

25th January, 2023

SDR & Labels Policy Team
FCA
12 Endeavour Square
London. E20 1JN

Submitted by e-mail to cp22-20@fca.org.uk

Dear Mark, Luisa & Federico,

CFA UK response to the FCA’s consultation CP22-20 on ‘Sustainability Disclosure Requirements (SDR) and Investment Labels’

The CFA Society of the UK (CFA UK)¹ is pleased to continue its dialogue² with the FCA on this important topic and follow up on our previous letter responding to the earlier Discussion Paper DP21/4 on the same topic. Greater clarity in and tighter supervision of retail investor communications regarding sustainability issues will make it more likely that capital wishing to be invested sustainably is invested sustainably. We also list our other responses on related topics, both to the FCA and other regulators, in Appendix III.

CFA UK formed a working group to draft this response letter, the membership of which is detailed below. CFA UK also surveyed its membership on questions related to the FCA’s consultation paper, receiving 105 responses; the answers provided by the survey participants were helpful in forming the views of the working group. A link to the full survey is provided in the footnote below³.

Our detailed responses to the questions in this consultation are enclosed in Appendix II, however, we would like to highlight the following overriding points in this covering letter:

- **THE BENEFIT OF FUND SUSTAINABILITY LABELS:** Our survey revealed that in general our members support the concept of sustainability labels for retail funds. In our membership survey, participants gave an aggregate score averaging 7.09 across 105 individual responses when answering the question: “on a scale of 0-10, to what extent do you think Retail investors can benefit from a sustainable fund labelling regime?”.
- **‘SUSTAINABLE FOCUS’:** The majority of our members believe the 70% assets threshold for the ‘Sustainable Focus’ category to be too low and insufficiently well defined. CFA UK strongly recommends that the FCA more clearly defines how the threshold should be calculated and that definitions and treatments of various instruments be harmonised at an international level. At this stage we prefer an 80% threshold be adopted in alignment with the US and the EU and that perhaps this be extended also to portfolio management services for consistency (lowering this from the proposed 90%).

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 UK’s response to the FCA’s Discussion Paper 21/4 (Jan. 2022): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/letter-to-fca--dp21-4-final.pdf>

³ https://eu.surveymonkey.com/results/SM-Y3NjFQO1Jxbj8zm41uv34A_3D_3D/

- **‘SUSTAINABLE IMPROVERS’:** CFA UK has some material concerns about the ‘*Sustainable Improver*’ category and particularly its implementation. More CFA UK members disliked than liked this category. We like the ambition of it and recognise the importance of markets motivating and financing the ‘Just Transition’, but believe the FCA’s prime objective must be the protection of retail consumers and we are concerned that the two points below amount to the creation of a significant greenwashing risk:

 - Firstly, we have difficulty with the inclusion of the word “Sustainable” in the title of this label given that, by definition, the assets invested in are not currently sustainable. If this category went forward as proposed, the first and most prominent disclosure would surely have to be “the fund’s assets are not yet/currently sustainable”.
 - Secondly, we have concerns that retail investors will be overwhelmed with the complexity of the stewardship reporting over such long-term horizons and that firms’ disclosures may be insufficiently clear to allow the FCA to properly scrutinise firms’ ‘home-made KPIs’ and so be able to supervise these funds effectively. This would be particularly applicable for social or bio-diversity issues, for example, where the available data does not have the reliability, quality and consistency of, say, climate data.

- **SUSTAINABLE IMPACT:** A majority of our members supported this category, but we have concerns that few funds will apply for labels. A key requirement of this category is for “additional” capital in primary markets; this makes it very difficult to construct a portfolio from listed securities alone. Many companies with pioneering ‘E’ or ‘S’ solutions are often still privately-owned or IPO-candidates. Without a significant proportion of assets invested in green ‘UoP’ bonds, this appears to leave funds to select assets from a relatively high-risk mix of illiquid strategies, IPO shares and alternative asset classes, all mostly inappropriate for retail mutual fund investors. We recommend that the FCA drop the requirement for additionality and use the presence of a ‘Theory of Change’ (with associated KPIs) as evidence of impact intentionality.

- **INTENTIONALITY:** CFA UK strongly supports the 5-layered pyramid of disclosures, but we question why the FCA proposes “to emphasise” ‘intentionality’ above ‘the fund objective’ required as the first layer in the disclosures. We believe a fund’s intentions should be fully expressed in its objectives and that the proposed “emphasis” on intentionality is unnecessary or possibly confusing. As the old adage runs, “the road to ruin is paved with good intentions”. We query how the FCA can supervise funds on the basis of intentions and do not recall any precedent for it.

- **NON-HIERARCHICAL & MUTUALLY EXCLUSIVE:** The FCA has stated that it aims for the three categories to be both non-hierarchical and mutually exclusive. However, our members clearly find that this has not been achieved. In our membership survey, less than a quarter of our members agreed that the labels, as described, were mutually exclusive, and only one-third see the regime as non-hierarchical. We observe that it is very hard to be mutually exclusive without being hierarchical; or non-hierarchical without being exclusive. Given the choice, we would prefer that they were mutually exclusive so that choices could be clearer for investors.

- **SELF-GENERATED, NON-STANDARDISED KPIs:** Our membership survey also shows overwhelming explicit support for at least partial introduction of standard KPIs. Allowing firms to set all of the KPIs may introduce welcome flexibility for product design,

but it also means that funds will be marking their own homework when it comes to measuring past performance in the future. It also will impair investors' ability to compare the sustainability performance of funds within each category as no two funds will be reporting KPIs on the same basis. We see the need for more flexibility in the setting of social or bio-diversity KPIs, for example, but with TCFD reporting now mandatory for funds, see no reason why certain climate metrics cannot be already fixed and a mandatory requirement for listed equities and bond funds. This would help everyone to steer fairly through the potential opacity of carbon off-sets, for example.

