Association for Financial Markets in Europe

Consultation Response

Sustainability Disclosure Requirements (SDR) and investment labels

25 January 2023

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to respond to the FCA's consultation paper (CP22/20) on Sustainability Disclosure Requirements (SDR) and investment labels (the "Consultation Paper").

AFME broadly welcomes the proposed SDR and investment labels and supports the focus on establishing credible, effective product labels for sustainable investments. We have focused our response on the perspective of our members as wholesale banks which, while not directly subject to many of the proposed requirements, will be impacted for example as manufacturers and distributors of sustainable investments and through the provision of data that will be needed by investment managers to comply with the requirements. Our members will also be directly subject to the proposed anti-greenwashing rule and strongly support the aim of establishing an effective regulatory framework for sustainable finance in the UK.

AFME has contributed to the development of the European sustainable finance legislative framework from its early stages. Throughout this ongoing process, we have drawn some lessons as to how firms have interpreted and implemented new transparency rules, including principle-based measures as well as the more prescriptive requirements. We welcome that the FCA has also sought to reflect on the experience of firms and is seeking to establish a labelling regime. We put forward recommendations on how the FCA can offer clarity and precision to facilitate the future implementation of the new rules, promote legal certainty, and mitigate greenwashing risks.

AFME welcomed HM Government's "Greening Finance: A Roadmap to Sustainable Investing" published in October 2021. We strongly support the government's proposals to establish an integrated framework for sustainability disclosures across the economy including the elements of corporate disclosures, asset manager and asset owner disclosures and investment product disclosures. We welcome the progress made by the FCA in the areas within its mandate and wish to highlight the importance of ensuring that an integrated framework is achieved in practice. While we welcome the announcement by the government that it will publish its updated Green Finance Strategy in Q1 2023, AFME members would welcome additional clarity on how the proposed SDR and investment labels will be integrated into the broader SDR framework, including with respect to the timing of corporate disclosures and how this will fit with the timing of the introduction of the proposed investment labels. The availability of sustainability data is an important prerequisite to the disclosures proposed under the SDR and investment labels framework. There also remains uncertainty regarding the approach to a UK Green Taxonomy and the timing of further work on this. While we appreciate that this is not all within the FCA's remit, we encourage the FCA to continue to reflect upon how the proposals in the Consultation Paper will fit within the broader UK regulatory and disclosure framework for sustainable finance and to clarify this where possible.

Addressing these questions at this early stage in the design of the new disclosure and labelling rules will greatly facilitate their design, delivery and implementation. Most importantly, clear and understandable definitions and criteria underpinning the requirements should provide adequate levels of legal certainty for financial market participants, enhancing the tools for sustainable investment decision-making and mitigating reputational risks, and retail investors, building trust in the market and preventing greenwashing.

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We therefore focus on potential challenges arising from the practical implementation of the proposed SDR and investment labels including:

- timing considerations and criteria for the proposed labels;
- the marketing and distribution of products with some sustainability characteristics but which do not meet the eligibility criteria for one of the proposed sustainable investment labels; and
- the cross-border distribution of funds and the implications for double labelling of funds under the UK and EU frameworks.

Consultation questions

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

We broadly agree with the proposed scope of the regime. However, certain amendments have been suggested from a scope perspective in our responses which are outlined below.

Timing

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

In order to demonstrate compliance with the category-specific criteria for each sustainable investment label, as well as the cross-cutting criteria, firms directly in scope of the regime will require data in respect of the assets in which they are investing. Such firms may look to the 'manufacturer' of instruments that will form part of a portfolio subject to a sustainable investment label to make the relevant data available. AFME members therefore wish to highlight the importance of sequencing in relation to the introduction of the proposed sustainable investment labels as data availability is a key component in ensuring the operability of the SDR regime. In particular, the data that would be required to evidence compliance with the sustainable investment label criteria currently would often not be available. AFME members would therefore strongly support alignment from a timing perspective with the introduction of the ISSB standards and the output of the Transition Plan Taskforce ("TPT") in order to provide the underlying framework for the sustainable investment label requirements from a data availability perspective. In addition, the rollout of corporate disclosure obligations in advance of the obligations applicable to financial institutions would prevent the issues that EU-regulated firms have faced where the information required to meet regulatory obligations is often not available.

