impact investing institute

The Impact Investing Institute's response to the Financial Conduct Authority's CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels

25 January 2023

SUMMARY

We warmly welcome the FCA's proposals, which we believe are a significant step towards meeting the vital objective of enhancing consumer trust in sustainability products through clearer and more reliable product descriptions, as outlined in Occasional Paper 62. At the Impact Investing Institute, our mission is to accelerate the growth and improve the effectiveness of the impact investing market in the UK and internationally. Impact investments are investments made with an explicit intention to generate positive, measurable social and environmental impact alongside a financial return (ref. the Global Impact Investing Network [GIIN]). We believe that impact investing makes capital markets fairer and work better for people and the planet, in turn helping them to deliver sustainable and inclusive economic growth. We are pleased to have contributed directly to the FCA's work as a member of the Disclosures and Labels Advisory Group (DLAG). We have hosted roundtables[1] and gathered feedback to provide FCA with the views of leading impact investors and other experts amongst our supporters and networks.

The proposals come at a crucial point, given the need to protect the integrity of sustainable and impact investing at a time of huge growth and, in many areas, unfortunate dilution, compromise and controversy. Tackling greenwashing and empowering consumers to make informed choices are mutually reinforcing endeavours. Our consultation response is framed around the belief that it is critically important that the Sustainability Disclosure Requirements and investment labels strike a balance between codifying existing best practice, raising the bar for sustainable investing across the financial sector, and leaving space for continued innovation. Such a regime should promote transparency and accountability, protect consumers, and sit within a wider policy and regulatory environment that incorporates investee enterprise reporting and the full value chain of those providing financial services, including distributors of financial products.

Given our organisational purpose and expertise, our response to the consultation paper ("CP") is focused on the Sustainable Impact label. Where relevant, we also provide comment on other areas too. Whilst there is much with which we agree on the design of the Sustainable Impact label, we are concerned that a few key features do not align with, nor accommodate, the direction of travel of the global impact investing market. Furthermore, these key features risk confusing consumers. Consequently, we are concerned that some 'best in class' impact investing products, which may already have a strong theory of change and robust metrics and disclosures, would struggle to be eligible for the label as currently designed. This would also lead to confusion within other FCA labels, as impact products could be forced into the Sustainable Focus or Sustainable Improvers labels.

In summary, we make the following recommendations to address what we believe are design limitations of the Sustainable Impact label:

[1] We would be pleased to provide to the FCA more granular feedback from our latest roundtable held on 12 January 2023, as we did with our previous roundtables in January and May 2022. In all cases, we brought together asset managers spanning asset classes, geographies and impact investing approaches, as well as key industry bodies and relevant NGOs, to discuss perspectives on the FCA's proposals.

1. **Replace requirement for additionality.** The CP requires that an investor using the Sustainable Impact label can demonstrate their additionality (4.38, p.36 and 4.41, p.37). As defined in the CP, this means: "whether a proposed activity will produce some 'extra good' in the future relative to a specified baseline, typically the counter-factual in which the investment has not taken place" (Box 4, p.28). We understand, and support the intention, that the FCA is using this concept to define how the investor can demonstrate they are contributing towards solutions with their Sustainable Impact products, so that consumers are assured of the integrity of the products and the FCA have a clear indicator for supervisory purposes.

   However, additionality is not a concept that consumers will recognise or understand readily, so runs counter to the effort to improve consumer comprehension. Even among asset managers, there is no consensus on its meaning, although most would agree that it is a problematic standard to satisfy. If the standard includes a requirement for a counterfactual, then it becomes near-impossible to evidence. As the CP notes, the GIIN has excluded it from its definition of impact investing.

   The CP goes on to reference the belief, held by some, that "financial additionality" (i.e., the provision of new capital) is "a necessary element of impact investing", which both implies that the provision of new capital is necessarily impactful *and* that other forms of investor contribution (such as stewardship) are not impactful. We are concerned that this results in an arbitrary prioritisation of the provision of new capital over other forms of investor contribution, in turn essentially restricting eligible investments to private assets (or primary issuances).

   We therefore recommend the FCA to replace their reference to and requirement for additionality with a description of investor contribution that is more easily and widely understood and applied, and with reference to the list in Box 3 on p.25 (albeit expanded – see recommendation 3, below).

