CFA Society United Kingdom

7 January, 2022

Gwil Mason
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Submitted by e-mail to: dp21-4@fca.org.uk

Dear Mr Mason,

CFA UK response to the FCA regarding DP21-4: Sustainability Disclosure Requirements (SDR) and investment labels

The CFA Society of the UK (CFA UK)[1] is pleased to respond further on this important topic which is fundamental to the investment profession being seen to provide good service to wider society.

CFA UK fully agrees that financial services firms have an important role to play in the UK's transition to a more sustainable future and we believe that the FCA's proposals are a welcome positive step towards that. We also agree with the FCA that there is a genuine risk of consumer harm through greenwashing in the absence of appropriate regulation and so fully support the FCA with this initiative.

Achieving transparency and consumer trust in this developing market for ESG and sustainable products will be essential if it is to succeed; this is the reason why CFA Institute has developed its ESG Disclosure Standards for Investment Products[2]. CFA Institute's ESG standards are of course voluntary, but we are hopeful that they will see wide-scale global adoption, particularly by firms wishing to promote and educate investors on their approach to ESG investing, and so help raise the bar on the quality of ESG disclosures across the world.

CFA UK has been an active participant in regulatory consultations on stewardship, TCFD reporting and broader ESG reporting by asset managers, pension schemes and corporates over the few last years. Please see Appendix III for a full list of recent relevant consultation response letters. Our responses to the questions in this Discussion Paper are in Appendix II of this document.

[1] CFA UK's mission is to help build a better investor profession for the ultimate benefit of society. We refer you to Appendix 1 for a brief overview of both CFA UK and our umbrella organisation, CFA Institute.
[2] CFA Institute's ESG Disclosure Standards for Investment Products (November 2021): https://www.cfainstitute.org/en/ethics-standards/codes/esg-standards

EXECUTIVE SUMMARY

Below we summarise and highlight five key recommendations which underpin all our responses to the questions raised in the Discussion Paper:

1. **Harmonisation with EU and globally:** CFA UK welcomes the efforts that the FCA has made to align their proposals with the EU's SFDR regulations; however, we propose a system that offers even less divergence. Globally, we hope that divergences are kept to a minimum and that over time, perhaps within grandfathering regimes, we will be able to see convergence of regimes towards accepted, harmonised global best practice. CFA UK also agrees with the FCA on the need to standardise sustainability disclosures on a global basis over the coming years and recognises the central role that the forthcoming ISSB standards will play in the achievement of that goal.

2. **Regulatory classification & labelling system:** We support the FCA's proposed introduction of both a classification and labelling system under their regulatory oversight and the delineated approach for Retail and Institutional markets. We have previously supported the development of a labelling system that could be easily understood by investors but caveated that this needed independent and ideally regulatory oversight if greenwashing risks were to be mitigated [3].

3. **A simple approach that can be developed over time:** While we are supportive of the FCA's proposed introduction of a labelling system, we strongly encourage the FCA to develop as simple an approach as possible initially. We have concerns that 'Transitioning', 'Alignment' and 'Impact' for potential introduction in later years are not mutually exclusive categories and recommend the distinctions between them be developed in later years once investors are better educated in this area and the infrastructure for sustainability disclosures is further advanced. We recommend <u>three</u> rather than five classifications as illustrated below. This has the benefit of being more closely aligned with SFDR.

FCA Proposal:		**CFA UK Proposal:**
'NOT PROMOTED AS SUSTAINABLE'	→	'NOT PROMOTED AS ESG INTEGRATED OR SUSTAINABLE'
'RESPONSIBLE INVESTMENT'	→	'ESG INTEGRATED'
'TRANSITIONAL'	→	'SUSTAINABLE'
'ALIGNED'		
'IMPACT'		

[3] CFA UK's response to the Investment Association's consultation on sustainability & responsible investment (March 2019): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-letter-to-jess-foulds-at-the-ia_.pdf

We expect funds in the 'Sustainable' category to have an ESG integrated investment process capable of not only identifying ESG risks and opportunities to protect the value of the portfolio but in addition to improve the sustainability of people and planet. Essentially 'Sustainable' funds should be viewed and positioned as a deeper extension of 'ESG Integrated' funds. This simpler approach should also make it easier for the FCA to regulate and enforce against effectively in early years and allow clear definitions to emerge and be understood.