- **ANTI-GREENWASHING RULE:** we strongly support the introduction of this rule and recognise its importance in emphasising the importance of eradicating greenwashing claims. Nowadays marketing claims of sustainability are increasingly effective in attracting retail capital and therefore need to be tightly supervised.
- **INDEPENDENT VERIFICATION:** we strongly agree with the FCA that this should be voluntary. It is equally important that the standards of independent verifiers are high, otherwise 'greenwashing through verification' is a serious risk. We would encourage the FCA to ask leading professional verifier firms to agree and adopt an industry code or set of standards so that the FCA can recognise those firms performing independent verification services. This would help set minimum expected standards for skills and experience in this nascent sector where there currently is a lack of qualified human resource and hopefully ensure non-signatory firms would be marginalised.
- **FUND OF FUNDS:** we believe these products should be brought into scope. We believe an 80% sustainable assets test should also apply here and that the FCA needs to apply great care when determining the exact formula for this test to avoid both arbitrage and unintended exclusions.
- **GREATER INCLUSION OF PASSIVE FUNDS & ETPs:** CFA UK notes that the criteria for all three categories will be challenging for a genuine passive fund to meet, given the number of securities they hold and the level of in-house stewardship resource that is required to support that. We suggest more consideration be given to allowing the proposed labelling regime to be applicable for passive benchmark-based funds as well as actively managed funds.
- **INDIVIDUAL PENSIONS:** we agree with the FCA's aim to eradicate greenwashing, especially in all retail products. Introducing SDR to the pensions sector, however, has some unique challenges, most notably the many different types of pension products that exist and the many different types of beneficial investor. We believe this will require further consultation, perhaps in collaboration with the DWP and TPR.

In line with our Society's purpose, our responses to the consultation questions aim to highlight relevant issues to help the investment community to serve its stakeholders well and to build a more sustainable future.

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,



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input from CFA UK's Pensions Expert Panel (Q25-30)

and the oversight of the [CFA UK Professionalism Steering Committee](#)

APPENDIX I: About CFA UK and CFA Institute

CFA UK is a professional body representing close to 12,000 members across the UK's investment community and a proud member of CFA Institute's worldwide network of member societies.

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 purpose of CFA UK is to educate, connect and inspire the investment community to build a sustainable future: we aim to meet the investment community's needs for skills and knowledge; bring the investment community together; help people build rewarding careers within an inclusive and diverse investment community and help the investment community serve its stakeholders well.
- 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.
- It 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/CFAINstitute.

APPENDIX II: Responses to questions

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

CFA UK generally agrees with the proposed scope presented in the consultation paper.

We understand the reasons for not including overseas funds in the current proposals but would welcome a clear and explicit timeline for the extension of the SDR regime to all overseas funds available in the UK in the publication of the Position Statement anticipated on 30 June 2023. This would contribute to the success of the new SDR regime and ensure a level playing field.

CFA UK appreciates the absence of AuM thresholds for products; we agree there should be no exclusions.

CFA UK believes it would make sense to consider bringing the entire ETP category (ETFs, ETNs, and ETCs). Usage of these products continues to increase by many retail investors and they are widely accessible on retail platforms.

We also believe Funds of Funds should be brought into scope. Ordinarily the manager has no direct control over the underlying investments in the funds and this potentially presents a problem for ensuring compliance with the new regulation on an ongoing basis. However, this should be capable of being overcome if each underlying fund qualifies for a label. The portfolio management services threshold of 90% of AuM as proposed in section 3.7 of the consultation paper could be adopted at the Fund of Funds level. This should enable the creation of Fund of Funds products not just restricted to one of the three labelling categories – Focus, Improvers, Impact – but offering a combination of potentially all three. This does create the dilemma of which label the Fund of Funds should have – just ‘Sustainable’ perhaps?

Concerning individual pension products, this is a complex area and we understand why the FCA has excluded these from the initial proposals but would like to include them in the future. We refer you to our answers to Q25-31 below for further details.

It is unclear for us why the draft legislative definition for the TCFD-product on page 5 of the rules in Annex A excludes Social Entrepreneurship Funds (SEF) and Registered Venture Capital Funds (RVECA). In our opinion, those AIFs may reflect well the spirit of Sustainable Impact or other labels; we note that these funds feature in the concurrent ESMA consultation⁴.

CFA UK has no specific comments regarding distributors.

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

CFA UK strongly supports the proposal for the anti-greenwashing rule and agrees it should be implemented with immediate effect from 1st July, 2023.

⁴ ESMA Consultation Paper on Guidelines on funds’ names using ESG or Sustainability related terms (18 November 2022): https://www.esma.europa.eu/sites/default/files/library/esma34-472-373_guidelines_on_funds_names.pdf

This regulation will provide important incremental definition over and above PRIN 2.1, Principle 7 and COBS 4.2.1 as to what is meant by fair, clear and not misleading within the context of ESG or Sustainability. It will enable the FCA to clamp down on firms making misleading sustainability-related claims and protect retail investors.

With the anti-greenwashing rule coming in with immediate effect, we suggest the FCA adopts a proportionate approach to those firms that are in the process of updating their existing fund literature. We note, for example, that ESMA is currently looking to introduce similar proposals and is allowing for a six-month grace period (see 4.4, paragraph 23, page 12).

In terms of the other deadlines and timescales given within the paper CP22/20, CFA UK finds these to be mostly consistent with one another and well thought through and, in summary, as reasonable as any other timescale could be, given the number of external deliverables from outside the FCA and upon which these proposals depend, especially the ISSB accounting standards but also the EU's social taxonomy and the UK's green taxonomy.

Specifically:

- We agree with the 12-month period to implement labelling and consumer-facing / pre-contractual disclosures by 30 June 2024 (with the exception of the 'naming and marketing rules – see below);
- We think disclosures at the fund level should be prioritised and agree with the deadlines of 30 June, 2025 (24-month period after publication of the PS) for the production of entity-level disclosures for large firms and the 30 June, 2026 (36-months after publication of the PS for small firms);
- We would like the proposed deadline for performance related disclosures (24 months after publication of the PS) ideally to be reduced to 12 months. If a product applies a sustainable label within 12 months of the PS (by 30 June 2024), then we believe it should already be in a position to have its KPIs in place by this date also. We would also ask that current year and prior year comparable KPIs be required by the proposed date of 30 June 2025. With non-standardised (and therefore non-comparable) KPIs being permitted, the fund's own data trend assumes a greater importance than it might do if KPIs were standardised and comparability across funds were possible.

