

## Issues of legal uncertainty arising in the context of the FCA Discussion Paper on Sustainability Disclosure Requirements (SDR) and investment labels



The FCA's discussion paper "[Sustainability Disclosure Requirements and investment labels](#)" (the **Discussion Paper** or **DP**), published on 3 November, sets out the FCA's proposals around Sustainability Disclosure Requirements ("**SDR**") and a sustainable investment labelling scheme. The SDR build on the UK's implementation of the Task Force on Climate-related Financial Disclosure (**TCFD**). The FCA is looking to make TCFD mandatory for asset managers and asset owners from 2022 (for the first phase).

A list of uncertainties arising from the Directive, prepared by Phil Bartram of Travers Smith LLP, is set out below.

- Whilst we acknowledge the need to make swift progress, it is vital that the new SDR regime does not come into effect for firms before all of the detail is in place, including fully-fledged FCA rules and guidance, in order for firms to be able to make informed decisions; and that the SDR moves in step with other aspects of the government's Roadmap, for which the FCA is not solely responsible. For example, since the SDR will link into the UK Green Taxonomy, it will be important to have made at least substantial progress on the development of the UK Taxonomy screening criteria before asking firms to sign up through SDR product labels to targets for Taxonomy-alignment. The same may be true of the relationship between SDR and the ISSB global baseline sustainability reporting standards. In the EU, the SFDR came into force many months before its detailed Regulatory Technical Standards were fleshed out, and before the EU Green Taxonomy technical screening criteria were fully developed. Critical regulatory guidance emerged some four months after the regime came into effect. This has led to considerable legal uncertainty and required certain firms to back-track on their plans and recategorise certain products as details emerged. In this area, once the SDR is up and running, it would also be preferable for the regime not to be elaborated through policy tools such as speeches and Dear CEO letters.
- For the same reason, it will be important for there to be a clear and predictable set of **transitional provisions** and it may be preferable if there is phased implementation in relation to different market participants in the investment chain (eg asset owners versus fund managers) so that market participants are able thoughtfully to respond to the needs and preferences of their stakeholders. Similarly, the direction of travel on sustainability preference rules for investment advisors should be clear at the point at which fund managers must make decisions about product categorisation.
- The new regime should be consistent with and fit clearly into **existing product governance** arrangements. On the other hand, it will be important to avoid false assumptions about current market structures. For example, not all funds are sold through formal distribution channels where the distributor is subject to UK-retained MiFID product governance distribution obligations.
- The attempt to standardise terminology must carefully avoid **muddling definitions with obligations**. For example, in relation to an SFDR Article 8 product, it is unclear whether investing in companies with "good governance" was intended to be a qualifying criterion or an obligation on an Article 8 product manager.

**Registered Charity Number: 1164902.**

"The FMLC" and "The Financial Markets Law Committee" are terms used to describe a committee appointed by Financial Markets Law Committee, a limited company ("FMLC" or "the Company"). Registered office: 8 Lothbury, London, EC2R 7HH. Registered in England and Wales. Company Registration Number: 8733443.

- We suggest that it may be misleading to describe funds which (only) integrate sustainability risk or opportunities in order to maximise risk-adjusted return as “**responsible**”. They are responsible in the sense that, in most cases, the manager as fiduciary ought to be considering such risks and opportunities alongside others. But they may not be “responsible” in the sense of responding to the climate emergency or pressing social concerns.
- Consumer-facing standardised or template disclosures or labels (in relation to inevitably complex financial, environmental and social issues) should not be **so simplified as themselves to become unclear or misleading**. The experience of PRIIPS-KIID should be borne in mind.
- We welcome the FCA's ambition for consistency and compatibility between global regimes and specifically the recognition that firms will need to be able to **map SDR product labels against EU SFDR categories**. However, we are not convinced that the mapping suggested in paragraph 3.12 of the Discussion Paper (and elsewhere) is accurate, in particular in light of the European Commission Q&A on the scope of SFDR published on 26 July 2021. For example, under that guidance, an SFDR Article 9 product must make exclusively (100%) sustainable investments within the meaning of Article 2(17) SFDR. A UK SDR "Sustainable/Aligned" product (with only a "high allocation" to Taxonomy-aligned sustainable activities) would not necessarily qualify. We would be happy to expand on this point.
- We believe that the DLAG would benefit from representation from the **private capital industry**, such as private equity, private credit, real estate and infrastructure fund managers. For example, it will be important to strike a careful balance between preventing greenwashing by using objective (as opposed to subjective) criteria versus the ability of a closed-ended, blind pool fund to describe in advance its allocation to particular types of investment, such as Taxonomy-aligned investments. In the draft SFDR Regulatory Technical Standards, reference is made to "minimum proportions" of sustainable or Taxonomy-aligned investments. For blind pool products, there is a risk that such descriptions could be unclear or misleading because, until diligence is undertaken, it won't be possible to categorise a product and a portfolio of illiquid assets cannot easily or quickly be reshaped.