4. **Only one label:** We also recommend that only one of these three classifications – 'Sustainable' – is actually labelled whilst the other two classifications - 'Not Promoted as either ESG Integrated or Sustainable' and 'ESG Integrated' are not designated with a label or 'kite-mark' but are identified instead through template disclosures. We recommend these disclosures be located in the same place on relevant investor documentation (Fact Sheet, KIID, KID etc.) as where the 'Sustainable' label sits for funds classified in the 'Sustainable' category. In this way investors and their advisers will be easily facilitated and so become accustomed to looking for a fund's classification as part of their due diligence process.

5. **'ESG Integrated', not 'Responsible':** We dislike the titling 'Responsible' for the middle-category. We find it unhelpfully describes a 'value' rather than the portfolio construction process. We would hope that all investments offered to UK investors were done so responsibly (and not irresponsibly). Furthermore, we believe retail investors could become easily confused about which of 'Responsible' and 'Sustainable' investments had stronger sustainability credentials and we do not think 'Responsible' is a term that investors find helpful. Therefore, we recommend this category be titled as 'ESG Integrated' (and also not carry a label).

Should you have any questions or points of clarification regarding this letter or our responses to the questions, do not hesitate to contact us.

Yours sincerely,

Will Goodhart
Chief Executive
CFA Society of the UK

Andrew Burton
Professionalism Adviser
CFA Society of the UK

With thanks for the oversight of the CFA UK Professionalism Steering Committee

APPENDIX I: About CFA UK and CFA Institute

CFA UK serves nearly twelve thousand leading members of the UK investment profession. Many of our members work with pension funds, either managing investment portfolios, advising on investments, or as in-house employees responsible for pension investment oversight.

- The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests.
- Founded in 1955, CFA UK is one of the largest member societies of CFA Institute and provides continuing education, advocacy, information and career support on behalf of its members.
- Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.
- For more information, visit www.cfauk.org or follow us on Twitter @cfauk and on LinkedIn.com/company/cfa-uk/.

CFA Institute is the global association for investment professionals that sets the standard for professional excellence and credentials.

- The organisation is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow.
- CFA Institute awards the Chartered Financial Analyst® (CFA) and Certificate in Investment Performance Measurement® (CIPM) designations worldwide, publishes research, conducts professional development programs, and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.
- CFA Institute has members in 162 markets, of which more than 170,000 hold the Chartered Financial Analyst® (CFA) designation. CFA Institute has nine offices worldwide and there are 158 local member societies.

For more information, visit www.cfainstitute.org or follow us on Twitter at @CFAInstitute and on Facebook.com/CFA Institute.

APPENDIX II: Responses to questions

Q1. What are your views on the tiered approach set out in Figure 2? We welcome views on any concerns and/or practical challenges.

CFA UK supports the 3-tiered approach set out in Figure 2.

We strongly support the two disclosure layers for institutional and retail, though would recommend that the institutional disclosures still should be made available to retail investors should they want them. This would support the education of the more sophisticated elements of the retail investor base on sustainability issues. We recommend the detailed institutional disclosures are either in the same document behind the retail summary or incorporated by way of a link reference.

We also agree that a labelling system under regulatory supervision would be a welcome development for retail investors. They will help to simplify a complex area for retail investors, many of whom lack the time or inclination to wade through significant disclosures on sustainability. We are conscious that sustainable investment remains a rapidly evolving area, so the labelling regime should be as simple as possible and then evolve to accommodate future trends (see our response to question 4). We think it should also be subject to consumer-testing prior to implementation.

Q2. Which firms and products should be in scope of requirements for labels and disclosures? We particularly welcome views on whether labels would be more appropriate for certain types of product than for others, please provide examples.

We think that all funds intended to be marketed to UK investors should be subject to the new disclosure requirements. As we explain in our responses to questions 2-4 below, however, we believe there should only be one label – 'Sustainable'.

Capturing all funds in a classification system would create both a level playing field and a regime most easily understood and navigated by UK investors. We believe excluding certain funds from the requirements would lead to confusion with investors and potentially become an 'opt out' for some funds that would otherwise be 'Not promoted as sustainable'.

