible.

Q10: Does our approach to firm requirements around categorisation and displaying labels, including not requiring independent verification at this stage, seem

appropriate? If not, what alternative do you suggest and why?

In relation to some of the characteristics of product classification and labelling, if the FCA's requirements are clearly articulated, subject to robust criteria and clearly measurable, then third party verification may be unnecessary. In addition, by adding unnecessary cost, it may put smaller firms off seeking verification, whilst also blurring responsibility for misreporting where it comes to light.

In practice, the absence of credible standards means that firms are likely to need to rely on third-party or proprietary frameworks to demonstrate alignment. In those cases, we believe that independent verification will be required to meet the FCA's expectations that the standard used is robust and credible. But it will be important to ensure that the standard of those providing the verification is sufficiently high so that verification can be trusted. We would encourage the FCA and Treasury to consider this in their work on regulatory oversight of ESG data and ratings providers.

We would also encourage the FCA to reconsider the degree to which retail investors will engage with the vast amount of pre-contractual disclosures, and consequently, whether it is realistic to assume that they will be sufficiently aware of the self-certification nature of the label, or whether they may interpret the trademarked graphic as an endorsement from the FCA.

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

We remain supportive of the tiered approach. We think that it is important to strike a balance between ensuring that consumers can easily access the most relevant information regarding the product's sustainability characteristics, but not overwhelm retail investors with a large amount of information.

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

We strongly favour the integration of SDR with existing and upcoming disclosures on TCFD. Broadening TCFD entity-level and product-level disclosures to encompass climate impacts, and wider sustainability impacts, risks and opportunities is the least burdensome and the most useful – for both consumers and institutional investors – to produce reporting, as many climate impacts overlap considerably with climate risks and opportunities, whilst many sustainability considerations interact closely with climate considerations.

Q13: Do you agree with our proposals for consumer-facing disclosures, including location, scope,

content and frequency of disclosure and updates? If not, what alternatives do you suggest and why?

We would encourage the FCA to be more specific on the elements that it would expect to see in the Key Information Documents.

As highlighted in the previous response to question 8, we believe that it will be challenging to determine the views of a "reasonable investor" to draw up a comprehensive list of unexpected investments as these could be highly subjective. This is a particular issue for funds in the sustainable improvers category, where many assets may initially seem unexpected. To comply with the rules, fund managers may wish to make this list as comprehensive as possible, which could be prohibited by the 2-page limit. We also expect that this section would need to change much more frequently than the other elements due to new information becoming available on assets as well as turnover in the portfolio. This is at odds with the requirement to inform clients in writing at least 60 days before the change is made: we want fund managers to be able to act quickly on new information and disclose this as soon as possible. Our preferred approach would therefore be to include this in the sustainable product report.

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

We agree with this proposal to avoid boilerplate disclosures. If such a template were to be developed by industry, we would expect that this would need to be supported and overseen by the regulator, to ensure that it remains robust and credible.

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

We agree with the proposal to require more in-depth pre-contractual disclosures in addition to consumer-facing disclosures. We note that the FCA expects this information to be static, however some of the required disclosures in paragraph 5.50 are likely to change over time – for example, how the target environmental and/or social profile of the product's assets align with the product's sustainability objective as the composition of the product changes. We would welcome further detail from the FCA on what it would consider "material changes" requiring updates to the pre-contractual disclosures.

We also have the same concerns about the "unexpected investments" disclosures highlighted in response to previous questions. The current provisions on disclosing potential trade-offs and unexpected investment are too vague and subjective. We would also welcome a DNSH criterion, at a minimum for the sustainable focus and impact categories. While we agree that this would be more restrictive, we believe that the label needs to set a high bar.

Q16: Do you agree with our proposals for ongoing sustainability-related performance disclosures in the

sustainability product report? If not, what alternative do you suggest and why? In your response, please comment on our proposed scope, location, format, content and frequency of disclosure updates.

The criteria for the sustainable focus category state that the sustainability report must "disclose how that strategy has been applied to achieve continuous improvement in environmental and/or social sustainability of the product's assets". While we are supportive of detailed stewardship disclosures for all products, we are not convinced whether a continuous improvement in sustainability is feasible for assets that are already considered "aligned".