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.

On the costs side of the equation, it is hard for the CFA UK to comment on the specifics presented in the cost-benefit analysis as we are not an investment firm and privy to precise cost structures of individual firms. However, we believe that it is of great importance that the regulation does not create substantial entry barriers by introducing high one-off and ongoing costs, thereby hindering the competition benefiting retail investors. Smaller firms are more likely to be impacted the most by the additional costs of complying with the new SDR regime.

On the benefits side of the equation, CFA UK believes that the benefit of eradicating greenwashing is material and is critical to supporting trust in the investment sector. On the basis of the costs of the regulation as presented by the FCA in Annexe II, we believe the benefits of this regulation will outweigh the costs. We highlight that in our membership survey

participants gave an aggregate score averaging 7.09 across 105 individual responses when answering the question “on a scale of 0-10, to what extent do you think Retail investors can benefit from a sustainable fund labelling regime?”.

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.

CFA UK broadly supports the proposed characterisation of what constitutes a sustainable investment and the FCA’s description of the ‘channels’ by which sustainability outcomes can be pursued.

CFA UK is also cognisant that sustainability goals may be achieved outside of the FCA’s defined channels and by other means for example by covenants in loan agreements or investments made provisional on a corporate’s sustainability manifesto.

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?

We are also strongly supportive of the proposed pyramid of disclosures 1-5 proposed for each fund, namely: fund objective, policy & strategy, KPIs, resources and governance. We find these disclosures far more important than any ‘emphasis’ on intentionality as they can be effectively measured and subsequently monitored. “The road to ruin is paved with good intentions”; intentionality is intrinsically vaguer and, as it is no more than a statement at the outset, may have no bearing on actual outcomes. As such, it has the potential to disappoint investors, promising but not delivering, and ultimately undermining trust in the investment sector. We query how the FCA can supervise funds on the basis of intentions and do not recall precedent for it.

Our emphasis would be firmly on the pyramid of disclosures and not on intentionality. Including it appears to be duplicative, not additive, and potentially confusing and we would prefer to rely on the fund objective, the first layer of the disclosures pyramid, which has a measurable, concrete target, rather than placing an “emphasis” on a potentially vague statement of intent.

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? In particular, we welcome your views on:

We like the concepts behind the three distinct categories and understand the benefits of distinguishing between products. In particular, we appreciate how their distinctiveness will help educate the retail investor on the multi-dimensionality of sustainable investment.

However, we do not believe our members find that the proposed regime achieves the FCA’s stated aims of the labels being both mutually-exclusive and non-hierarchical. In our membership survey, less than a quarter of our members agreed that the labels, as described, were mutually exclusive, and only one-third see the regime as non-hierarchical. We observe that it is very hard to be mutually exclusive without being hierarchical; or non-hierarchical without being exclusive. Given the choice, we would prefer that they were mutually exclusive so that choices, definitions and criteria could be clearer for investors.

We comment below on each of the three proposed categories:

a. Sustainable Focus: whether at least 70% of a ‘Sustainable focus’ product’s assets must meet a credible statement of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme?

We polled the membership on whether the ‘Sustainable Focus’ label was “effective and fit-for-purpose”; the responses we collected from CFA members are fairly supportive – 51.5% said yes, 31.5% said no and 17% were unsure.

We then polled them separately (members could choose more than one option so they do not sum to 100%) on whether:

- (i) the 70% threshold was appropriate (11% supported this);
- (ii) to change the fixed threshold for the “Sustainable Focus” label to 80%, in line with currently proposed EU and actual US regulation (57% supported this);
- (iii) to ask firms to publish the minimum percentage of the fund's assets meeting the relevant criteria within the label, thereby allowing greater flexibility and promoting competition (49% supported this).

From this we conclude that our membership shares the views of the working group that the category will work for investors but feel that the proposed 70% threshold is too low and that 80% in line with the US and EU would be preferable.

There was an opportunity for participants in the survey to add additional comment to the first “effectiveness and fit-for-purpose” question. We received a number of common and notable criticisms which help explain the significant minority who remain to be convinced by the proposal:

- (i) the threshold should be different for equities, fixed income and multi-asset; and
- (ii) by being set as low as 70% the threshold was allowing for 30% of assets to be unsustainable which was felt to be too high a proportion. Whilst it helps that the funds have to list “unexpected assets”, the absence of a DNSH condition and the risks of as much as 30% of a fund being invested in unsustainable companies represented a real risk that retail customers could be misled as to the aggregate overall sustainability of a ‘Sustainable Focus’ fund.
- (iii) The absence of a precise methodology of how to calculate the percentage of the portfolio that meets the statement is not clearly stated in the proposed regulation. We note that the definition of “assets” in 3.1.16 on page 15 of the proposed rules in Annex D goes no further than to say the “scheme property”. Should a gilt be deemed to be sustainable, or does it have to be a green gilt? How should security lending be treated? Are cash and derivatives included and, if not, should they be deducted from both numerator and denominator in determining the fund’s %age? We also believe there should be a carve out for efficient portfolio management exposure e.g. FX swaps (to hedge FX), government bond futures (to hedge duration), credit / equity index to hedge risk etc. Many of our members were concerned about consequent incomparability if these questions were left to firms themselves to interpret and the risk of inadvertent greenwashing due to the lack of more detailed prescription. It is critical that the FCA is aligned with other leading global

- regulators on these issues; otherwise 80% in the US is not the same as 80% in the UK or 80% in the EU;
- (iv) the apparent and unfair bias in favour of ‘funds’ over ‘discretionary fund managers’ in allowing for a 70% threshold for funds yet setting a 90% threshold for discretionary fund management services.

In summary, CFA UK strongly recommends that the FCA more clearly defines how the threshold should be calculated. At this stage we would prefer the 80% threshold be adopted in alignment with the US and the EU and that perhaps this be extended also to portfolio management services. Over time, we would like the FCA to consider moving to a more flexible regime in which funds set their own %-age threshold (above a certain minimum of say 70% or 80%) with that figure embedded in the fund’s label.