As detailed later in our response to question 4, we recommend the use of three categories rather than five at this juncture, and note this would also map out exactly to the EU's SFDR as follows:

- Article 6 funds could be 'Not promoted as either ESG Integrated or Sustainable'
- Article 8 funds could be ''ESG Integrated' (see our response to question 9)
- Article 9 funds could be 'Sustainable'

With regards to overseas funds from non-EU jurisdictions, the FCA could consider introducing grandfathering provisions to allow overseas manufacturers in jurisdictions with similar disclosure regimes some additional time to fully comply with the UK's new requirements.

We recommend that only 'Sustainable' Funds should benefit from a 'label' or 'kite-mark'. Funds in the other two categories should use template disclosures instead such as 'Not marketed as sustainable or ESG Integrated' and 'Constructed taking environmental, social and governance factors into account to protect the value of the portfolio'.

Q3: Which aspects of these initiatives, or any others, would be particularly useful to consider (for example in defining terms such as responsible, sustainable and impact) and how best should we engage with them?

One of the most useful lessons that the FCA can take from the various initiatives listed in the DP is that the proliferation of different approaches has probably not yet been helpful for end investors. While it will be important to reflect the development of market norms, it will be more important to be able to explain any terms clearly and easily to end investors (without requiring significant advances in investor education).

We recommend that the FCA should use the terms 'ESG Integrated' (not 'Responsible, see our response to question 9), 'Sustainable' and 'Impact' as defined below:

- 'ESG Integrated' could be defined as taking environmental, social and governance factors into account to protect the value of the portfolio;
- 'Sustainable' is a deeper extension of 'ESG Integrated' using the same processes but through a double materiality lens to see beyond the value of the portfolio into co-dependent stakeholder ecosystems. It could be defined as integrating environmental, social and governance factors to improve the sustainability of people and planet; and
- 'Impact' could be defined as funds that set specific targets for improving the sustainability of people and planet and report on those.

The FCA should work closely with the UK bodies listed – namely the IA, TISA and the BSI but should bear in mind that some bodies have developed their own frameworks that might not align to the simple approach that we propose above and that might allow a wider set of providers and vehicles to be defined as 'Sustainable'. We see the establishment of the DLAG is a welcome initiative to facilitate this.

The FCA should also strive to ensure that the new UK regime can be explained with reference to other international guidance and be consistent with it wherever possible. This should help ensure that the potential barriers to the export of UK funds overseas and the import of overseas funds into the UK are as limited as possible and that consumer choice is not being restricted as a result. We believe CFA Institute's Global ESG Standards for Investment Products would serve as a strong foundation for the detailed disclosures to be required of institutional investors.

Q4: Do you agree with the labelling and classification system set out in Figure 3, including the design principles we have considered and mapping to SFDR? We welcome views on further considerations and/or challenges.

While we are supportive of the FCA's proposed introduction of a labelling and classification system, we strongly encourage the FCA to develop as simple an approach as possible initially and then to build from that point once key initiatives currently in progress such as the UK taxonomy and the ISSB standards become finalised. It is for that reason that we propose a simpler version of the approach described in the paper. We recommend only three rather than five classifications as follows – 'Not Promoted as either ESG Integrated or Sustainable' / 'ESG Integrated' / 'Sustainable'). We prefer to leave the distinctions between 'Transitioning', 'Alignment' and 'Impact' for potential introduction in later years. For the avoidance of doubt, we would expect funds in the 'Sustainable' category to have an ESG integrated investment process capable of not only identifying ESG risks and opportunities to protect the value of the portfolio but in addition to improve the sustainability of people and planet. This should also make it easier for FCA to regulate and enforce against effectively and allow a clear definition of 'Sustainable' to emerge and become widely understood.

We also recommend that only one of these three classifications – 'Sustainable' – is actually labelled whilst the other two classifications - 'Not Promoted as either ESG Integrated or Sustainable' and 'ESG Integrated' are not designated with a label or 'kite-mark' but are identified through template disclosures as explained above in our answer to question 3. These disclosures should be located in the same place on relevant investor documentation (Fact Sheet, KIID, KID etc.) as where the 'Sustainable' label sits for funds that are classified in the 'Sustainable' category. In this way investors and their advisers will be easily facilitated and so become accustomed to looking for a fund's classification as part of their due diligence process.