We also note that the requirement to ensure that the requirement that "data relied upon to meet the criteria (ie for its KPIs) is sufficient to be disclosed (ie accurate and complete, including through use of proxies and assumptions where appropriate)" may be prohibitive. Much sustainability data suffers from insufficient coverage, and often is not audited. There is also wide variation across asset classes.

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

We agree with the proposals. As highlighted in our response to DP21/4, it is important to avoid a situation where institutional investors in pooled funds that are also marketed to retail investors are able to receive information on sustainability criteria, but not for discretionary portfolio management services.

We would welcome clarification of the "reasonable timeframe" for responding to requests.

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

We agree with the proposals to mandate sustainability entity reports for asset managers that build on the TCFD entity-disclosures. As highlighted in our response to CP 21/17, we would like to see these requirements be phased in for asset managers with under £5 billion over time.

We see the consumer-facing and pre-contractual disclosures as the critical disclosure requirements to tackle greenwashing. We recognise that the disclosure requirements will present a significant burden on fund managers resources. We therefore welcome the proposals for flexibility by allowing cross-references to existing disclosures.

As with TCFD reporting, we are supportive of aligning timing and frequency with firms' financial reporting.

Q19: Do you agree with how our proposals reflect the ISSB's standards, including referencing UK-adopted

IFRS S1 in our Handbook Guidance once finalised? If not, please explain why?

We recognise the challenges of developing clear and specific guidance on the content while the ISSB standards remain under development. While we have concerns about the overall sequencing of regulation and the additional resource burden, for both the FCA and in-scope firms, of updating the disclosure requirements at a later stage, we believe that the current wording will allow for a wide range of disclosures, and we therefore welcome the finalised ISSB S1 standard being included in future.

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

We agree with the proposal to introduce a general "anti-greenwashing" rule. We do not think that it makes sense to have separate requirements based on whether funds will be marketed to retail or institutional investors. Many institutional investors are still at risk of falling victim to greenwashing. Developing a consistent framework for sustainability disclosures is needed to ensure the integrity of the UK financial system.

In practice, we expect that managers marketing to retail investors will not differentiate the product for institutional investors as this will require additional resources. However, an unintended consequence could be that fewer sustainable products are made available to retail investors to avoid having to adhere to the naming and marketing rules. We therefore encourage the FCA to consider extending the scope of the rules to products offered to institutional investors sooner rather than later.

We note that while the term "greenwashing" is the most commonly used and may therefore be most meaningful to retail investors, it does suggest a narrower focus on environmental issues. The FCA may wish to consider whether another name may be more appropriate.

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

We broadly agree with the product naming rule, with a couple of caveats:

› The criteria for the labels may be stricter than some of the prohibited terms. Specifically, in many cases portfolio emissions are dominated by a small number of high-emitting assets. We think it is therefore possible for a fund to be on a Paris-aligned emissions pathway without meeting the 70% threshold for aligned assets required for the Sustainable Focus label.
› We would welcome more detail on the FCA's position on the subset of ethical funds that currently make up a significant part of the sustainable products landscape. Some of these funds may meet the requirements for the labels, but many are based primarily on negative screening. We would encourage the FCA to clarify whether "ethical" is likely to be a permitted term.

We anticipate that there might be some creativity in naming future products (for example, using solutions rather than impact) and would welcome greater clarity from the FCA as to how it will address these in future.

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

We believe there is currently a gap between the proposed naming and marketing rules. For example, as outlined in paragraph 6.16, a product may track an ESG-tilted benchmark and should disclose the use of this benchmark. As index providers are not in scope of these rules, we anticipate that there could be a situation where such a benchmark could include a prohibited term in its name. While the product naming rule would not allow the product to be named after the benchmark in this case, the prohibited term would still appear in the marketing materials. This could be confusing to retail investors and, despite the absence of the label, suggest to them that the product meets the same standard as a labelled product that includes the same term in its name.

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

No further comments.

