



**Response: FCA Consultation on Sustainability Disclosure
Requirements (SDR) and Investment Labels
January 2021**

Background

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 250 market-infrastructures, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~20%). with everything from local entities in emerging markets to groups based in major financial centres. Collectively, member exchanges are home to nearly 53,000 listed companies, and the market capitalisation of these entities is over \$95 trillion, while the 50 distinct CCP clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up \$1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise financial stability, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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Overview and Specific Observations

The WFE welcomes the FCA's consultation on Sustainability Disclosure Requirements (SDR) and Investment Labels. This year we have seen record inflows into sustainable investment products¹ and our own [Annual Sustainability Survey](#) demonstrates the growing demand from investors for sustainable products. As this market grows, we believe consumers have the right to be able to navigate it easily and receive the right level of information to effectively assess which products meet their needs.

The sustainable investing space has recently been the subject of rapid regulatory change. In the European Union, the Sustainable Finance Disclosure Regulation necessitates mandatory ESG disclosure for asset managers, requiring them to sort their investment products into different 'green' categories. Meanwhile, voluntary initiatives include (i) [IOSCO's](#) report on Sustainability-Related Practices, Policies, Procedures and Disclosures in the Asset Management Industry; (ii) the [CFA Institute's](#) Global ESG Disclosure Standards for Investment Products; and (iii) the FCA's "[Dear Chair](#)" letter which challenged Authorised Fund Managers (AFMs) of ESG and sustainable investment funds where fund applications were poorly drafted and lacked adequate information on chosen investment strategies. This reflects the FCA's renewed objectives of encouraging improvements in the design, delivery and disclosure of sustainability-related funds. Given the move towards mandatory disclosure in a number of jurisdictions, we would question the need for further voluntary guidelines and frameworks at this time. However, the FCA should utilize the breadth of material on offer to ensure that a harmonised approach exists to the greatest extent possible, in the interests of maximising global impetus.

Fund labeling provides clarity through offering an independent view on the quality of sustainable financial management, the ESG criteria used, and the engagement of asset managers with issuers. This will play a key role in encouraging transparency and accountability amongst firms for their sustainability claims, and protect investors from 'greenwashing', by providing a basis for ESG measures to be rigorously applied and communicated. As noted in the FCA's most recent [ESG Strategy](#), market participants must be able to trust green and other ESG-labelled instruments and products. Our members agree that consumers should be able to rely on labeling to accurately reflect the characteristics of funds, in turn allowing those consumers to track funds' performance against a clearly defined mandate.

From a regulatory perspective, consistent labelling can help to reduce market fragmentation, by establishing clear categories for sustainable investment products, as well as drive down the cost to fund managers where multiple labeling approaches exist. We note that the FCA will focus its SDR and labeling efforts on climate first, as per the forthcoming sustainability standards under the newly established International Sustainability Standards Board (ISSB). This is right, though the pandemic has acted as a catalyst in highlighting the importance of social issues to both corporates and investors and this momentum should not be lost either. The SDR should certainly expand its remit in due course to reflect wider sustainability issues.

We look forward to a fuller consultation in 2022 on the specific details of a labeling and SDR framework. In order to help progress the development of this framework, we have the following observations to make:

Consistency with IOSCO Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosures in the Asset Management Industry

We would express some caution about whether labels will automatically increase a funds' credibility. Labeling has taken off significantly across individual jurisdictions in the EU² and the European Commission is further developing an [ecolabel](#) for retail financial products. The experience in the EU suggests that, whilst labels can provide coherence

¹ [Global Sustainable Fund Assets hit Record \\$2.3tn in Q2 2021](#)

² The following labels exist in the EU: the French SRI and Greefin Labels, Belgium's Towards Sustainability, Luxembourg's LuxFlag, the Nordics' Nordic Swan Ecolabel, Austria's Umweltzeichen and Germany's FNG-Siegel.

in the internal processes for investors, they do not guarantee the green credentials of investments. To prevent over-reliance on labeling, we would encourage investors to undertake their own due diligence as part of the stewardship process. Moreover, consumers will have different investment goals and risk appetites and we note that different investment strategies can exist among the same labeling systems which can sometimes contradict one another—for example exclusionary screening vs corporate engagement. This demonstrates that even with labelling, consumers may struggle to assess product suitability which could lead to a lack of trust in the market for sustainable products.