2. **Provide a more balanced view of how both the enterprise and the investor contribute towards impact:** there appears to be some inconsistency in the way that impact is described in the Sustainable Impact label. The consumer-facing disclosures place an emphasis on the enterprise impact – "Invests in solutions to problems affecting people or the planet to achieve real-world impact" (4.23, p.31). However, the category description and rationale places much more emphasis on the investor contribution and resulting impact – "This category of product would pursue its sustainability goals by directing typically new capital to projects and activities that offer solutions to environmental or social problems" (4.43, p.37). We believe this is potentially confusing to the consumer and unrepresentative of the impact investing market. "Impact" is typically understood to be the outcomes for people and the planet generated by the underlying enterprise (or asset) in which a fund is invested. Investors can contribute to this impact through financial (e.g., capital allocation) and non-financial (e.g., stewardship) activities.

   We recommend that the CP presents a more balanced view of the importance and potential eligibility of investments generating both enterprise and investor contribution for the Sustainable Impact label. This includes removing the hierarchy of 'primary' and 'secondary' channels for sustainability outcomes (4.43, p.38). To complement this, it would be helpful for the FCA to expand upon the information provided in Box 3 on p.25 with a fuller description of the "main channels or mechanisms by which an investor may plausibly contribute to positive outcomes for the environment and/ or society."

3. **Provide a more balanced view of the potential for both private and public market investments to qualify as impact investments**: as explained above, there is a danger that the CP's weighting towards the provision of new capital as more impactful than other forms of investor contribution promotes the idea that new capital is either (a) inherently more impactful or (b) more likely to be considered impactful because it is easier to measure. This results in narrowing the investable universe predominantly to private assets, and risks excluding assets which meet the CP's definition of an impact product as providing ''sustainability solutions to environmental and/or social problems" simply because they are traded on the secondary market.

4. **Emphasise and build out the requirement for Sustainable Impact products to have a theory of change.** A theory of change is a well-established mechanism for articulating a problem affecting people or the planet, the solution to that problem, and how the investor intends to contribute towards that solution. We strongly endorse the FCA's requirement for Sustainable Impact products to have a theory of change and recommend that the FCA provides a fuller explanation of its role and structure – how it is the mechanism that sets the investment objectives and strategy, and governs the process for determining asset selection, investor contribution, KPI selection for measurement and reporting, and mitigation and escalation strategies for those occasions when intended outcomes are not achieved.

   This amendment would provide a robust and highly differentiated framework for the Sustainable Impact label that, we believe, would require sufficient supporting documentation as to make FCA supervision effective. It requires the investor to have a clearly defined framework both for selecting assets based on their expected positive impacts in the real-world, and for recording how they, the investor, seek to contribute towards enhancing those impacts and mitigating negative consequences. Strengthening the overarching framework of the Sustainable Impact label in this way allows for more expansive criteria with regards to demonstrating impact – thereby allowing for the full range of asset types and strategies that can deliver impact.

   We would be happy to assist the FCA in developing a template and guidance for theories of change. For example, we have published guidance on the development of a theory of change in our draft Just Transition Criteria (p13-15), which builds on the work of the GIIN, to support financial institutions to design and manage investment products that contribute towards a just transition to a global net zero economy (more detail in section 3.2 of our response below). We also recommend that the FCA provide worked examples of theories of change that conform to best practice, after engagement with best-in-class impact investors and other stakeholders.

5. **Replace reference to 'underserved markets' and 'market failures':** the CP emphasises throughout that Sustainable Impact products are "invested in assets that provide solutions to environmental or social problems, *often in underserved markets or to address observed market failures*". We fully agree that impact investing products must make clear the problem, or unmet need, they are intending to solve and how they contribute towards the solution, however, we caution against using the descriptors 'underserved markets' and 'market failures'. Similarly to additionality, they are not commonly understood concepts, inviting a subjective determination by investors and therefore making it difficult to practically interpret as the primary channel for sustainability outcomes, as is proposed. 'Underserved markets', for example, could be interpreted more narrowly as meaning 'underserved stakeholders', or invite a range on interpretations with regards to nascency, scale, reach, etc.

We recommend replacing these terms with a description that is better aligned with the FCA's consumer-facing disclosure, in order to facilitate consumer comprehension, such as "meeting an unmet societal or environmental need". We recommend that investors, as part of their theory of change, are required to provide evidence for this unmet need, e.g., a Sustainable Development Goal target and country-, regional-, or community-level data.