As explained in our response to question 9 below, we dislike the titling 'Responsible' for the middle-category. We find it unhelpfully describes a 'value' rather than the portfolio construction process - we would hope that all investments offered to UK investors were done so responsibly (and not irresponsibly) but can see why certain funds might not be constructed by integrating ESG factors into their investment process. Furthermore, we believe retail investors could become easily confused about which of 'Responsible' and 'Sustainable' investments had stronger sustainability credentials and we do not think 'Responsible' is a term that investors find helpful. Therefore, we recommend this category be titled as 'ESG Integrated'.

Our simpler proposals map exactly to the SFDR. We perceive this as an advantage and it still affords the possibility of further categories being developed over time as the infrastructure of sustainability reporting matures for corporates and for firms and funds. As outlined in our response to question 2, the FCA could consider a grandfathering regime in relation to non-EU funds being marketed into the UK.

Q5: What are your views on 'entry-level' criteria, set at the relevant entity level, before products can be considered 'Responsible' or 'Sustainable'? We welcome views on what the potential criteria could be and whether a higher entity-level standard should be applied for 'Sustainable' products. We also welcome feedback on potential challenges with this approach.

We support the requirement for sustainability credentials at the entity level as well as the product level. In most investment firms, the majority of 'stewardship' or 'ESG' resources are centralised firm resources accessible by the individual fund managers responsible for the product. Furthermore, a firm's culture will have a heavy influence on the degree and intensity to which sustainability factors are embedded at the product level. We consider it right that this should be reflected in a report at the entity level.

The entity level report should not be confused or conflated with any sustainability reporting that a listed or private fund group might produce for the purposes of their own debt and equity investor communications. There will be overlaps between the content of the two documents, but the entity level report required by this regulation should be focused specifically on and describe the policies, processes and available resources supporting that firm's fund management operations and not stray into areas, for example, like staff travel policies, staff working practices or carbon off-set transactions at the corporate level.

As explained in our response to question 3, we think it a reasonable principle that the 'entry-level' criteria for an 'ESG Integrated' investment firm should be lower than that for a 'Sustainable' investment firm. The former's investment process integrates ESG factors to protect the value of the portfolio; the latter integrates ESG factors to protect people and planet.

In terms of the criteria, this is a complex area as firms have different business models, investment processes and approaches to sustainability. The regulations would need to be sufficiently flexible to accommodate different models, for example:

- the large global groups which run both sustainable, ESG-integrated and non-sustainable/ESG integrated oriented funds;
- firms with specialisations and large weightings by AuM for example in money-market funds or private markets (where data is hard to come by); or
- the managers who conduct/locate all their sustainability resources at the individual fund level.

One more obvious objective criterion is the minimum percentage of a firm's or fund's AuM that is actually invested at all times in accordance with an 'ESG Integrated' and/or 'Sustainable' classification. However, because it is at the firm level, this criterion would still need to be flexible enough to cater for a firm specialising in an asset class which was intrinsically not marketed as sustainable (like money-market funds due to the lack of full scope-3 reporting) or in private market assets (where data to evidence sustainability might currently be hard to come by).

Another criterion might be the ratio of a firm's annual budget for dedicated 'stewardship' or 'ESG' resources divided by its AuM. This would need to be supported, however, by clear guidance from the FCA as to what resources should be included or excluded from this calculation. For example:

- in a boutique active equity firm where the portfolio managers and analysts conduct their own 'ESG' analysis rather than relying on a centralised team, what proportion of their salary costs could be designated as 'sustainability resources'? Or:
- in a passive equity firm that subscribes to third-party data to drive their quantitative based 'Transition' strategies, could the cost of any and all data provider services be included? And what proportion of its annual IT development budget funding the model?
- We feel this would be very interesting data to collect. However, at the same time we have concerns that it implicitly carries the value judgement that the more a firm spends on sustainability the better the firm must be at measuring and managing it, yet that might not turn out actually to be the case. It could be targeting resources ineffectively in the wrong areas.

Ultimately the entity level report might be best assessed by an independent verification agent in the same way that an investment firm that claims it complies with GIPS-reporting can support this by having its data scrutinised by an approved, independent verification agent. The agent could review the firm's sustainability policy and the degree to which this was properly governed and implemented. That this would be a regulatory requirement and subject to FCA supervision should help ensure that both firms and verifiers adhere to all provided guidance.