With regards to the implementation timings for the anti-greenwashing rule, members would welcome clarity from the FCA as to the requirements that will come into force with the anti-greenwashing rule. For example, caution should be taken in order to avoid an indirect introduction of the details of the SDR and investment labels regime a year early, with firms being held to a higher standard in advance of these rules coming into effect. Members strongly support a gradual and targeted implementation of the rules due to the operational implications for firms in scope, particularly in relation to the implementation of the investment label requirements. For this reason, the FCA should confirm the operational implications of applying the investment labels and consumer-facing disclosure requirements mid-year, which is likely to present a greater operational challenge than applying these requirements from January 2025.

We also emphasise that if the standards are updated in the relatively near future, the impact of this would need to be carefully managed. For example, if products change labels this could undermine the developments of the market.

Proposed sustainable investment product labels

We set out below our views on the proposed sustainable investment product labels. We have grouped this in response to the following questions:

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?

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:

- ***a. Sustainable Focus: whether at least 70% of a 'sustainable focus' product's assets must meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme?***
- ***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?***
- ***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?***

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?***

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.***

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?

AFME members broadly welcome the approach to categorisation and labelling, together with an enhanced regime to drive up standards in relation to sustainable investments. However, we note that the sustainability objectives of the three label categories are drafted with a focus on actively managed funds rather than passive investments tracking a sustainable index used as a benchmark. Further clarification will be needed from the FCA on the treatment of passive investment strategies within the SDR regime. For example, in the case of structured products, caution should also be taken to avoid any secondary impact which might prevent structured products from being utilised in discretionary portfolios by asset managers or funds that are applying for a sustainable investment label. There are many aspects of the proposed labelling rules which are not directly applicable to these products - in particular, the Resource and Governance and Stewardship principles (principles 4 & 5) as many of these types of products are synthetically hedged and passively tracking a sustainable benchmark algorithmically determined, rather than actively managed.

Products which do not use a sustainable investment label but nevertheless have some sustainability- or ESG-related characteristics may still meet the needs of a particular consumer. It is therefore important that consumers receive the information that they need to understand the features of such products so that they can understand and access suitable solutions. This risk could be addressed through:

- the inclusion of an additional category as an additional sustainable investment label. Capturing products that go beyond baseline ESG integration, but that would not qualify for one of the three currently proposed sustainable investment labels, would recognise the importance of ensuring a range of products with sustainability features in meeting bespoke consumer needs and ensure that adequate and proportionate information is provided about the sustainability-related features of such products;

- the amendment or dis-application of the proposed naming and marketing rules such that they do not limit the disclosures that can be made in relation to sustainability-related features that are integral to a product's investment policy and strategy; and/or

- allowing products qualifying under another framework, such as the EU SFDR or the proposed SEC rules, to explicitly disclose this in the SDR disclosures (including in the consumer-facing disclosures).

As well as member firms that are caught by these proposed requirements, many AFME members are manufacturers of financial products and many AFME members will be indirectly impacted by the proposed requirements due to the upstream effect on products manufactured by banks that will form part of a portfolio subject to a sustainable investment label.

Concerning independent verification, members agree with the FCA's proposal not to introduce a mandatory requirement for firms to seek independent verification of their labelling at this stage which allows firms the flexibility to develop their own proprietary model in this regard.

Additionally, we note that the Consultation Paper proposal indicates that "a firm must carry out due diligence on any data, research, and analytical resources it relies upon (including when third-party ESG data service providers are used), ensuring that any gaps and shortcomings identified are documented and appropriately mitigated". However, provisions should not place a disproportionate burden on firms using these services. Shortcomings related to the transparency of methodologies and governance processes of ESG data providers should be addressed through relevant initiatives including the work of the Working Group on ESG ratings and Data Providers to develop a Code of Conduct and the upcoming HM Treasury consultation on the regulatory oversight of these firms.

