FCA sets out plans for sustainability disclosures and product labels

AT A GLANCE

November 2021

What's new?

- The FCA published a discussion paper, DP21/4: Sustainability Disclosure Requirements (SDRs) and investment labels on 3 November 2021.
- It is seeking views on SDRs for asset managers and certain asset owners, as well as a new sustainable investment product labelling system, after these measures were announced by HM Treasury in its sustainable finance roadmap in October 2021.
- The discussion paper forms part of the FCA's new ESG strategy. See our recent At a glance covering the key aspects of that strategy.

What does this mean?

- The FCA is considering a three-tiered approach to sustainability disclosures and product labelling. This incorporates: product labels, consumer-facing disclosures for investment products, and detailed disclosures for asset managers and certain asset owners.
- It proposes that the entity and product-level disclosure requirements would build on its June 2021 proposals for TCFD-aligned disclosures, widening the scope beyond climate to other sustainability factors.
- The FCA envisages that the scope of firms and products caught by SDRs would be based on the proposed scope of its TCFD regime.

Product labels

- The regulator wants to leverage existing initiatives to define common terms, classifications and disclosures. In particular, it recognises that many UK firms are subject to the EU SFDR and so wants to explore how products classified under SFDR can map against the UK framework.
- The regulator sets out a possible approach consisting of three labels, together with classification criteria. The first is a 'Sustainable' product label, which relates to products that pursue specific sustainability characteristics, themes or objectives alongside delivering a financial return. These are divided into three types of product: 'impact', 'aligned' (both mapped by the FCA to Article 9 funds under SFDR) and 'transitioning' (mapped by the FCA to Article 8 funds under SFDR). Each of these have minimum asset exposure criteria to 'sustainable' assets.
- The second label being explored is for 'Responsible' products, defined as those where the fund manager considers sustainability or stewardship issues in making its investment decisions - but does not pursue a specific sustainability objective.
- The regulator is also considering a label for a wider range of investment products that are not promoted as sustainable. This would apply to products that do not take any sustainability factors into account, even as a risk management tool.

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Consumer-facing disclosures

- This initial layer of disclosures for investment products aims to be more accessible to retail consumers. The FCA says it could include: investment product label, product objective, investment strategy, proportion of assets allocated to sustainable investments (according to UK Taxonomy criteria), approach to investor stewardship, wider sustainability performance metrics. These disclosures would be intended to sit alongside KIIDs.
- The FCA is also considering prescribing a baseline set of sustainability metrics to enable consumers to understand the sustainable performance of the product over time, e.g. carbon reduction metrics.

Detailed disclosures

- These more granular disclosures would provide additional detail aimed at institutional investors. They would apply to asset managers/owners and products, as an extension of the FCA's proposed TCFD-aligned disclosures.
- The additional detail could include, for example, more information on the methodologies underpinning the metrics for assessing sustainability performance, as well as on data sources/limitations, taxonomy alignment, and benchmarking.

What do firms need to do?

- The discussion paper represents a significant step in the development of the UK regulatory framework for sustainable finance. It asks some fundamental questions about the appropriate direction of travel for ESG regulation for asset managers and owners, so firms should engage in the debate.
- The issues across all three tiers under consideration for the SDRs could significantly overlap with the EU SFDR, which many UK entities are in scope of. This means that many firms will be subject to two separate regimes, which could create significant compliance and operational challenges given the likely divergence in approaches between the EU and UK.
- Given the overlaps with the SFDR, as well as a wider range of ESG initiatives including mandatory TCFD reporting, firms should start planning how the SDRs could be implemented as part of a broader strategic ESG regulatory programme rather than on a standalone basis.

Next steps

The discussion paper closes to comments on 7 January 2022. The FCA plans to consult on policy proposals in Q2 2022. The regulator says it will also explore the introduction of sustainability requirements for financial advisers in due course. Separately, the FCA plans to finalise its policy on climate-related disclosures by the end of 2021, following CP21/17 issued in June 2021.

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