Q6: What do you consider to be the appropriate balance between principles and prescription in defining the criteria for sustainable product classification? We welcome examples of quantifiable, measurable thresholds and criteria.

There has to be a high level of prescription to avoid greenwashing and to allow investors to conduct some form of objective comparison between funds.

The metrics should be consistent with the UK Taxonomy once it becomes available and be capable of being calculated from corporate disclosures required under the ISSB standards once they too are finalised.

As stated in question 5 but much more easily applied at fund level, an obvious metric is the minimum percentage of a fund's AuM that at all times meets the criteria of 'ESG Integrated' or 'Sustainable'.

Q7: Do you agree with these high-level features of impact investing? If not, why not?

CFA UK supports the BSI definition of 'Impact Investing'. We note that CFAI Institute's 'Global ESG Standards for Investment Products' use the Global Impact Investing Network (GIIN)'s [4] very similar definition of 'Impact Investing'.

Please explain, with reference to the following characteristics:

- ***intentionality –*** CFA UK regards this as a core component of 'Impact Investing'. However, it is also important that the intent is evidenced by the presence of a credible mechanism and sufficient resources to achieve the intended objective.
- ***return expectations –*** 'Impact Investing' is meant to generate a return. It is not charitable philanthropy. However, the financial return is no more important than the positive, measurable social or environmental impact.
- ***impact measurement –*** CFA UK regards this also as a core component of 'Impact Investing'. Just as financial returns must be measured, so too must the investment's progress towards its declared social or environmental goals.
- ***additionality –*** CFA UK regards additionality as more nuanced. If it was required for the whole of a fund's portfolio to be measurably additional, then this would significantly narrow the number of funds making it into the 'Impact Investing' category. However, without some degree of additionality, we doubt whether a fund can really be impactful. Perhaps there needs to be a discussion to establish what would be a reasonable required threshold of an impact fund's additionality. There is also the question as to whether positions held for portfolio management purposes (FX swaps, government bond futures, cash) should be included in this calculation or whether the calculation should only be performed on the core investment assets in the portfolio.
- ***other characteristics that an impact product should have –*** no additional comment.

[4] https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing

Q8: What are your views on our treatment of transitioning assets for:

a: the inclusion of a sub-category of 'Transitioning' funds under the 'Sustainable' label?

As stated previously we see the labels within the 'Sustainable' category as useful but recommend just using the 'Sustainable' label in the first phase before introducing these sub-classifications later once the UK Taxonomy and ideally the ISSB standards too are available.

b: possible minimum criteria, including minimum allocation thresholds, for 'Sustainable' funds in either sub-category?

CFA UK agrees that in due course minimum allocation thresholds could also be set for all three proposed sub-categories of 'Sustainable' funds. Initially we would propose just one category for 'Sustainable'.

Without such thresholds in place, the risk of greenwashing is acute. An easily understood and calculable threshold would be the minimum percentage of a fund's assets that are invested in relevant (e.g. 'Transitioning', 'Aligned' or 'Impact') assets at all times.

Q9: What are your views on potential criteria for 'Responsible' investment products?

We acknowledge the origins of and widespread use today of the term 'Responsible' investing and the proposed use of it in the SDR Regulation. However, we dislike its use and do not believe it is helpful for investors. It also implies that all other investing that is not 'responsible' is therefore somehow 'irresponsible'.

Much depends on the precise criteria which are set for this category, but if the bar is set low as might be inferred from the description in the paper, we believe that this category should be classified, but not labelled, as 'ESG Integrated'.

We believe that most active UK funds now would qualify to meet these requirements and many passive funds could perhaps too depending on their choice of index. Both i) integration of ESG factors into a firm's investment processes and ii) targeting of long-term sustainable returns are almost regarded as a market standard today such that this option might be regarded as the 'default' classification for many UK funds currently provided they could evidence some stewardship activity.

It is therefore quite critical where the FCA sets the bar for the criteria for this category, especially in relation to the evidence of extensive and sustained stewardship across the portfolio's assets. Is it merely enough to 'consider' ESG factors in the investment process or will the criteria be sufficiently detailed and proscriptive around 'how' and 'to what lengths' ESG factors are considered? In the absence of strong prescription and stretching criteria, we do not think this classification merits a label and so propose it should be described instead by a template disclosure as we detailed earlier in our responses to questions 2- 4.