‘Sustainable focus’ label

With respect to the ‘Sustainable focus’ category, the proposed criteria require at least 70% of a ‘sustainable focus’ product’s assets to meet a credible standard of environmental and/or social sustainability, or to align with a specified environmental and/or social sustainability theme. In relation to the ‘credible standard’ and alignment with ‘a specified environmental and/or social sustainability theme’ proposed, AFME members understand that the FCA is not being prescriptive at this stage as to what the standards should be. It is noted that the UK Green Taxonomy is provided as one way to meet the ‘credible standard’. However, members would welcome further guidance or examples of these standards proposed and how these standards would be met in practice, including examples of models or approaches which could be developed by firms. In particular, in light of the delay and potential change in approach to the UK Green Taxonomy[1], members would find it very helpful to have other examples of what the FCA would consider as meeting the ‘credible standard’ and confirmation from the FCA as to whether firms can develop their own proprietary models in this regard. Members would also welcome a non-exhaustive list of examples of standards demonstrating alignment with specified environmental and/or social sustainability themes that would be acceptable for this classification or a further definition of this condition, such as the UN Sustainable Development Goals (SDGs), Sustainability Accounting Standards Board (SASB), guidance from the International Capital Market Association (ICMA) and the International Swaps and Derivatives Association (ISDA). This would provide firms with a better understanding of what the FCA would or would not consider to be appropriate for this purpose, especially at a time when the sustainable finance market is developing and where innovation must be supported.

We note that the FCA will consider updating the requirements over time. However, members would strongly support guidance in advance of the rules taking effect. This would ensure a clear and coherent framework, rather than creating the potential perception that the rules could be narrowed or amended over time. The uncertainty, on the other hand, could discourage the use of this label as it is difficult for firms to adjust their approach once a product has been launched.

AFME members find the proposal for a 70% threshold in relation to the applicability of this category helpful. However, members would welcome guidance from the FCA as to how the 70% threshold should be calculated. Members consider that this is necessary to ensure a consistent approach across the market with the application of this requirement – which will in turn facilitate effective comparability by consumers between different products using the ‘sustainable focus’ label, and allow end investors to take well-informed investment decisions. Members would also appreciate guidance in relation to the application of the 70% threshold on an ongoing basis. For example, if a fund fluctuates causing a dip below the 70% threshold, how should this be addressed? Would the FCA allow a passive breach if the fund was brought back into compliance within a reasonable period, and what period of time would the FCA consider to be reasonable here? This also links to the point raised above in relation to what amounts to a credible standard of environmental and/or social sustainability and a specified environmental and/or social sustainability theme as the ongoing 70% threshold will inherently link to the nature of the standard applied.

‘Sustainable improvers’ label

In relation to the ‘Sustainable improvers’ category, the proposed criteria require that products in this category aim to invest in assets that have the potential to deliver measurable improvements in their environmental and/or social sustainability over time, including in response to the stewardship influence of the firm.

AFME members would support the FCA in developing its own definition of ‘stewardship’ to ensure this is being defined consistently across the market and would welcome alignment against the stewardship outcomes

[1] https://questions-statements.parliament.uk/written-statements/detail/2022-12-14/hcws444

under the FRC's UK Stewardship Code. AFME members would additionally welcome clarification on the general level of engagement required to define 'stewardship activities', including in respect of proxy voting.

AFME members strongly support this category, and consider it essential to have a label which reflects the need to accommodate investment in assets transitioning to becoming more sustainable. In achieving the criteria proposed, AFME members would welcome this category being broader and not being limited to the stewardship influence of the firm to help transitioning companies comply with the criteria imposed by the label. It is noted that in relation to this label, the expectation expressed in the Consultation Paper is that this category of products would pursue its sustainability goals primarily via the channel of investor stewardship. AFME members would welcome clarity on the role of investment stewardship specific to this label as distinguished from the stewardship requirements under the qualifying criteria. For example, whether it is a requirement for the sustainable improver label that KPIs are set by the firm in relation to the contribution of stewardship activities and outcomes to the achievement of the product's sustainability objective, and whether there is a need for active involvement to improve the stewardship activities of the product's assets over time or if a transition strategy would be sufficient for the application of this label (for example, where there is improvement against a compliant transition plan, AFME members consider that this should not necessitate the need for additional active involvement). As KPIs are to be set by the firm, AFME members would welcome parameters on the criteria to be set in order to help illustrate what the FCA would and would not consider to be effective KPIs for this label.