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 polled the membership on whether the ‘Sustainable Improvers’ label was “effective and fit-for-purpose”; the responses we collected from CFA members were less supportive than for the ‘Sustainable Focus’ category – 43% said yes, 44% said no and 13% were unsure.

We applaud the intention behind the creation of this category and the recognition it rightly places on the importance of financing the transition of the UK and global economies onto a more sustainable footing. At the same time, we recognise that this category is attempting to tackle topics that will play out over many years and at a different pace from topic to topic and sector to sector. It is a hugely complex area, and we fear that, to be effective, the disclosures that funds will need to make will overwhelm the average retail investor.

We note that the ISSB’s standards are some way off being finalised and approved; we note that some sustainability related data, such as social or bio-diversity data, is less widely available and lacks the consistency, quality and reliability of climate data, for example. We fear that, in short, many retail investors will get no further than the label, name and objective of the fund, leaving the remainder of the pyramid of disclosures for fund selectors, advisors and regulators to concern themselves with. Monitoring the evolution of these disclosures over time will become a rare pursuit and effective supervision of them by the FCA will require significant resourcing, especially for fixed income funds which typically hold many more securities and especially if firms’ disclosures are insufficiently clear.

Perhaps we are being overly cynical, but we see great potential for funds to dress themselves up as ‘improving’ for many years, when they are not; for retail investors to lack the capacity to look at the detail; for regulators to lack the resources to supervise the detail if firm disclosures are poor and the trust of the investment sector ultimately to be undermined.

The FCA’s primary responsibility is to protect consumers and not to help fund the transition of the economy. In its cost benefit analysis, the FCA estimates, based on *Morningstar* data, that 450 funds will be affected by these proposed reforms and that potentially one-third will apply for a label. We do not know proportionately how many

of these 150 labelled funds will be ‘Focus’, ‘Improvers’ or ‘Impact’ respectively, but, assuming an even split, we query whether the benefit to the transition of the economy from 50 retail funds is worth the risks articulated in the paragraphs above.

As with the “effective and fit-for-purpose” question in our survey for the ‘Sustainable Focus’ category, we included a comment box. We received the following common and notable criticisms which help explain the small majority who remain to be convinced by the proposal:

- (i) The qualitative nature of effective stewardship and non-financial information coupled with the long-term time horizons at play led to a number of respondents concluding the proposals were open to potential abuse and ‘greenwashing’;
- (ii) As ‘*Sustainable Improver*’ funds will be investing in currently unsustainable companies, the funds should not be labelled sustainable at all. One participant suggested these funds simply should be labelled ‘Stewardship’ on the basis that that was the real aim of the category. A slightly more retail-friendly version of this might be “*Engagement*”;
- (iii) Without more stringent and prescriptive KPIs provided by the FCA, we believe the category may be open to abuse and misinterpretation. Funds are effectively left to mark their own homework, especially in areas with poor data, and there is likely to be no uniform way to compare the achievements of different ‘*Sustainable Improver*’ funds with each other.

In summary, CFA UK is unconvinced by the proposals for this category. On balance it seems to create more potential problems than the potential benefits are worth. It is significantly different from ‘*Sustainable Focus*’ and ‘*Sustainable Impact*’, as it, by definition, does not invest in currently sustainable assets. Should it not be labelled differently to reflect this, without the ‘Sustainable’ handle, which would reduce greenwashing concerns. If it were to proceed as proposed, surely the very first disclosure would have to be “the assets in this fund are not yet/currently sustainable”.

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?

We polled the membership on whether the ‘*Sustainable Impact*’ label was “effective and fit-for-purpose”; the profile of the responses we collected from CFA members was similar to that received for the ‘*Sustainable Focus*’ category – 52% said yes, 36% said no and 12% were unsure.

Overall, the CFA UK working group shared the view of the majority of the polled membership and were supportive of this label.

As to the question of whether ‘impact’ or ‘solution’ would be a better term, we are divided. Some members opine that ‘solution’ would be easier for retail investors to understand; others opine that ‘impact’ is already a widely understood term within the investment world and brings with it a definition and the expectation of ‘additionality’ from the underlying investments.

The requirement of this category for "additional" capital in primary markets makes it very difficult to construct a portfolio from listed securities alone. Many companies with pioneering 'E' or 'S' solutions are often still privately-owned or IPO-candidates. Without a significant proportion of assets invested in green 'UoP' bonds, this appears to leave funds to select assets from a relatively high-risk mix of illiquid strategies, IPO shares and alternative asset classes, all mostly inappropriate for retail mutual fund investors. This was members' most notable and consistently made comment in the survey's comment box for this question. If there was less emphasis on investor contribution and a better balance with enterprise contribution, it would be possible to develop funds that would support retail investment and that would be delivering impact through engagement/cost of capital as well as through the enterprises' activities. The key characteristic of a fund claiming this label should be the presence of a theory of change as reflected in the drafting of rule 3.2.8 (2)(a), the incorporation of that theory of change across the entire investment process and its measurement through specific KPIs as per the drafting of rule 3.2.8 (3).

Reviewing also the drafting of rule 3.2.8 (1), (2b) and (2c), we have concerns about exactly what the rule may be looking for 'Sustainable Impact' funds' objectives to be. In short, we would prefer the rule to require 'Sustainable Impact' funds to aim to deliver real world outputs rather than real world outcomes. We note that "real world outcomes" can be often difficult or even impossible to measure; aiming for "real world outputs", on the other hand, suggests a more focus set of goals, specific to the fund and underlying investments, which can be measured and therefore more legitimately targeted and referenced in the funds' KPIs.

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 polled our membership on whether there should be "an additional fourth label for products not promoted as sustainable, not qualifying as sustainable, or not applying for a UK sustainable label to ensure complete labelling coverage in line with the complete disclosure coverage" – 52% said yes, 44% said no and 4% were unsure.

The working group noted that the FCA had followed feedback received from its DLAG group in not recommending a label for all funds not being categorised in one of the sustainable label categories. In particular, the working group shared the FCA's concerns that if such a label were required, and the FCA's assumptions were correct that the clear majority (two-thirds) of available retail funds would not have a sustainable fund label, that this in turn might create the overall market impression that investing in a labelled fund might be considered unusual and therefore something not to be recommended.

