SDR and labels policy
Financial Conduct Authority
12 Endeavour Square
London E20
1JN

CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels

Dear Sir/Madam

Border to Coast is wholly owned by 11 local government pension scheme (LGPS) funds who, collectively, have c.£60bn of investments. We were established to provide cost-effective, innovative, and responsible investment opportunities that deliver returns over the long-term. This is on behalf of the more than one million LGPS members, over 2,700 employers, and the millions of taxpayers associated with our Partner Funds.

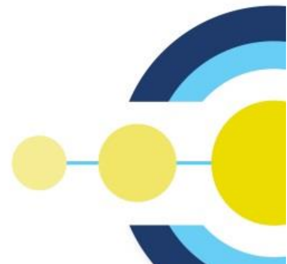
As a long term, strategic investor, Responsible Investment is central to our corporate and investment philosophy. We practice active ownership through voting and engagement, and integrate ESG factors into our investment decision-making. Combining financial and ESG analysis helps us identify broader risks, which leads to better informed investment decisions, improved risk-adjusted returns and a more holistic approach to investing.

A clearer and more consistent approach to definitions will, we believe, help tackle 'greenwashing', and a more structured approach will improve transparency for investors. However, we are concerned at the potential unintended consequences of some aspects of the proposed labelling regime, particularly in terms of its potential to direct capital flow away from sectors (and asset classes) transitioning to a more sustainable future.

We support the submission you have received from the Investment Association on this issue. However, we thought it may be helpful to emphasise a number of points from our perspective with the aim of supporting the further development of the SDR framework.

Labelling

We are supportive of the reduction in the number of labels from five to three, the avoidance of creating a hierarchy, and welcome the FCA's attempt to capture the concept of transition through the sustainable improvers label. However, it is essential these measures support international alignment on sustainable finance rules, and note concerns that the FCA's proposals represent divergence from the Sustainable Finance Disclosure Regulation. The FCA's labelling regime should have the flexibility to respond to developments in this still relatively new area.



Each of the three proposed fund labels take a different approach to the definition of sustainable investment. We would therefore welcome clarity on the FCA's definition and its consistent application across the three labels.

- The Sustainable Focus label objective is to invest in assets that meet or are aligned with a credible standard of environmental and/or social sustainability or theme. Due to the nature of the investments in companies already meeting a high standard of sustainability, the requirement to demonstrate continuous improvements through investor stewardship activities may not be achievable.

- In terms of the Sustainable Improvers label, we are concerned it will be difficult to demonstrate measurable improvements in portfolios across all sustainability themes, not just transitioning to net zero, and across asset classes. As such there remains an implicit risk that investors are drawn to products described as having a sustainable focus or impact.

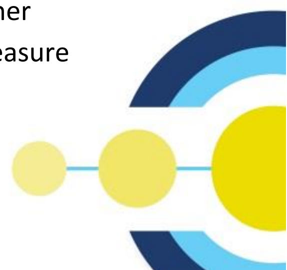
- The Sustainable Impact label requires the ability to demonstrate financial additionality through the deployment of new capital. Additionality is not a requirement of the Global Impact Investing Network (GIIN) draft guidance and we ask the FCA to instead consider use of the term 'contribution' which is commonly used in the impact investing space.

More broadly the FCA needs to consider the unintended consequences of the proposed labelling regime; it could result in some companies and sectors (which are more difficult to transition) having significant challenges in attracting the capital required. We recognise that the FCA's aim is to raise standards but we believe there is a risk that this could lead to significant movements by managers to meet the criteria during the implementation period, and hence investors, which could impact market stability.

Stewardship

As an active steward we welcome the emphasis the FCA has placed on stewardship in the labelling framework. However, investor stewardship is more challenging for some asset classes (e.g. fixed income, sovereign bonds, and private assets) because of share class structure or ownership, or where there is significant state ownership or sovereign debt. It must also be acknowledged that engagement cannot guarantee certain outcomes and it is difficult to link outcomes to stewardship activities of specific investors. The emphasis should be on plausibility, not causality.

We must avoid creating circumstances where volume of engagement is encouraged over quality, increasing reliance on templated approaches. This 'volume over quality' approach risks companies finding themselves engaged on issues less relevant to their success and therefore frustrated by the process. Contrary to the objective, this could decrease the quality of stewardship and, worse still, result in investors pursuing a more short-term investment horizon, investing in companies where quick wins can be achieved. An unsustainable demand for engagement activity could also lead to additional stresses on the market for experienced stewardship professionals resulting in further inflation in salaries, or less-experienced staff taking on roles. Where KPIs are proposed to measure



engagement, they should reflect that engagement and positive outcomes may take place over a number of years, not a single annual period, and may need to change to reflect company or market developments.

Terms

We would ask the FCA to reconsider the proposed rules around the prohibited use of sustainability-related terms in product names and marketing materials. We are concerned this will lead to less transparency and disclosure from firms regarding consideration of ESG risks and opportunities, fearing information disclosure will prompt unreasonable challenge. We believe our use of the word 'responsible', for example, is entirely justifiable to describe our investment approach (integrating ESG into decision-making and active stewardship) across all our funds in line both with common English and sector usage. It would therefore be disproportionate to only allow the term to be used in line with specific label criteria. The FCA should consider tightening the list to cover terms with specific meanings in this area. Further clarity over what constitutes marketing materials would also be welcome.

Data

Finally, we would underline the widely-recognised challenges around acquiring data in this area. These proposals require investments to be assessed as sustainable with third-party verification. This will rely on ESG data and disclosures from corporates and will potentially give a more prominent role to ESG data and ratings providers and test the limits of the availability of sustainability data across asset classes.

I would be pleased to discuss these proposals and their implementation in more detail.

Yours faithfully

Jane Firth
Head of Responsible Investment