AFME members wish to highlight that firms' ability to comply with the requirements of this category will be limited if there is a lack of data availability and data quality. The timing of implementation, alongside initiatives to improve data quality, is therefore key in this regard and, accordingly, AFME members consider that appropriate sequencing with the output of the Transition Plan Taskforce is necessary to ensure that firms can effectively evaluate whether clients are progressing against relevant targets. In addition, members would also request further guidance on how this category would be addressed if sustainability improvements are made in one area and not in others, and the approach that should be taken to measuring improvements in such circumstances for the purposes of this label. We also note the early stage of development of metrics for some ESG aspects, such as social factors. .

'Sustainable impact' label

AFME members support the overall concept of the 'sustainable impact' label and agree with the FCA that firms should be able to demonstrate and measure the 'additionality' of their contribution to 'real-world' sustainability outcomes under this label. Members however believe that this should not be narrowly defined as only investing new capital. New capital can be one way of demonstrating additionality, but it is not the only way. AFME members would propose expanding this label to include other examples to avoid limiting its scope.

Portfolio management

It is proposed that portfolio management services can only use a label if 90% or more of the value of all constituent products in which they invest qualify for the same sustainable investment label. In this regard, AFME members wish to highlight that certain asset classes are less likely to have products with labels (cash, sovereign bonds, commodities) making the 90% threshold unachievable for most diversified portfolios, therefore a lower threshold should be considered. AFME members would also support flexibility to allow for a label to be used for portfolio management services whereby 90% of the assets qualify for different labels as proposed under this regime, therefore not limiting the 90% threshold to assets qualifying for the same sustainable investment label. This could be achieved either by adjusting the currently proposed requirements, or by adding an additional label for such portfolios in order to ensure that appropriate information is being communicated to consumers on the level of sustainability alignment of such portfolios. A possible name for this label could be 'Multi- Sustainable' to indicate that funds under this category would have the three distinct approaches in how they incorporate sustainability considerations into their investment processes, providing investors with the option to pursue diversified, lower-cost strategies.

In addition, overseas products are not included in the scope of the consultation. However, AFME members will often manage portfolios which invest in both UK-domiciled funds and European-domiciled funds. Members would therefore request further guidance on the approach to overseas funds in such circumstances in order to avoid the situation where achieving the threshold of 90% will be unachievable in such a scenario. The different approaches taken between jurisdictions, for example between the FCA's proposals Article 8 SFDR and the SEC proposals may also create challenges for portfolios that include cross-border investments.,

Given the diversified nature of the portfolios managed by AFME members, it is unlikely that all the underlying investments of a product will have the same label, therefore single-label alignment is unlikely to be achievable in a diversified portfolio. Similar concerns arise in relation to the management of multi-asset funds and funds of funds. AFME members would therefore urge the FCA to consider the approach in this regard in order to allow flexibility to reflect the nature of portfolio management services.

No sustainable label

Q7: Do you agree with our proposal to only introduce labels for sustainable investment products (ie to not require a label for 'non-sustainable' investment products)? If not, what alternative do you suggest?

We note that the 'Not Promoted as Sustainable' category set out in Discussion Paper 21/14 has not been included within the proposed rules following feedback that this category could unduly create a negative impression and disincentivise consumers from investing in these products (even if the products are not positioning themselves as being sustainable). However, whilst the 'Not Promoted as Sustainable' label is not proposed to be taken forward, AFME members are concerned that in practice where there is 'no sustainable investment label' this will become a de facto 'Not Promoted as Sustainable' category. In particular, due to the proposed restrictions on the information that can be provided in the consumer-facing disclosure where there is no sustainable investment label (in particular, the proposal that the label field must be marked with 'no sustainable label' and other fields under the content section must be marked with 'not applicable' or 'N/A') there is limited ability for products without a sustainability objective (which do not qualify for a sustainable investment label), but that nevertheless run ESG strategies which go beyond 'ESG integration', to explain these to consumers.

These products have some sustainability- or ESG-related characteristics that may still meet the needs of a particular consumer. It is therefore important that consumers receive the information that they need to understand the sustainability- or ESG-related features of such products in order to ensure they can understand and access products suitable for their profile and preferences. Capturing products that go beyond baseline ESG integration, but that would not qualify for one of the three currently proposed sustainable investment labels, would recognise the importance of ensuring a range of products with sustainability features in meeting consumer needs and ensure that adequate and proportionate information is provided about the sustainability-related features of such products (see also our response to question 10 above).