We also note that the addition of this fourth label would represent a significant change to the FCA's proposals as it effectively converts a 'labelling regime' into a 'categorisation regime'.

At the same time, the working group empathised with the membership's obvious desire to make the SDR regime complete and to provide a 'stick' as well as a 'carrot' to firms applying for a label for their funds. One member observed that no EU article 6 funds say that they are Article 6, with the consequence that they are sometimes mistakenly assumed to be article 8 funds. They also noted that data providers such as Morningstar

clearly ‘label’ Article 8 and Article 9 funds whereas Article 6 funds are not labelled as Article 6 funds. Our reading of the intention of the FCA’s paragraph 7.2 is that data providers such as *Morningstar* would be caught under the definition of ‘distributor’ in that they provide a product or service. We agree with that conclusion and would wish the UK avoid the situation described above as it currently plays out in the EU.

We debated what this fourth label might be called. ‘Not Sustainable’ was unanimously rejected as too controversial and problematic; ‘Not promoted as sustainable’ seemed to be the best compromise though it would flatter funds that are simply not sustainable and is quite a mouthful.

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?*

As explained above, CFA UK generally understands and supports the thinking behind the three distinct sustainable labels and agrees with most of the criteria. We also regard the guidance in Appendix 2 as helpful. However, we have some material concerns regarding unintended consequences and the practical implementation of the proposed regulations. We also believe the FCA has not achieved some of its stated aims in the design of the proposals:

- On the whole, our members prefer a greater level of prescription, particularly in the realm of KPIs. We polled our membership on whether firms should be allowed to choose their own KPIs or whether at least a portion of them should be drawn from “standard verifiable metrics either reported by ESG data providers or based on existing / future international standards” – 84% preferred the latter more prescriptive approach, with only 16% happy to leave this to firms. Allowing firms to set all of the KPIs may introduce welcome flexibility for product design, but it also means that funds will be marking their own homework when it comes to measuring past performance in the future. We can see benefits of flexibility in KPI-setting for say social or biodiversity funds but in the realm of climate, certain KPIs could be standardised now, at least for listed equity and bond funds. That would assist all concerned with the navigation of the complexities of carbon offsets, for example. Non-standardised KPIs will impair investors’ ability to compare the sustainability performance of funds within each category as no two funds will be reporting KPIs on the same basis. Noting that it requires probably three years of data before a trend for the reporting fund can emerge; with KPIs proposed to be published first in 2025, this trend will not emerge until 2027.
- The definitions of the ‘*Sustainable Focus*’ and ‘*Sustainable Impact*’ categories are not mutually exclusive. We see overlaps between these two categories. It is possible that a fund would wish to invest in a mix of both (if not all three) categories in order to achieve diversification and yet neither/none of them exceeds a percentage of 50%. It would be hard for the fund to label themselves in this instance unless they pursue a fund of funds approach (see our answer to question 1 above);
- With regard to ‘*Sustainable Focus*’ funds we are concerned that both i) the definition of assets and ii) the formula for the calculation of the minimum percentage of assets are

insufficiently clear in a number of respects, as explained in more detail in our answer to question 6a) above;

- Whilst the FCA has put forward a very robust framework to measure stewardship in Rule 3.2.7 and in the guidance in Appendix II, we have concerns that the complexity of the task (based on non-financial information over such long investment horizons and monitored by each fund against its own KPIs) may overwhelm retail investors with detail as well as the FCA's own supervision resources if firms' disclosures are not clear. In this environment, the 'Sustainable Improver' label could be open to deliberate or inadvertent abuse and greenwashing given that its assets are, unlike those of the other two categories, not currently sustainable;
- The "credible standard" is not prescribed, which may create a situation where it is hard to compare funds' sustainability credentials, match investor sustainability preferences and all too easy for firms to use their own KPIs which can read impressively but actually carry little meaning. To eliminate this problem, SDR should prescribe at least some core KPIs to be used by firms in the same way as TCFD, UN SDGs etc. have done.

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.

Please see our responses to questions 5-8 above.

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?

We polled our membership on whether independent verification should be made mandatory whilst observing that this would materially increase the costs to funds and ultimately investors of doing so – 55% said voluntary verification should be encouraged, 31% said it should be mandatory whilst 23% said it should be neither mandatory or encouraged.

The verification topic is arguably more nuanced than a survey can allow for. In discussing this question, the working group also came down in favour of voluntary independent verification, but equally concluded that:

- (i) since the labels were in effect supervised by the FCA independent verification should be less necessary than for GIPS® and fund performance reporting, for example, where there is no regulatory oversight;
- (ii) to mitigate the risk of "greenwashing by verification", the FCA ought to encourage professional verification firms to draw up and adopt an industry code or set of standards so that the FCA can recognise those firms performing independent verification services. This would help set minimum expected standards for skills and experience in this nascent sector where there currently is a lack of qualified human resource and hopefully ensure non-signatory firms would be marginalised.

The proposals mention the opportunity to display the label on the relevant digital medium i.e. the main product webpage with a link to the FCA's website. This is an idea we support, however, there is no mention in the proposals of how the label might be used in non-digital mediums. Should the label feature, for example, in the fund prospectus, presentation and factsheet and in time any replacement of the recently jettisoned KIID?

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 fully support the two-tier disclosure approach proposed on the basis that both the consumer-facing and detailed disclosures are made available to all investors.

We polled our membership on whether they supported a two-tiered structure for the sustainable product disclosures: a consumer-facing layer of disclosure (in a new standalone document, containing a summary of the product's key sustainability-related features), and more detailed disclosures at both the product and entity level (containing more granular information, which could be useful to institutional investors or retail investors seeking more information) – 88% said yes and only 12% were against. Those voting against were largely concerned about the additional cost for no benefit.

We note that in "Figure 7 - Summary of disclosure items" on page 54 "Stewardship (KPIs)" are required in the detailed "Sustainability product report (Part B)", but not in the "Summary Consumer-facing" materials. However, in the continuation of Figure 7 on page 55 "Ongoing reporting on sustainability metrics/KPIs" is required for both the detailed "Sustainability product report (Part B)" and the "Summary Consumer-facing" materials. As KPIs will be key to evaluating the effectiveness of the 'Sustainable Improver' label, we believe there should be reference to the "Stewardship (KPIs)" in the "Summary Consumer-facing" materials as well as the detailed "Sustainability product report (part B)" in the relevant row of Figure 7 on page 54.