Q10: Do you agree that there are types of products for which sustainability factors, objectives and characteristics may not be relevant or considered? If not, why not? How would you describe or label such products?

CFA UK agrees that there are types of investment products for which sustainability factors may not be considered. However, this does not mean they are not relevant. Indeed, surely every investment surely has some attributable carbon exposure and sustainability profile. In some cases, though, it might be significantly less material.

As one example, whilst this is planned to be only for a matter of a few years, TCFD reporting currently excludes Scope-3 emissions which means that financial companies report a very limited carbon footprint as a consequence. Include scope emissions and that position changes enormously. So, consider a money-market fund invested predominantly in short-term paper issued by banks, insurers and other financial institutions. Currently, the sustainability characteristics of this investment will not be considered and reported on, but they are relevant.

As a second example, and as explained in our response to question 12 below, under current regulatory rules and TCFD guidance, derivatives are excluded from TCFD reporting obligations – yet they clearly can have significant sustainability characteristics. Consider for example fund investing in commodity derivatives. Again, under current regulatory rules, the sustainability characteristics of this investment will not need to be considered or reported on, but we would argue they could be very relevant.

Q11: How do you consider products tracking Climate Transition and Paris-aligned benchmarks should be classified?

Without further details being provided, we would consider such products as being classified under the 'Transitional' label under the FCA's proposals and probably under the 'Sustainable' label under our proposals. The category in which passive investments are classified will be determined by their index and the degree to which ESG factors and sustainability feature in its selection methodology.

Q12: What do you consider the role of derivatives, shortselling and securities lending to be in sustainable investing? Please explain your views.

DERIVATIVES

This is a complex area, however, CFA UK recommends that the FCA undertakes to bring derivatives within the remit of sustainability reporting after wide consultation with users. As derivative markets are global, co-operation with other regulatory bodies also would seem necessary.

It is complex firstly, because this Discussion Paper wishes to address the use of derivatives generally yet the way derivatives are used varies hugely from fund vehicle to vehicle. Pension schemes mainly use interest rate derivatives for hedging purposes. Use of derivatives within, say, retail targeted investment trusts, PRIIPs or UCITS will be limited and restricted under the terms and conditions in their prospectus. The Discussion Paper highlights the nascent but increasing use by some of derivatives to manage sustainability risks. At the other end of the spectrum hedge funds might be run exclusively investing in derivatives. Such hedge funds might:

- achieve the economic exposure to a list of underlying (perhaps unsustainable) investments via derivatives and so achieve the same economic exposure as a long-only fund investing in the same underlying investments but without any obligation to report any carbon exposures; or
- in the context of this Discussion Paper become automatically classified as 'Not Promoted as ESG Integrated or Sustainable' when in fact they might be if the underlying investments were held instead of derivatives.

Perhaps a distinction should be drawn between derivatives used for portfolio management purposes and derivatives used for investment purposes.

It is complex secondly because derivatives come in different forms. To take one example, an option gives the holder contingent economic exposure to the underlying, the realisation of which is typically contingent on the market price of the underlying moving above the strike or below the put price. In other words, the holder of the option is not necessarily going to end up long/short of the underlying investment with all its (un)sustainable credentials. A forward contract, on the other hand, gives rise immediately to economic exposure from the point the contract is entered into and for all intents and purposes the buyer has immediate forward exposure to the underlying investment's (un)sustainable credentials.

SHORT-SELLING/SECURITIES LENDING

Where a fund has short-sold an investment, the purchaser of that investment will need to own and report on the sustainability characteristics of that investment. Since there is only one investment, by extension it makes sense for the fund with the short to be able to report the mirror-image negative sustainability characteristics of that same investment. This has interesting consequences as sustainability strategies could be developed by hedge funds for example in relation to carbon reporting whereby within each sector a long position is taken in the most sustainable company and a short position in the least sustainable company. This would produce a negative carbon footprint and require explanation.