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?

AFME members consider that it is important to ensure that clear disclosures are provided to consumers in relation to the sustainability-related features of products which do not use a sustainable investment label (for example in relation to ESG integration, ESG tilt or negative screening strategies). AFME members therefore strongly support the proposal that where firms adopt sustainability-related investment policies and strategies that are integral to their investment policy and strategy, firms should be able to describe these factually and in a proportionate way in their disclosures. AFME members would however find additional guidance helpful in terms of the extent of the disclosures that can be made in this regard, as detailed further below in our response to questions 21 and 22 below.

In relation to products with no sustainable investment label, the proposal is for the label field in the consumer-facing disclosure to be marked with 'no sustainable label' and other fields to be marked with 'not applicable' or 'N/A'. As discussed in our response to question 10 above, we suggest that the FCA considers an approach that would facilitate the disclosure of sustainability-related information for products that are not eligible for one of the three proposed labels. Members consider that consumer-facing disclosures should allow for the inclusion of sustainability-related information which would be useful to the consumer, instead of the consumer receiving consumer-facing information which has 'N/A' in all fields. An alternative could be to consider a standardised negative screening section to the disclosures, which would also apply to products that are not eligible for a sustainability label.

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?

As discussed above, AFME members wish to highlight the importance of sequencing of sustainability disclosure requirements between corporates and financial institutions. The availability of corporate sustainability data is a key component in ensuring the operability and effectiveness of the SDR regime. In particular, the data that would be required to evidence compliance with the sustainable investment label criteria currently would often not be available. AFME members would therefore strongly support alignment from a timing perspective with the introduction of the ISSB standards.

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

AFME members are supportive of the proposed rule's objective to mitigate greenwashing risks and are generally supportive of the proposed anti-greenwashing rule. AFME members have already undertaken a significant amount of work to mitigate misrepresentation risk, which can take the form of an overarching framework with further detail at a line-of-business level. This reflects the need to tailor firms' approaches to be fair and not misleading in a manner appropriate to each business line, taking into account the nature of the products and services provided. AFME members consider that this will also be the case with the application of the general anti-greenwashing rule. However, it is important that the FCA anti-greenwashing rule is clear and does not create uncertainty in the market as anti-greenwashing policy may stifle innovation – as well as lead to 'green-hushing' with firms opting to remain silent about their climate strategies.

We note the FCA's intention that the proposed anti-greenwashing rule aims to clarify existing rules in a sustainability context. Given the proposed application of the general anti-greenwashing rule to all regulated firms, and in order to provide clarity in relation to the application of the proposed rule in practice, AFME members would welcome a discussion with the FCA regarding how this rule applies to different types of products and services, beyond funds. In particular, AFME members would be grateful for clarity on how the concept of 'proportionality' will be applied under the proposed anti-greenwashing rule, similar to other regulatory regimes such as the FCA PROD requirements or COBS 4.2.2, in order to reflect that the 'clear, fair and not misleading' standard and to ensure that consistency with the sustainability profile of the product or service is not a ‘one size fits all’ question and will vary depending on multiple factors, including the sophistication of the recipients of the information.

From a proportionality perspective, AFME members would also appreciate further guidance on how the proposed anti-greenwashing rule would be applied to statements that firms are required to make under other regulatory regimes – for example, disclosures made in compliance with Article 8 of the EU Sustainable Finance Disclosure Regulation (“SFDR”) which may require the use of terms prohibited for the marketing of products that do not align with the equivalent standards and thresholds under the proposed SDR regime.

AFME members would additionally welcome clarification on the scope of the proposed general anti-greenwashing rule and whether unregulated business undertaken by regulated entities would be captured. Whilst AFME members understand the overall scope of the rules and their application to all regulated firms, AFME members would welcome further clarification on how far the proposed rule extends to the unregulated business of a regulated firm. In addition, AFME members also consider that the territorial scope of the rules should be clarified, for example, to confirm that the general anti-greenwashing rule would not apply to information provided by a UK-regulated firm to recipients overseas where firms may be required to comply with local sustainability-related requirements.