In the spirit of strengthening the overall proposed regime, we also recommend the following:

1. **Provide further guidance on the 'unexpected' disclosures rule, and on adverse / unintended negative impacts.** We also would welcome further guidance from the FCA on the circumstances in which assets that don't "meet a credible standard of environmental and/or sustainability or align with a specified sustainability theme" may be held, and the purposes for which they would be held. We suggest that the FCA could identify broad themes against which fund managers could assess potential harm – for example, concerning human rights, biodiversity, etc. – but allow fund managers to select the most appropriate disclosures and indicators as applicable to their fund or investment strategy.
2. **Rename the 'Anti-greenwashing' rule an 'Anti-impact washing' or 'Anti-sustainability washing' rule**. This would retain the same principles and approach of an anti-greenwashing rule but more explicitly encompass all sustainability issues.
3. **Coordination with other regulators and government to align understanding, regulations and guidance around sustainable investing**. We hope that the the FCA re-engages with market participants and EU policymakers to further explore and clarify interoperability with the Sustainable Finance Disclosure Regulation (SFDR), and considers providing worked examples of how mapping to SFDR would work in practice.

ABOUT THE IMPACT INVESTING INSTITUTE

The Impact Investing Institute was launched in 2019 with a mission: to accelerate the growth and improve the effectiveness of the impact investing market in the UK and internationally. Our aim is for capital markets to be fairer and work better for people and the planet, in order to deliver sustainable and inclusive economic growth.

We are an independent, non-profit organisation, which brought together two influential initiatives: the Government's Taskforce for Growing a Culture of Social Impact Investing in the UK, and the UK National Advisory Board on Impact Investing. We are part of the GSG – the Global Steering Group on Impact Investing Network, which brings together leaders from finance, business, and philanthropy to contribute to solving some of the world's most pressing social and environmental challenges. Our Theory of Change describes how we plan to achieve change in the short-, medium- and long-term. We run a series of research, education and advocacy programmes designed to bring about the market conditions to enable impact investing to flourish.

Our full response begins from the next page. We are delighted to continue to participate in the DLAG and welcome any additional opportunity to help the FCA to deliver this important initiative.

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1. SCOPE OF LABELLING REGIME

1.1 The need for a comprehensive labelling regime

- *Question 1: 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 warmly welcome the FCA's commitment to tackle green-, social- and impact- washing and its recognition of the growing prominence and importance of impact investing. Whilst we acknowledge the additional challenges in applying a labelling regime to pension products, given they are consumer-facing and represent a significant part of the financial markets, **we recommend they are treated as a high priority for the next stage** (more detail in Section 7 below).

- *Question 2: Do you agree with the proposed implementation timeline? If not, what alternative timeline would you prefer, and why?*

Investor sustainability reporting is dependent upon enterpise (i.e., underlying asset) sustainability reporting. **We welcome commitments from the FCA to work alongside government and other regulators to accelerate the development and implementation of workable corporate sustainability disclosure regimes, including a green taxonomy and appropriate social metrics**.

1.2 Emphasis on intentionality

- *Question 5: 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 agree with the emphasis on intentionality across the proposed approach to the labelling and classification of investment products (section 3.2 of CP). We believe this (i) places the emphasis, rightly, on matters within the control of the investment manager, (ii) establishes a robust overarching framework, leaving room for different underlying investment approaches with regards to themes, asset classes, geographies etc., (iii) manages consumer expectations by acknowledging that positive outcomes are not absolutely guaranteed, while providing clear criteria to safeguard against impact-washing, and (iv) reflects leading market practice.

We are, however, concerned that the mutual exclusivity of the labels makes it very difficult for investors adopting a blended strategy to pursue sustainable objectives across a range of asset classes – it could distort investor decisions rather than reflect market reality. We would therefore **welcome guidance from the FCA for investors with blended strategies** – for example, clarifying that Sustainable Improver funds can hold (already) 'sustainable' assets.