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?

The necessity of introducing reasonable, understandable disclosures eclipses which framework underpins the new regime. Given TCFD's well established status as a reference point for reasonable climate disclosures and the FCA's adoption of TCFD for London Stock Exchange listed issuers, we support the proposal. We also support a flexible approach to align with the future ISSB standards over time as they develop.

However, we note that:

- current issuer disclosures relating to many alternative assets are not yet sufficiently fit-for-purpose to allow even for climate-related disclosures across all asset classes; and
- fund Social or Bio-diversity disclosures will be far harder to make than climate-related disclosures given the poorer quality, consistency and availability of Social and Bio-diversity data currently;

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?

The proposal is to create a new standalone two-page document for the consumer-facing disclosures, to complement and sit alongside the existing KID document. This adds to the monthly factsheet and prospectus that form a fund's key documents. The FCA is also proposing a new sustainability product report. We highlight the potential for overwhelming consumers with too much information. Documents need to be clearly distinguishable to mitigate this risk. A name for the consumer-facing disclosure could help consumers easily identify documents.

We support the proposed location of the consumer facing disclosure in a prominent place on the firm's website. We also support the review and update of the disclosures every twelve months.

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 polled our membership on the subject of a template and asked whether they supported i) an FCA prescribed template, ii) no prescription or iii) industry-led initiative to develop a template – 54% voted for the industry-led template, 37% wanted the FCA to design the template and only 17% voted for there to be no standardisation yet on the basis that the area was still evolving so quickly.

CFA UK believe it is helpful for consumers to receive information in a standard format, which also facilitates product comparison, and supports the development of a disclosure template by the industry in conjunction with trade bodies as a sensible initial approach. However, once such a template has been developed by the industry, CFA UK recommends that the FCA require its use so that a standard form is used by all firms.

The FCA should also try to ensure that the industry body producing the template agree a process for review of the template to ensure that there is room for the development of the sustainability disclosures over time. We note that the CFA Institute's Global ESG Disclosure Standards for Investment Products are a useful source of reference in the development of any template disclosure and would be happy to help and potentially participate in this process.

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 updates.

CFA UK generally supports the FCA's proposals but have made some minor comments below in the format requested:

Scope:

CFA UK broadly agrees with the scope of the pre-disclosure requirements.

Format, Location and Content:

CFA UK support the proposals.

Regarding the table of category specific criteria on page 62, we note that an escalation plan is mentioned for the 'Sustainable Impact' category, but not for 'Sustainable Improvers', we believe that this should also be a requirement for the latter in order to facilitate timely divestment for companies failing to improve in line with expectations.

Frequency of Disclosure:

CFA UK believe that pre-contractual disclosures relating to sustainability should be updated in the same way as other non-financial disclosures currently are i.e. when there is any significant/material change.

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.

CFA UK agrees with substantially all points of the sustainability-related disclosures required in the sustainability product report.

Scope:

We agree that this report should be required of all funds with a label.

Location:

We agree that the link to the report should be located in a part of the website which is prominent and easily accessible from the home page.

Format:

We agree with the use of TCFD reporting as a basis prior to the finalisation of ISSB S1.

Content:

We support the proposed disclosures. Even though it is recognised that it is challenging to prescribe standard quantitative metrics, in the longer term it should remain an objective to allow retail clients make sense of this and compare performance.

If firms are initially allowed to set their own KPIs, the regulator should keep in mind the potential conflict of interests of reporting firms, i.e. the incentive to make the case in favour of their investments and obscure commercial risks or uncertainties regarding environmental effectiveness. There is a significant risk of misallocation of capital amongst new emergent technologies, particular in relation to technologies conducive to continuing use of fossil fuels, which could significantly harm retail consumers. The FCA should consider receiving advice from independent energy experts, either as an ongoing panel or on an ad hoc basis, to evaluate whether the KPIs give consumers a balanced representation of technologies in terms of their risks and benefits and effectiveness comparative to alternative technologies. An example of a document which summarises the status of technologies is the classifications in the IEA's Clean Technology Guide and its Technology Readiness Level scale of technologies along the low-carbon value chain, although the categorisations of technologies' commercial readiness in these documents may be too broad for effective consumer protection.

Frequency:

We agree with the proposals to publish on an annual basis and in line with any changes to the label. We did query what the penalties might be for a fund failing to do so.

We also note that whilst paragraph 5.78 of the Consultation Paper envisages that the Sustainability Product Report should be updated every 12 months, this appears not to be incorporated into the rules in ESG 4.5.13. We also query whether the requirement to review consumer-facing disclosures and pre-contractual disclosures every 12 months also applies to Part B of sustainability product report, given that Part B is not primarily intended for consumers.

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?

CFA UK agrees with the proposals.

Noting ESG 4.5.14 requires a firm that receives a request for an on-demand sustainability report, to prepare the on-demand sustainability information “within a reasonable period of time,”; we would welcome further clarity as to what might be considered a “reasonable” timeframe.

We also wondered what should happen in a situation where, for example, a small firm is unable to control the timing of “on-demand” requests and becomes inundated and overwhelmed. In such circumstances, it might be necessary to keep the same disclosure format/scope on a private basis (available to clients only, not published online), with the FCA having the right to request access to reports and their supporting evidence at any time.

The FCA’s proposal for the “on demand” regime is premised on the assumption that it would be less onerous for the reporting firm than publishing reports on a regular basis. If the true preference of firms is unclear, the FCA might consider allowing firms the choice as to whether they would prefer their reporting policy for private clients to be on an on-demand or scheduled basis.

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.

CFA UK agree with the proposals, although we note that it is difficult to be definitive about this given that the ISSB's standards are some way from being finalised.

Scope:

We agree that it should apply to all in-scope asset managers.

Location and Format:

We support prominent place on website, and flexibility in which report disclosures are located.