We also wish to highlight the importance of international coordination in relation to supervisory approaches to addressing greenwashing, and encourage the FCA to coordinate through IOSCO and with counterparts in other jurisdictions, including the EU, to avoid fragmentation, misalignment, and the ensuing challenges with the cross-border distribution of sustainable investment products.[2]

AFME members consider that the dialogue and guidance requested above is important to ensure the effective application of the general anti-greenwashing rule and therefore would support this taking place prior to the anti-greenwashing rule taking effect.

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?

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

AFME members wish to raise the potential impact of the proposed product naming rule on products which do not use a sustainable investment label but nevertheless have some sustainability-related characteristics. Consumers should be provided with clear information about the sustainability-related features of such products as these may still meet the needs of a particular consumer who may otherwise be limited in their ability to identify such products if the prohibited terms cannot be used to describe the relevant sustainability-related features.

In addition, marketing funds without a description of their sustainability characteristics does not work from a practical perspective and will be potentially misleading to investors. Specifically, for funds that follow ESG integration, communication on what this means is essential to offer transparency. Similarly, funds that are seeking to achieve Net-Zero outcomes need to provide information on sustainability and climate change, and communicate on the progress towards achieving the strategy’s Net-Zero objectives. Another example where challenges could arise is index-linked funds where the fund takes on the name of the underlying index but where the index is not subject to the to the UK proportionality rule. Please also see our comments above regarding portfolio management.

[2] See also AFME’s response to the EU ESAs’ Call for Evidence on greenwashing, available at https://www.afme.eu/Portals/0/DispatchFeaturedImages/230110%20AFME%20response%20ESAs%20greenwashing%20CFE.pdf

AFME members therefore strongly support the proposal that where firms adopt sustainability-related investment policies and strategies that are integral to their investment policy and strategy, firms should be able to describe these factually and in a proportionate way in their disclosures. AFME members would however appreciate further guidance on what a 'factual and proportionate' disclosure should look like for these purposes in order to help clarify the parameters of what the FCA considers acceptable for such disclosures. In addition, AFME members would support an explicit clarification that firms can also refer to any other classifications that may be applicable to a product, for example, if a product is classified as Article 8 under SFDR, ICMA Principles/Guidelines or other sustainability labels that may apply at national level in Europe. AFME members would like to highlight the need to ensure interoperability between different frameworks in order to avoid fragmentation and would therefore strongly support explicit guidance from the FCA in relation to how other regimes can be referenced under the proposed rules.

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

AFME members would welcome clarity of the applicability of these rules to product manufacturers and their responsibilities with regard to distributors under the proposed rules.

Cross-border interaction

We welcome the mapping to SFDR requirements and SEC proposals set out in Annex 1 to the Consultation Paper and that the FCA recognises that many UK firms are already subject to SFDR. While we acknowledge, and support, that the FCA's proposed framework is designed as a labelling regime and therefore has a different starting point to SFDR, the differences could give rise to complexity for firms and for investors. The cross-border distribution of funds and the suggested double labelling of funds under the UK and EU regime as well as the commercial implications in terms of complexity. We also encourage coordination with ESMA with respect to its proposed guidelines on funds' names using ESG or sustainability-related terms. We note that ESMA does not propose to introduce restrictions on terms used in the marketing of funds.

We note that the FCA plans to consult separately on its approach to overseas products to address the issue identified in paragraph 7.12 of the Consultation Paper where prohibited sustainability-related terms are used in relation to the naming and marketing of overseas products. In this respect, the temporary measure outlined in paragraph 7.12 suggests that if a financial institution is distributing non-UK ESG funds into the UK that it should add the notation "This product is based overseas and is not subject to FCA sustainable investment labelling and disclosure requirements". While this measure/approach is referenced as temporary, it may however from a commercial perspective seem incongruous to a UK client. We would therefore emphasise the need for the rules in relation to overseas products to be implemented as closely as possible to the rules as proposed to UK funds in order to address this issue.

If financial institutions have to apply both labels, the flow charts noted in Annex 1 may present operational difficulties given the lack of convergence – for example, a client that can book investments in both an entity's EU and UK location will get contrasting sustainability-related information. We would therefore welcome an FCA proposal for how to document/reconcile such situation, as this has the potential to pose issues in being "clear, fair and not misleading" (e.g. where a product qualifies as Article 9 under SFDR but has no UK sustainability label).

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About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.[3]

[3] AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.