2. IMPROVING THE IMPACT LABEL

This section of our response addresses the following questions:

- *Question 6: 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?*

- *Question 8: Do you agree with our proposed qualifying criteria? If not, what alternatives do you suggest and why? In your response, please consider:*

  a. *whether the criteria strike the right balance between principles and prescription*
  b. *the different components to the criteria (including the implementing guidance in Appendix 2)*
  c. *whether they sufficiently delineate the different label categories, and;*
  d. *whether terms such as 'assets' are understood in this context?*

- *Question 9: Do you agree with the category-specific criteria for:*

  a. *The 'Sustainable focus' category, including the 70% threshold?*
  b. *The 'Sustainable improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?*
  c. *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.

2.1 Clarifying the definition of impact investing

Section 4.14 of the CP references the Global Impact Investing Network's (GIIN) definition of impact investing, which is globally the most widely accepted: "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return." However, there are three elements of the CP which we are concerned contribute towards narrowing the application of this definition, which puts the Sustainable Impact label at risk of creating uncertainty and excluding significant – and growing – parts of the impact investing market.

<u>A. Additionality</u>

We understand, and support the intention, that the FCA is using this concept to help define how an investor can demonstrate they are contributing towards solutions with their Sustainable Impact products, so that consumers are assured of the integrity of the products and the FCA have a clear indicator for supervisory purposes. However, we are concerned that the definition and use of 'additionality' and 'contribution' are not consistent nor clear throughout the CP. We believe that this will create confusion for consumers and make supervision more difficult for the following reasons.

The CP requires that an investor using the Sustainable Impact label can demonstrate their additionality (4.38, p.36 and 4.41, p.37). As defined in the CP, this means: "whether a proposed activity will produce some 'extra good' in the future relative to a specified baseline, typically the counter-factual in which the investment has not taken place" (Box 4, p.28). However, additionality is not a concept that consumers will recognise or understand readily, so runs counter to the effort to improve consumer comprehension. Even among asset managers, there is no consensus on its meaning, although most would agree that it is a problematic standard to satisfy. If the standard includes a requirement for a counterfactual, then it becomes near-impossible to evidence.

The CP also acknowledges that additionality is not included in the GIIN definition of impact investing. As Amit Bouri, Chief Executive Officer and Co-Founder of the, GIIN states, "requiring additionality as a defining criterion… inherently marginalises the impact investment market, implying that it will never be robust with competing investors vying for good deals and bringing with them all the benefits of a healthy investment market." The CP goes on to reference the belief, held by some, that "financial additionality" (i.e., the provision of new capital) is "a necessary element of impact investing", which both implies that the provision of new capital is necessarily impactful *and* that other forms of investor contribution (such as stewardship) are not impactful. We are concerned that this results in an arbitrary prioritisation of the provision of new capital over other forms of investor contribution, in turn essentially restricting eligible investments to private assets (or primary issuances).

Hence using additionality as a defining feature of impact investing and the investor's contribution is inconsistent with market practice and risks setting an unreachable bar. It could exclude assets that align with with the CP's definition of a Sustainable Impact product – providing ''sustainability solutions to environmental and/or social problems" – simply because they are traded on the secondary market. **We therefore recommend the FCA replace their reference to and requirement for additionality with a description of investor contribution that is more easily and widely understood and applied, and with reference to the list in Box 3 on p.25. This includes removing the hierarchy of 'primary' and 'secondary' channels for sustainability outcomes (4.43, p.38).**

To complement this, it would be helpful for the FCA to expand upon the information provided in Box 3 on p.25 with a fuller description of the "main channels or mechanisms by which an investor may plausibly contribute to positive outcomes for the environment and/ or society." For example, by including: participation in IPOs, collaborative stewardship, and wider engagement activities, such as provision of advice, training and in-kind support to assets, policy advocacy, and cross-industry engagement (e.g., with credit rating agencies, auditors and data and service providers etc.) to improve the robustness of their assessments, data and products. See also the GIIN's paper, "Impact Investing In Listed Equities: Strategies For Pursuing Impact" (due to be updated soon).

B. Enterprise impact vs investor contribution to enterprise impact

There appears to be some inconsistency in the way that impact is described in the Sustainable Impact label. The consumer-facing disclosures place an emphasis on the enterprise impact – "Invests in solutions to problems affecting people or the planet to achieve real-world impact" (4.23, p.31). However, the category description and rationale places an emphasis on the investor impact – "This category of product would pursue its sustainability goals by directing typically new capital to projects and activities that offer solutions to environmental or social problems" (4.43, p.37). We believe this is potentially confusing to the consumer and unrepresentative of the impact investing market. "Impact" is typically understood to be the outcomes for people and the planet generated by the underlying enterprise (or asset) in which a fund is invested. Investors can contribute to this impact through financial (e.g., capital allocation) and non-financial (e.g., stewardship) activities.