Content:

We support this reflecting the TCFD framework.

Frequency of disclosures and updates:

We agree these disclosures should be updated annually. The longer and staggered implementation timetable (2025 and 2026) seems pragmatic as it i) allows firm to focus first on product disclosures and ii) allows small firms to learn best practice from the larger firms.

CFA UK values how the entity reports should enable investors to distinguish between those investment firms which have invested time, effort and resources to meet clear and considered

sustainability objectives and those firms which have exaggerated their sustainability credentials by simply highlighting a few sustainable initiatives or claiming their products are sustainable without sufficient basis.

Given that the proposal is only to introduce core entity-level disclosure requirements, describing firm-level decisions and policies, the proposal seems appropriately calibrated.

We note that whilst Paragraph 5.104 says that the detailed entity level disclosure must be updated on an annual basis, there is no rule to that effect in ESG 4.6.

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.

It is difficult to be definitive about this as the ISSB's standards are some way off being agreed. However, the FCA's signalled intent is in the right direction. The standards should be referenced by rule update in the FCA handbook, once they have been finalised. In the interim, some guidance from the FCA may be needed.

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

The anti-greenwashing rule to ensure accurate and proportionate naming and marketing of products as laid down in paragraph 6.9 is an important one which we thoroughly support. Nowadays fund managers' marketing claims of sustainability are increasingly effective in attracting retail capital and therefore need to be tightly supervised. Removing funds that merely use ESG integration or exclusionary screening from the pool of truly sustainable funds will add weight and merit to the labels, and help consumers make sense of what can be a confusing selection. The naming aspect is particularly key as clients may be filtering investments based on an indication of sustainability in a fund name (following the introduction of the labels, clients should instead be able to filter based on the sustainable label they desire).

In terms of timing, the CP proposes for the anti-greenwashing rule to take immediate effect on publication of the PS on 30 June, 2023. As mentioned above in our response to question 2, we believe that the FCA should adopt a proportionate approach to enforcement in relation to existing funds that are in the process of updating their existing fund literature. We note, for example, that ESMA is currently looking to introduce similar proposals and is allowing for a six-month grace period (see 4.4, paragraph 23, page 12).

The practicalities of the anti-greenwashing rule will be critical, and how best to identify misleading products and to take enforcement action. We would encourage the use of metrics to monitor instances of misleading marketing of ESG products and to concretely clamp down on greenwashing.

We assume that the anti-greenwashing rule will apply not only to funds offered to UK retail investors by FCA authorised firms but also those funds which are offered to UK retail investors from unauthorised firms via authorised representatives.

The rules state that naming and marketing should be consistent with the sustainability profile of the product i.e. proportionate and not exaggerated; it may be helpful if the FCA provided more guidance and examples to help firms clearly determine what is proportionate and what constitutes an exaggeration to avoid this being left open to interpretation.

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?

CFA UK agrees with the focus on these questions by the FCA and the DLAG. Both naming and misnaming carry power. We note that the proposals are in line with those currently in place or proposed by other leading global regulators.

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

CFA supports what the rule is trying to achieve.

We hold a concern, however, that excluding institutional products leaves room for i) loopholes and ii) potential confusion. Consider:

- (i) a defined contribution plan that is not in scope, which allows for retail participants being convinced by less-than-reliable sustainable marketing.
- (ii) retail investors may become aware (via third-party database providers for example) of institutional funds that do not qualify for a label yet use ESG or sustainable definitions and terminology as they are not caught by the SDR.

We support the FCA's intention to extend the SDR regime into pensions in due course, noting the additional complexities that this brings. Please see our responses to questions 25-30 below.

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

The scope for misleading investment communications remains in any restrictive regulatory environment, however, we believe the FCA has achieved its aim of tackling greenwashing proportionally and effectively through its disclosure requirements in CP22/20. Once these disclosures are in place, however, the subsequent regulatory scrutiny of them is equally as important.

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

We agree with the proposals but submit that an uneven and confusing playing field between UK funds and non-domiciled UK funds is likely to persist until overseas fund offerings are brought into the regime.

All distributors, including retail investment portals, are rightly required to adopt the publishing and communication of the labels accurately and clearly. Should a retail investor search for fund products on retail investment portals using ESG or sustainability keywords (and not the FCA's labels), however, the search results would group labelled UK-based products with non-labelled overseas products which creates two risks:

- first, it creates an uneven playing field between UK funds and non-domiciled UK funds, as the overseas funds, which may comply with the regime and represent better investments, will not carry a label to promote them;

- second, the list may include overseas funds that would not be compliant with the labelling regime but otherwise compare favourably on other measures and so attract investment that would otherwise not have gone to a non-labelled fund.

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 note that the pensions fund universe is far from uniform and that just the personal pension products regulated by the FCA include:

- (i) Standard personal pensions, offered by most large pension providers, with a certain range of investment funds to choose from;
- (ii) Stakeholder pensions, a basic version of standard personal pensions geared towards affordability and flexibility for pension takers;
- (iii) Group personal pensions, which quite often have a governance committee taking responsibility for ensuring suitability of fund choices;
- (iv) Self-Invested Personal Pensions (SIPP), with a wider range of investment options than in the standard version.

Insofar as personal pension products are invested in listed equities and bond funds only, we agree with the FCA's statement in paragraph 8.9 that the FCA's proposed sustainability disclosure regulations labelling rules for retail funds could be extended relatively easily to funds available under personal pension arrangements.

For default funds, we also agree with the statement in paragraph 8.10 that potentially the proposed threshold for portfolio management services could apply, noting that in our earlier response to question 6a) we have received member feedback to argue that this threshold should be at 80% and aligned with and not different from the threshold applicable to 'Sustainable Focus' funds.

We note that SIPPs can be invested in a wide range of asset categories including both direct shareholdings (UK and overseas) as well as commercial property and land. It is difficult to see how the sustainability disclosure rules and labelling proposals can extend fairly to such or similar funds.