As regards securities lending, this is also a complex area and CFA UK recommends that the FCA consult further on it. Depending on how the rules are written, funds could use stock lending to manipulate reported positions by borrowing holdings in sustainable companies or lending holdings in unsustainable companies either over quarter- and year-end dates or indeed for longer periods if that was what was being measured.

Q13: What are your views on streamlining disclosure requirements under TCFD and SDR, and are there any jurisdictional or other limitations we should consider?

In many respects TCFD reporting has become the pioneering model for broader ESG reporting. Carbon reporting is arguably the biggest and most easily identifiable social or environmental risk and so has been understandably prioritised. However, it is just one of many social and environmental risks that investors will be required to address under SDR.

However, we have concerns that today the data, disclosures and agreed metrics of ESG factors beyond climate is so relatively under-developed and that it may therefore be a while before the TCFD framework can be effectively utilised universally across the ESG factors. The progression of the ISSB's work on new international sustainability standards is clearly a critical component of this as is the availability of the UK Taxonomy.

As the question implies, there are then consequent jurisdictional issues that arise in respect of the importing of overseas funds into the UK market and the exporting of UK funds into overseas markets. If different jurisdictions adopt widely different reporting standards, this could lead to a plethora of gold-plating requirements and make cross-border investment business far more expensive to undertake.

Q14: What are your views on consumer-facing disclosures, including the content and any considerations on location, format (e.g. an 'ESG factsheet') and scope?

We support the FCA's proposed initiatives to educate retail investors on sustainability issues and to develop a standardised taxonomy to help simplify this relatively new, complex and important topic.

We would support the inclusion of certain standardised ESG factsheet style disclosures in both the UCITS KIID and the PRIIPS KID, as suggested, once the current review processes of these documents are finally concluded.

Q15: What are your views on product-level disclosures, including structure, content, alignment with SFDR and degree of prescription?

At the product level, CFA UK believes it is important to achieve a reasonably high degree of baseline prescription in order to ensure comparability of funds and to help the sector develop a harmonised and consistent approach to measuring and reporting on sustainability. As the Discussion Paper highlights, this is particularly relevant in the cases of quoting recognised sources and using standardised calculations to ensure information provided is of a reliable and consistent quality.

That said, the institutional market should be given sufficient freedom for innovation, especially as this is still a relatively nascent area, and the more detailed institutional-targeted disclosures should therefore also allow for innovation.

As regards alignment with SFDR, and as stated in our answer to question 13, it is deeply desirable that there is a high-level of consistency with SFDR, especially at the base-line level of definitions and calculations, to ensure the development of a 'common sustainability language and currency'. With three categories rather than five at launch, we believe our simpler proposal has the potential for greater alignment with SFDR.

Q16: What are your views on building on TCFD entity-level disclosures, including any practical challenges you may face in broadening to sustainability-related disclosures?

We agree that entity level disclosures are as important as product level disclosures, especially in relation to understanding firms' approaches to ESG integration, their sustainability culture and the intensity of their stewardship activities. We believe the first round of Stewardship reports from UK asset managers and asset owners completed under the revamped 2020 version of the FRC's Stewardship Code contain good examples of the reporting that we would hope firms in other jurisdictions can emulate.

We re-iterate our comment made in response to question 5 that the entity-level report should be focused on the fund management policies, processes and resources devoted to sustainability and distinct from any other sustainability report that the fund management group may have produced for the purposes of their own corporate communications with their debt and equity investors.

Q17: How can we best ensure alignment with requirements in the EU and other jurisdictions, as well as with the forthcoming ISSB standard? Please explain any practical or other considerations.

We support the FCA's proposed approach with regard to both seeking alignment with SFDR entity- and product- disclosures and adoption of the forthcoming ISSB standard once it becomes available. As explained previously we recommend a system at launch with three rather than five categories which therefore should be more easily aligned with the EU's system's requirements at least on day-1.

Q18: What are your views on the roles of other market participants in communicating sustainability-related information along the investment chain?

As regards the advised market, and as commented in our answer to question 2 of our response to CP21/17 on TCFD reporting by firms[5], we believe financial advisors need to be brought into the fold of these new sustainability regulations. They perform a key education role for end-investors. As indicated in our response, these new requirements could be rolled out progressively on a proportionate basis to the largest financial advisors first, though with not too much of a time-lag to minimise the risk of discriminating against end-investors being advised by smaller advisory firms.