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

We would urge the FCA to develop its approach to overseas funds sooner rather than later. This "temporary solution" is already a reality with overseas funds potentially categorised according to the EU SFDR regime. It would be very confusing for retail investors to be presented with an Article 8 or 9 fund while being told it does not meet UK sustainability disclosure requirements. Distributors might feel incentivised to suggest to clients, based on the diagram in Appendix I, that such funds "map" to the relevant category under UK SDR, but without the fund manager having obtained a label. This again could introduce greenwashing and should be addressed by the FCA as soon as possible.

One unintended consequence which regulators and industry should remain alive to is the possibility that savers choose products with the wrong risk/return objectives by prioritising sustainability labelling over all criteria in their fund selection. Sometimes this might drive savers to excess risk, as it will potentially be harder for sovereign bonds to demonstrate taxonomy alignment. We would therefore urge the FCA to consider how distributors might assess their client's suitability alongside their preferences.

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

We believe that the application of the labelling regime to pensions products should be a priority for the FCA to consider. Private pensions now form the largest component of total household wealth.[2] But there are a range of different pension products making it difficult to develop a single threshold. We agree that based on the current proposals, the starting point for such a label should be based on the constituent funds (where applicable), and the key question will be how to aggregate labels into a

[2] Office for National Statistics - Household total wealth in Great Britain: April 2018 to March 2020

headline metric. In its simplest form, this could be the proportion of the product is subject to any of the sustainability labels. Alternatively, there could be different requirements for a pensions product to be considered sustainable based on a threshold. As the FCA noted, both options will be challenging particularly for default funds as arrangements change over time and it may not be clear to beneficiaries why this proportion changes as they approach retirement, especially if their pensions no longer meets the threshold. As mentioned in the responses to previous questions, we also have reservations of the applicability of the labelling regime to some asset classes outside of listed equities, and such a metric may therefore not be meaningful. Pension products may also include underlying funds registered in other jurisdictions, making it necessary to clarify the treatment of overseas products.

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

We are broadly in favour of applying the same naming and marketing rules to ensure consistency. We believe that the main challenge for pension products is in determining the appropriate criteria for sustainability labels. We have reservations about changing the threshold of constituent funds for all pension products. A bigger issue in our view is that for default arrangements, an individual members' exposure to constituent funds is likely to evolve significantly as they approach retirement, which suggests that a static threshold may not be appropriate at all.

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

We would encourage the FCA to be mindful of the interlinkages and work with other financial regulators to ensure that the regime is applicable and consistent across the industry.

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

As many pension providers are already required to produce TCFD reports, either under FCA or DWP regulation, we don't see any particular challenges with extending the sustainability entity report disclosures to pension providers, though we would prefer that this is integrated into existing reporting and considers the overall reporting burden. Introducing consumer-facing and pre-contractual disclosures will require more careful consideration, primarily around the applicability of the labelling

regime to pension products. However, we don't see any reason to assume that it is not possible to extend the regime to other products over time.

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

It is difficult to comment on this while it is not clear how the labelling regime could apply to pension products. If the label is simply based on constituent funds, the exposure would vary for lifestyled or target date funds. It would therefore make sense to use the same approach as for the TCFD disclosures of selecting a representative profile. We also agree it would make sense to use this approach to disclosure of other sustainability-related metrics for all products.

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

Pension providers are one step further removed from real-economy firms and rely on information from investment managers. The process for collecting and collating the required metrics for TCFD reporting from fund managers is very time-consuming, and the quality of data varies hugely. We expect that only a small proportion of constituent funds initially will be subject to a label. Some assets may not fit well into any of the categories (such as cash or sovereign bonds). In other cases, fund managers have simply not sought to obtain the label, perhaps due the significant resource burden. Pension providers may ask fund managers to provide the information on non-labelled constituent funds so they can obtain the label, but there is currently no obligation to provide this type of data. Alternatively, they may rely on third-party verification and again we would urge the FCA to consider how it can oversee third-party ESG data and ratings providers.

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

challenges with the proposals, and suggest an alternative approach.

No comments.

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