We recommend that the CP presents a more balanced view of the importance and potential eligibility of investments generating both enterprise and investor contribution for the Sustainable

Impact label, which would be consistent with draft GIIN guidance and the European Securities and Markets Authority (ESMA)'s proposed guidelines on impact-related terms in fund names.

C. Underserved markets and market failures

Section 2.3 of the CP notes that other bodies define impact investing as seeking "to make a positive, measurable environmental or social impact, *including by directing capital to underserved markets or addressing market failures*", and the CP adopts this requirement in its definition and explanation. We fully agree that impact investing products must make clear the problem they are intending to solve and how they contribute towards the solution, however, we caution against using the descriptors 'underserved markets' and 'market failures'. Similarly to additionality, they are not commonly understood concepts, inviting a subjective determination by investors and therefore making it difficult to practically interpret as the primary channel for sustainability outcomes, as is proposed. 'Underserved markets', for example, could be interpreted more narrowly as meaning 'underserved stakeholders', or invite a range on interpretations with regards to nascency, scale, reach, etc.

We recommend replacing these terms with a description that is better aligned with the FCA's consumer-facing disclosure, in order to facilitate consumer comprehension, such as "meeting an unmet societal or environmental need". We recommend that investors, as part of their theory of change, are required to provide evidence for this unmet need, e.g., a Sustainable Development Goal target and country-, regional-, or community-level data.

2.2 Strengthening and differentiating the Sustainable Impact label

We strongly endorse the FCA's requirement for a Sustainable Impact product to have a theory of change and **recommend that this requirement is emphasised and built out**. A theory of change is a well-established mechanism for articulating a problem affecting people or the planet, the solution to that problem, and how the investor intends to contribute towards that solution. We recommend that the FCA provides a fuller explanation of the role and structure of the theory of change – how it is the mechanism that sets the investment objective and strategy, and governs the process for determining asset selection, investor contribution, KPI selection for measurement and reporting, and mitigation and escalation strategies for those occasions when intended outcomes are not achieved.

Emphasising the requirement for a theory of change would provide a robust and highly differentiated framework for the Sustainable Impact label that, we believe, would require sufficient supporting documentation as to make FCA supervision effective. It requires the investor to have a clearly defined framework both for selecting assets based on their expected positive impacts in the real-world, and for recording how they, the investor, contribute towards enhancing those impacts and mitigating negative consequences. **We would be happy to assist the FCA in developing a template and guidance for theories of change.** For example, we have published guidance on the development of a theory of change in our draft Just Transition Criteria (p13-15), which build on the work of the GIIN, to support financial institutions to design and manage investment products that contribute towards a just transition to a global net zero economy (more detail in section 3.2 of our response below). We also recommend that the FCA provide worked examples of theories of change that conform to best practice, after engagement with best-in-class impact investors and other stakeholders.

Strengthening the overarching framework of the Sustainable Impact label in this way allows for more expansive criteria with regards to demonstrating impact – thereby allowing for the full range of asset types and strategies that can deliver impact. Firstly, it recognises that **assets in both the private and**

public markets have the capacity to provide "sustainability solutions to environmental and/or social problems". In making it easier for public market assets to be eligible, it allows for the inclusion of funds that are typically more accessible and attractive to retail investors. Secondly, it recognises that **investor contribution can be achieved through capital allocation and/or investor stewardship. We recommend these are not presented in a hierarchy ('primary channel' vs 'secondary channel' for sustainability outcomes) but alongside one another.**

Following this, as per the GIIN's recommendation, it could be clearer to rephrase the Sustainable Focus label as "portfolios of companies that demonstrate positive environmental or social attributes as defined by credible standards used by the manager." This would provide a clearer contrast with the Sustainable Impact label, which focuses on building portfolios based on a targeted outcome and a theory of change. Accordingly, the Sustinable Focus label could include "best-in-class" funds that use various proprietary assessments and ratings, with the expectation that the manager provides clarity on the basis for their screening or assessments of companies.

