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SDR and Labels Policy

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The Financial Conduct Authority

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Sent via email to: cp22-20@fca.org.uk

Dear FCA,

Financial Markets Law Committee's Response to FCA Consultation Paper re Sustainability Disclosure Requirements and Investment Labels (CP22/20)

Background

1. The role of the Financial Markets Law Committee (the "**FMLC**" or the "**Committee**") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.
2. On 25 October 2022, the Financial Conduct Authority (the "**FCA**") published its consultation paper CP22/20, seeking views on a proposed new sustainability disclosure and labelling regime ("**SDR**") that builds on the existing Task Force on Climate-Related Financial Disclosures ("**TCFD**")-aligned disclosure regime applicable to UK asset managers.
3. The FMLC sets out below the uncertainties with respect to aspects of the SDR, as described in CP22/20, in respect of which the FMLC respectfully requests the FCA to provide further guidance.

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Further clarification of the overlap of the product categories under the SFDR and under the proposed SEC sustainability disclosure rules with the sustainable product labels under SDR

4. Annex 1 of CP22/20 maps out proposed product categories under the SDR against the product categories under the EU sustainability disclosure regime under the Sustainable Finance Disclosure Regulation (“**SFDR**”) and the product categories under the sustainability disclosure rules proposed by the US Securities and Exchange Commission (“**SEC**” and “**Proposed SEC Sustainability Rules**”, respectively).
5. This mapping out is helpful to market participants, many of whom are required to comply with multiple overlapping sustainability-related regimes in different jurisdictions.
6. In light of the changes in the parameters for Article 8 and Article 9 products under the SFDR, in particular the consultation paper published on 18 November 2022 by the European Securities and Markets Act (“**ESMA**”) proposing guidelines regarding the use of ESG or sustainability-related terms in funds’ names in the EU (“**ESMA Guidelines**”), the FMLC would recommend further clarification by way of an update to Annex 1 on how the Article 8 and Article 9 product categories may overlap with the sustainable product labels under the SDR. This would assist in reducing uncertainties regarding the overlap and any potential conflicts between these two regimes.

Clarification of the meaning of the term “sustainability profile”

7. The term “sustainability profile” is used throughout the CP22/20 and the proposed new FCA Handbook rules but the term is not defined. As the term is practically significant to firms’ obligations under the SDR, notably in ESG 3.3.1R(1), where firms must ensure that any reference to the sustainability characteristics of a product or service is “...consistent with the sustainability profile of the product or service...” it is important that market participants understand what that term encompasses. A definition of the term “sustainability profile” or commentary on its meaning would be helpful to reduce uncertainty regarding the impact of the new rules under SDR.

Clarification regarding restricted terms

8. The FMLC gratefully acknowledges the examples the FCA has provided in ESG 3.3.2R(2)(a) to (j) of restricted terms that may not be used in the name of a product or in the marketing materials relating to a product that does not qualify for, or use, any of the SDR product labels.
9. However, the provision in ESG 3.3.2R(2)(h) which prohibits the use of “any other term which implies that a sustainability product has sustainability characteristics” gives rise to legal uncertainty about the scope of terms that may be restricted as the FCA does not define the characteristics that would make it a restricted term. Further, it calls into question whether making available the ESG policy or including a factual description of the ESG approach of an investment manager in the marketing materials of a product that does not have an SDR product label not would cause that investment manager to breach ESG 3.3.2R(2)(h).
10. It would be helpful if the FCA could provide further commentary regarding the scope of ESG 3.3.2R(2)(h) and confirm that any factual and proportionate reference to the ESG

policy of an investment manager in respect or in connection with the marketing of a product that does not employ an SDR product label is not prohibited.

Clarification of the application of SDR to overseas funds managed by UK investment managers


11. The new rules proposed in CP22/20 do not apply in respect of overseas investment funds at this stage. The FCA, however, notes that overseas investment funds “form an important part of the overall regime”, and the FCA intends to follow-up with a separate consultation “in due course” as to how the new rules may be applied in respect of overseas funds.
12. Market participants would benefit from clarification from the FCA as to how the first phase (pending consultation of the regime to non-UK products) would impact overseas funds managed by a UK investment manager. Currently such overseas funds are caught by the defined term “TCFD Product”, which includes “an unauthorised AIF managed by a UK AIFM...”.
13. The FMLC recommends the FCA provide further clarification on whether UK AIFMs are required to comply with the SDR with respect to non-UK AIFs for which they act as AIFMs (“**UK Managed Overseas AIFs**”) which are offered to UK investors, as well as whether UK AIFMs are required to comply with the SDR with respect to UK Managed Overseas AIFs which are not offered to UK investors.

Clarification of the methodology for calculating AuM thresholds

14. UK firms within the scope of the SDR will be required to produce an entity-level sustainability report addressing how the firm manages sustainability-related risks and opportunities.
15. The FCA’s proposal for a phased implementation has taken a similar approach to its introduction of entity-level TCFD-aligned disclosures:
 - larger firms (with AuM of +£50 billion) will be required to make their first disclosures 24 months after the date of the FCA’s Policy Statement regarding SDR (provisionally by 30 June 2025); and
 - smaller firms (with AuM of £5-£50 billion), excluding those with under £5 billion in AuM, will be required to make their first disclosures 36 months after the date of the FCA’s Policy Statement regarding SDR (provisionally by 30 June 2026).
16. Firms must calculate their AuM on a 3-year rolling average, assessed annually, in relation to TCFD in-scope business only.
17. Firms, other than those with AuM below the £5 billion threshold (on a 3-year rolling average) are required to use the same method of calculation as an ‘enhanced scope Senior Manager and Certification Regime firm’ (set out under SYSC 23 Annex 1 8.2) when calculating their AUM threshold. Accordingly, AuM must be calculated using the method used to calculate the amount to be recorded in data element 1A (Total funds under management) in data item FSA038 (Volumes and Type of Business).

18. However, in PS21/24, the FCA states: "This method of calculation does not apply to asset owners or the £5 billion exemption threshold.", but does not clarify instead how the £5 billion threshold should be calculated. Further guidance from the FCA regarding the applicable methodology in respect of calculating AuM of investment managers whose AuM is below £5 billion would be much welcomed.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'BG' with a flourish.

Brian Gray

Chief Executive¹

¹ FMLC acknowledges the assistance of Ezra Zahabi of Akin Gump Strauss Hauer Feld LLP, Lorraine Johnston of Ashurst LLP, Simon Whitney of Travers Smith LLP, and Tiffany Cox of Macfarlanes LLP in writing this letter.