As regards, the unadvised market, the platforms very definitely need to be involved in this dialogue perhaps more than they currently are and we would recommend, for example, that they are gain representation on the DLAG on an urgent basis.

In all cases, we strongly recommend requiring inclusion of baseline sustainability disclosures in a revamped KID/KIID as this would ensure that these disclosures have to be communicated onto end-investors and discussed and explained.

Q19: Do you consider that there is a role for third-party verification of the proposed approach to disclosures, product classification and labelling and organisational arrangements of product providers? Do you consider that the role may be clearer for certain types of products than others?

CFA Institute's GIPS has become the global standard in terms of reporting both firms' and funds' investment returns. With GIPS, firms can choose to claim compliance or pay to have this verified by an independent verifier and we see no reason why over time the same system could not develop with regards to sustainability reporting. Under GIPS, to ensure consistency and quality assurance, verifiers do need to be authorised by CFA Institute and so in the same way the FCA, or perhaps the FRC, would have to authorise the verifiers of sustainability disclosures. We regard this latter point as especially

[5] CFAUK Response to the FCA on CP21-17: 'Enhancing climate-related disclosures by asset managers, insurers and FCA regulated pension providers' (https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/ccdr-letter-to-fca-cp21-17-final.pdf)

important to avoid greenwashing risks given that the unavoidable conflict of interest in the provision of verification as a paid service.

Q20: What approaches would you consider to be most effective in measuring the impact of our measures, including both regulatory and market-led approaches, and should disclosures be provided in a machinereadable format to better enable data collection and analysis?

Post implementation, the FCA could measure the effectiveness of these proposals by:

- Reviewing the quality of the disclosures and the number of incidences where their intervention was needed;
- Conducting consumer surveys of investors to establish the level of awareness around, say, the different product labels and what they mean;
- Monitoring over time the proportion of funds being sold under each of the five product labels.

Reviewing the degree to which regulators in other jurisdictions adopt the UK's approach to sustainability reporting or choose to adopt different approaches.

We support the proposal that disclosures should be made available in machine-readable format. This will enable sophisticated investors to more readily apply AI techniques to the data enabling far swifter analysis and comparison of funds.

Appendix III: Previous CFA UK Publications on Sustainability Reporting:

- Response to FCA regarding CP21/17: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers (September 2021): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/ccdr-letter-to-fca-cp21-17-final.pdf

- Response to FCA regarding CP21-18: Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets (September 2021): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/ccdr-letter-to-fca-cp21-18-psc-final.pdf

- Response to BEIS on their consultation on requiring mandatory climate-related financial disclosures by publicly-quoted companies, large private companies and Limited Liability Partnerships ("LLPs") (May 2021): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/beis-mandatory-tcfd.pdf

- Response to DWP's Consultation Response & Consultation on regulations (March 2021): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/follow-up-letter-to-department-for-work-and-pensions.pdf

- Response to the FCA regarding PS20/17: proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations (February 2021): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/ccdr-follow-up-letter-to-fca---february-2021.pdf

- Response to the FRC regarding the Discussion Paper on the Future of Corporate Reporting (February 2021): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/future-of-corporate-reporting.pdf

- Response to the CFA Institute's Consultation Paper on the development of the CFA Institute ESG Disclosure Standards for Investment Products (October 2020): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-uk-response-form-consultation-paper-on-esg-disclosure-standards.pdf

- Response to DWP's Consultation - Taking action on climate risk: improving governance & reporting by occupational pension schemes (October 2020): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/dwp-cc-full-letter-october-2020.pdf

• Response to the FCA regarding CP20/3: proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations (September 2020): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/ccdr-final-letter-to-fca.pdf

• Response to Consultation on PAS 7341 on Responsible & Sustainable Investment (February 2020): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-uk-letter-to-bsi-on-pas-7341-28-february-2020.pdf

• Response to the FRC and FCA joint discussion paper (DP19/1) "Building a regulatory framework for effective stewardship" (April 2019): https://www.cfauk.org/-/media/files/pdf/professionalism/cfa-letter-to-fca-on-dp19_01-final.pdf

• Response to the Investment Association's consultation on sustainability & responsible investment (March 2019): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-letter-to-jess-foulds-at-the-ia_.pdf