2.3 Guidelines for the development of robust KPIs and metrics

We welcome the CP's recognition of the importance of measuring outcomes against objectives (section 4.40), which is key to demonstrating the effectiveness of the theory of change. We support the CP's requirement that investors report "against rigorous, evidence-based KPIs that capture the investor contribution to positive sustainability outcomes" but **believe that this requirement should be expanded to include KPIs that capture the *enterprise* contribution to positive sustainability outcomes too – where relevant to the theory of change and the data is available.** We endorse firms using their own KPIs, but recommend that the FCA encourages simplicity, standardisation and comparability where possible.

The FCA could choose to require external, independent verification in line with the ninth principle of the Operating Principles for Impact Management. Many market participants already welcome third-party assurance on impact reporting. We recommend that such a requirement is accompanied by a renewed effort by the FCA to encourage greater consistency across providers of ESG data and impact verification services.

All disclosure should be provided in a machine-readable format, given the amounts of data required are large and will increase as methodologies develop. This would facilitate benchmarking and comparison by the users of sustainability information.

3. LABEL INTEGRITY AND AVOIDING HARM

This section also responds to questions 6, 8 and 9.

3.1 Avoiding harm and mitigating negative impacts

The CP's approach to avoiding significant harm requires that 70% of a Sustainable Focus product's assets (measured by investment value) must meet a credible standard of environmental and/or sustainability or align with a specified sustainability theme (section 4.30); 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 label (section 4.69); and an investor must identify any investment that might conflict with the sustainability objective, policy and strategy (section 4.56).

This approach provides a lot of flexibility for firms to self-determine the standard against which they assess the sustainability profile of their assets. We are concerned that the 70% threshold for the

Sustainable Focus label, combined with the lack of detail with regards to credible standards and the avoidance of negative impacts, would allow for qualifying investment products to contain assets which actively conflict with sustainability objectives. Meanwhile, we are concerned that the 90% product-level threshold is too restrictive, given that many portfolios often contain at least 10% of non-product holdings, such as cash. Given these issues, we are concerned that 'unexpected' disclosures rule, and requirement to "identify any investment made by a product that a reasonable investor (ie client or consumer) might consider to be in conflict with the sustainability objective, and the investment policy and strategy of the product.", do not provide a sufficiently robust framework.

We would therefore welcome further guidance from FCA on these requirements, and on the definition of "adverse environmental or social impacts" (5.54, p.62) / "unintended negative environmental or social impacts" (4.39, p.36) / "unintended negative consequences" (5.50, p.62). We suggest that the FCA could identify broad themes against which fund managers could assess potential harm – for example, concerning human rights, biodiversity, etc. – but allow fund managers to select the most appropriate disclosures and indicators as applicable to their fund or investment strategy. Many firms have developed their own exclusion policies, (e.g., Affirmative Investment Management's Exclusionary Criteria and WHEB Asset Management's Ethical Outcomes policy). Important market initiatives include the Glasgow Financial Alliance for Net Zero (GFANZ) and the UK's Transition Plan Taskforce (TPT), of which the Institute is a Delivery Group member. As the FCA acknowledges, the TPT's sector-neutral and sector-specific disclosure frameworks will provide a helpful basis for formulating disclosures and indicators for the Sustainable Improvers category; we support their integrat into the requirements and guidance once finalised.

The FCA could also cite examples of widely recognised and credible standards and initiatives to help guide investors, such as the TCFD framework, Climate Action 100+ Net Zero Benchmark, Transition Pathway Initiative, the Net Zero Investment Framework, or Science Based Targets initiative (SBTi). For Sustainable Impact products, we welcome the acknowledgement that the theory of change necessitates the identification and avoidance of unintended negative impacts (5.54, p.62).

We believe that this approach could allow for a **tweaked asset-level Sustainable Focus label threshold, whereby at least 90%** of all assets should align with a specified sustainability theme, and the remaining (up to) 10% of assets are assessed and deemed not to cause a level of adverse impact that would outweigh any positive sustainability outcomes. As noted elsewhere, most well-established sustainable funds allow a 3, 5 or 10% 'tolerance' as a reflection of the realities of investing, rather than up to 30%. **We do not believe an asset-level Sustainable Impact label threshold is necessary**: given the emphasis on the theory of change, we expect all investments to seek to positively contribute to the intended outcome(s). We also recommend that the Sustainable Focus threshold (and any future thresholds) includes flexibility for temporary fluctuations in percentage caused by sequencing of buying/selling and/or price fluctuations. This would be particularly helpful for blind-pool, self-liquidating funds, particularly those investing in liquid assets.