We would also like to extend two words of caution. We note that investors in individual pensions:

- often already have a dizzying range of choice of funds into which to invest their pension pot and that this breadth of choice can confound them. Such beneficiaries can make sub-optimal fund choices that are not holistic and in aggregate do not provide the protections and well-constructed diversification that can be found in a default fund, for example;
- can also be too distracted by labels such as those being discussed here; there are already a number of available funds targeted at personal pension investors with sustainability labels. Firstly, it is very difficult for these investors to interrogate the integrity of these labels; secondly, a sustainability-minded individual that is not knowledgeable in investments may easily over-allocate to such funds and thereby inadvertently introduce other risks into their pension portfolio;
- are fundamentally different from investors in funds:
 - For funds, retail investors might invest only a small proportion of their net investable wealth in any one specific fund, they could be of any age profile and were mostly well-off individuals;

- For pensions, the pension investment would in many cases represent a material proportion of the individual's overall wealth, could be at a late stage in their life and the individual concerned may not be that wealthy at all.

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?

At the highest level we support the FCA's aim of eradicating greenwashing from pension products as much as retail funds. Pension providers should therefore be required to be disciplined about their sustainability claims when promoting their schemes and/or funds.

To the extent that disclosures and labels are introduced, we do not see that the need for rules pertaining to thresholds should be any different for pension funds than for retail funds. To have different thresholds seems to open up arbitrage opportunities and the potential for confusion.

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?

Expanding the SDR and fund labelling regime to workplace pensions that fall under the remit of the DWP and are regulated by the TPR increases yet further the range of scheme types that need to be considered beyond those listed in our response to question 25 above.

Whilst the proportion of workplace pension assets is shifting progressively towards defined contribution ("DC") and away from defined benefit ("DB"), three-quarters of pension assets falling under the remit of the DWP are still in DB schemes. Most of these schemes invest in a wide range of assets not only direct shareholdings (UK and overseas) and commercial property and land, like SIPPs above, but will also numerous other alternative asset classes. The investment objectives for these scheme assets vary but diversification benefits and cash-flow matching feature prominently. It may be difficult to ascertain the sustainability profile of such assets and, furthermore, divestment of these typically illiquid assets, if they transpire to be unsustainable, may not be economically sensible.

Another problem is that as many of the UK's DB pension schemes mature their asset allocation is moving increasingly towards government bonds and away from equities and even credit. We assume that 'green gilts' would qualify as sustainable assets, but their supply is currently inadequate to satisfy the demand that complying with this requirement would create overnight. Our current understanding is that 'normal' gilts and index-linked gilts would not be regarded as sustainable assets.

It is critical that all risks, and not just those risks relating to sustainability, are considered. In this context, the reconfiguration of a large DB pension scheme assets to comply with SDR labelling thresholds is likely in many cases to represent a leviathan task that could also threaten to expose beneficiaries to imprudent levels of other investment risk, especially if it had to be implemented quickly.

There is arguably more scope to introduce a coherent regime to DC default schemes, as we opine in our response to question 25 above, though we would note that large DC default schemes may face many of the same issues highlighted above.

Q28: To what extent would the disclosures outlined in Chapter 5 be appropriate for pension providers i.e. 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 stated in our response to question 25 above, insofar as pension products are invested in listed equity and bond funds only, we believe that the FCA's proposed sustainability disclosure regulations for retail funds could be extended relatively easily to listed equity and bond funds available under personal pension arrangements.

We see significant potential challenges and disruption of trying to achieve this, however, at scheme level, particularly in relation to DB schemes and potentially also larger DC default schemes.

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?

As you state in paragraph 8.7 and 8.14, with TCFD reporting either mandatory or shortly to become mandatory for c.85% of personal and workplace pension funds by assets, the DWP and FCA could use the TCFD-aligned product level disclosures to form an appropriate baseline for medium- and large- schemes to be required to adopt, though we note that (i) there are many small schemes not yet required to produce TCFD reporting and (ii) currently issuer disclosures in relation to many alternative assets are not currently fit-for-purpose to allow for this across all asset classes.

Current pension regulations also require ESG factors, including not only climate-related but also social- or biodiversity-related, for example, to be considered by trustees but there are not as yet required disclosures outside of climate-related disclosures. It does depend on what is meant by 'baseline' in the question, but it would seem very difficult to introduce disclosures as mandatory when the necessary data-reporting infrastructure to complete these disclosures is some years away from being available, consistent, comparable and of sufficient quality.

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

We have no additional comments.

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.

With regard to IBIPs (insurance-based investment products), since an IBIP includes a life cover, which requires an expert view by a certified actuary, we consider this question beyond our scope.

With regards to ETPs and other passive products, we have already addressed the appropriateness of the proposals for these products earlier in our answer to question 1. CFA UK notes that the criteria for all three proposed categories will be challenging for a genuine passive fund to meet,

given the number of securities they hold and the level of in-house stewardship resource that is required to support that. We suggest more consideration be given to allowing the proposed labelling regime to be equally applicable for passive benchmark-based funds as well as actively managed funds.

APPENDIX III: Previous CFA UK consultation responses on related topics

- CFA UK's Response to the Transition Plan Taskforce's a Call for Evidence on a Sector-Neutral Framework for private sector transition plans (July 2022): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/call-for-evidence--transition-plan-taskforce---final-submission.pdf>
- CFA UK's Response to the UK Endorsement Board regarding the International Sustainability Standards Board (ISSB)'s Exposure Drafts IFRS S1 and IFRS S2 (June 2022): <https://www.cfauk.org/-/media/files/pdf/pdf/professionalism/invitation-to-comment---issb-exposure-drafts-ifrs-s1-and-ifrs-s2-cfauk-final-response.pdf>
- CFA UK's response to the FCA regarding DP21-4: Sustainability Disclosure Requirements (SDR) and investment labels (Jan 2022): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/letter-to-fca--dp21-4-final.pdf>
- CFA UK's response to the 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>
- CFA UK's response to the 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>
- CFA UK's 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>
- CFA UK's Second Response to DWP's regarding Taking Action on Climate Change (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>
- CFA UK's 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>
- CFA UK's First Response to DWP's regarding Taking Action on Climate Change (October 2020): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/dwp-cc-full-letter-october-2020.pdf>
- CFA UK's response to the FCA regarding CP20/3: proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations (October 2020): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/ccdr-final-letter-to-fca.pdf>