3.2 Development of metrics to avoid 'adverse environmental or social impacts'

Going forwards, we recommend that the FCA asks market participants to develop industry-wide, comparable metrics, under the broad 'adverse environmental or social impacts' themes it identifies, so the market is clear on the parameters of the definition. We hope that the UK will implement a robust, evidence-based, and practical Green Taxonomy, which could provide the basis for such metrics on the environmental side. As members of DWP's Taskforce on Social Factors (more detail in Section 9 below), we hope also to see the development of more standardised social metrics. Robust criteria are particularly crucial for the 'Sustainable Improvers' label, to guard against the risk of funds investing in assets that are perpetually reported as 'improving' but which are, in practice, achieving little demonstrable progress.

While UK government-led action is ongoing, our thought leadership on the Just Transition could help to describe what this means in practice today. Our Just Transition Finance Challenge is designed to support financial institutions in fulfilling such sustainability requirements. Working with 20 global financial and academic institutions, we are developing criteria to help investors integrate Just Transition considerations into their investment processes, allocations and engagement and ultimately mobilise more investment that delivers a fair and inclusive transition to Net Zero. The draft criteria are currently compatible with the FCA's three proposed labels, requiring:

1. Product-level commitment, through a Theory of Change or equivalent, to the three Just Transition Elements: (i) advancing climate and environmental action; (ii) improving socio-economic distribution and equity; and (iii) increasing community voice. This is supported by a description of the processes applied to investment selection, monitoring and divestment.
2. Each investment within a product is assessed for potential negative impacts and harmful consequences across all three Elements. This is demonstrated via selected disclosures and indicators and, where appropriate, identified safeguards.
3. Each investment within a product is selected and retained based on its (current or future) positive contribution to Advancing climate and environmental action AND *at least one of either* Improving socio-economic distribution and equity OR Increasing community voice. At a product level, there is a positive contribution made to all three Elements, demonstrated via KPIs selected at product level.

We are also exploring whether there is market interest and appetite for a Just Transition label and **would be happy to engage with the FCA and market participants on the development of similar requirements or guidance for its proposed labels**.

We also recommend that reporting criteria for stewardship and engagement are extended from the Sustainable Improvers category to all three labels. Such activities are equally important for funds that seek to invest in assets that already align with a target sustainability profile, as well as funds pursuing a Sustainable Impact strategy. We recommend the FCA considers key resources in this area, including: key steps for effective stewardship established under the Institutional Investors Group on Climate Change's (IIGCC) Net Zero Stewardship Toolkit (NZST); ShareAction's Voting Expectations of Asset Managers; and the Best Practice Engagement Reporting Template, also published by ShareAction last year.

4. INTERNATIONAL ALIGNMENT

This section responds to the following questions:

- *Question 12: 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?*

- *Question 15: 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 and updates.*
- *Question 19: 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?*
- *Question 29: 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?*

We welcome the FCA's commitment to developing world-leading standards, as well as its recognition of the benefits of interoperability with international equivalents, particularly Articles 8 and 9 of the EU Sustainable Finance Disclosure Regulation (SFDR), and ultimately the ISSB framework at the global level (Annex 1). We understand that this is a difficult balancing act and commend the FCA's efforts so far. However, we have identified three main challenges. Firstly, the CP's proposed three-label approach diverges substantially from the existing EU framework and will likely require those market participants active in both jurisdictions to develop a parallel compliance framework to that in place for SFDR. Secondly, divergence of key terminology definitions risks causing confusion and undermining market confidence – for example, many 'impact' funds in the EU wouldn't qualify as 'impact' in the UK. Thirdly, SFDR itself has created significant confusion in the EU, particularly around Article 9 qualifications, and, as such, identifying clear alignment with SFDR at this stage is very difficult. **We hope that the the FCA re-engages with market participants and EU policymakers to further explore and clarify interoperability**, and to consider providing worked examples of how mapping to SFDR would work in practice.

While the development of further standards on additional sustainability topics by ISSB will help to increase the availability and quality of sustainability-related information, we strongly recommend that the FCA introduces and upholds a focus on 'double materiality' – to enhance the 'financial materiality' lens currently employed by both TCFD and ISSB. Incorporating a double materiality lens into the SDR regime would support investors to disclose the impacts of investments on the climate and wider sustainability factors and how these impacts are mitigated over time, as opposed to simply the impacts of climate and wider sustainability factors on investments.

5. GREEN-, SOCIAL- AND IMPACT- WASHING

This section responds to the following question:

- *Question 20: Do you agree with our proposed general 'anti-greenwashing' rule? If not, what alternative do you suggest and why?*

We support the principles behind the proposed 'Anti-greenwashing rule' (sections 6.9 – 6.10) but believe **it should be renamed an 'Anti-impact washing' or 'Anti-sustainability washing' rule to explicitly encompass 'social-washing', too**. We agree that all regulated firms must ensure that the naming and marketing of financial products and services in the UK is clear, fair and not misleading, and consistent with the sustainability profile of the product or service. While the CP's description of the rule references the "sustainability profile" of the product or service, we believe that an 'Anti-impact washing' or 'Anti-sustainability washing' rule, which explicitly referenced social impact alongside environmental, would more comprehensively achieve this.

We welcome the FCA's recognition of the growing threat to consumers of risky products advertised on social media, and are pleased that any new 'anti-greenwashing' (or 'anti-impact/sustainability washing' rule would extend to the platforms which promote such products, as existing anti-fraud rules already do.

6. NAMING RULES

This section responds to the following question:

- *Question 21: Do you agree with our proposed product naming rule and prohibited terms we have identified? If not, what alternative do you suggest and why?*

We support the principles behind the proposed product naming rule and prohibited terms (sections 6.11 – 6.17), which should serve to increase consumer trust in sustainable finance products. To strengthen the list of prohibited terms, we believe **the term 'ethical' should be included**, given there is no standard definition of what constitutes an 'ethical' investment, and its common association and historical interchangeability with 'sustainable', 'responsible', 'ESG' and 'impact'.

The FCA may wish to **consider whether the list of prohibited terms should extend to firm names as well as product names**. Under existing proposals, for example, a new application-based investment firm could legally call itself "Green Investments", which could understandably mislead consumers. We would also welcome guidance from the FCA on how the naming rules apply to existing firms, particularly closed funds, to provide clarity on whether they need to change their name, and if so, by when.

7. PENSIONS

This section responds to the following questions:

- *Question 27: 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?*
- *Question 30: What other considerations or practical challenges should we take into account when expanding the labelling and disclosures regime to pension products?*

We firmly support the FCA's ambition to expand the labelling and disclosures regime to pension products (sections 8.12 and 8.17). To maximise its effectiveness, we recommend that the FCA **continues to engage with existing UK government efforts to encourage pension funds to invest with impact**. This includes DWP's Taskforce on Social Factors, which is seeking to help the UK's pensions industry to better understand social risks and opportunities and support genuinely sustainable outcomes in their investments. DLUHC's recommendation of a new 5% local investment target for the Local Government Pension Scheme (LGPS), which could catalyse £16bn in place-based impact investment (PBII), provides another opportunity. We informed this recommendation and are now working with local authorities to address investment barriers in order to realise this ambition.

We also suggest that the FCA **engages across government, particularly with DWP, to call for further clarification of fiduciary duties**. We have worked with leading law firms to publish a paper that explains how impact investing can help pension schemes manage the risks and opportunities presented by environmental, social and governance factors, and therefore deliver on fiduciary duties. Subsequently, through consultation with a range of UK pension schemes, we developed our Impact Investing Principles for Pensions, which have mobilised more than £20bn of assets, plus a range of investment consultants, to commit to embed an impact investing approach into their investments and advisory services. However, due to prevailing widespread misunderstanding, many schemes, investment consultants and asset managers remain cautious of pursuing an impact investing strategy. Alongside other influential thought-leaders, including the Principles for Responsible Investing (PRI), we have developed proposals for how the concept of fiduciary duties, and the supporting regulation and guidance, can be clarified to make it easier for pension scheme trustees/administering authorities to consider the impact of their investments on society and the environment.