To promote greater consistency at an international level, we would encourage the FCA to align its labeling framework with the recent recommendations made by IOSCO. This encourages securities regulators to consider clarifying or expanding existing regulatory requirements to improve product level disclosure in order to help investors understand: (a) sustainability-related products; and (b) material sustainability-related risks for all products. In particular, the new regime should focus on:

- A **product authorization system** which sets out disclosure expectations for sustainability-related products that are to be offered to the public. Product level disclosure should be provided for retail investors, but for institutional investors a more detailed disclosure at both the product and entity level should be required. This should expand on the existing entity-level TCFD disclosures and cover ESG metrics that go beyond climate.
- Setting out **parameters for the naming of sustainability-related products** to ensure that the name of a product adequately reflects the nature and extent of the product’s sustainability focus (including promoting consistency with the product’s name, its investment objectives, characteristics and/or strategies).
- Disclosure on **investment objectives and investment strategies**. Both of these should be made clear in product offering documents and should include information on the investment universe and investment selection process (including any reliance on ESG data and ratings).
- Disclosure of any **material sustainability-related risks** relating to investment in a specific sustainability-related product. This is likely to align with reporting obligations under the TCFD on reporting on climate-related risk and opportunity. Disclosure of risk is especially important because it can help inform investor capital allocation decisions.

Assurance and Supervision of the SDR

We note that the FCA has queried whether independent verification could play a role in verifying labels and disclosure. This is key to building trust and confidence in the disclosure process. [IOSCO](#) has made clear that it will focus its efforts on supporting the development of a comprehensive assurance framework for sustainability information—including assurance-related standard setting necessary to underpin mandatory assurance of sustainability disclosures. As a co-chair of the IOSCO AMCC’s Sustainable Task Force, we encourage the FCA to leverage the expertise of both IOSCO and the International Accounting Standards Board (IASB) in order to inform the development of its own assurance framework. In the absence of an underlying assurance framework, we would propose that a ‘limited’ level of assurance over sustainability disclosure is reasonable. This is less costly for companies and better suited to the current capacity and technical capabilities of the market for audit and assurance services.

A disclosure regime should be accompanied by effective supervisory and enforcement action, which is within the remit of the FCA’s existing toolkit. In order to encourage continuous learning and improvement amongst firms, the FCA should conduct an annual review of reporting and publish a summary of its findings.

Streamlining of Disclosure Requirements under the SDR, TCFD and International Requirements

We welcome this approach and agree that the FCA needs to design a regime that avoids duplication and ensures that clients and consumers are provided with clear, consistent and coherent information.

The UK government's [White Paper](#) on audit and corporate governance included a proposal to introduce a resilience statement in a company's strategic report. This will set out how directors assess a company's prospects and challenges to its business model in the short, medium and long-term and is likely to include reporting on climate-related risk. The consultation sought views on whether the resilience statement could be the place for TCFD disclosures to be made. To ensure consolidation and completeness in reporting, FCA regulated firms that will also be under scope of these new requirements could disclose forthcoming climate-related disclosure requirements at both the entity and product level for asset managers as part of this statement.

Role of Derivatives in Sustainable Investing

Early on, the role of sustainability was perhaps best observed in the equities markets, but in recent years a number of innovative products have been launched in the derivatives markets which will play a role in facilitating the green transition. Derivatives promote sustainable investment by enabling risk management of underlying exposures and by providing a forward price curve to assist with transparency and price discovery.

The WFE's own members have been involved in providing innovation to meet the increasing demand for sustainable derivatives products. Sustainable derivatives can encompass everything from the trading of carbon offsets to interest rate and foreign exchange futures hedging activity that is carried out to support a sustainable business. Trading of carbon credits will, in particular, be key to meeting net-zero pledges and the Paris Agreement goals. In response to this, our members have played their part in scaling up the voluntary carbon markets through the following:

- Launching contracts that will physically deliver credits that have been verified by the relevant standard setting bodies and registries³.
- Announcing plans to provide (i) access to capital at scale for the development of new climate projects worldwide; and (ii) helping the market scale through providing primary market access to a long-term supply chain of high-quality carbon credits.⁴
- Providing sustainable clearing solutions which enable clients to measure the impact of their support for sustainable activities by tracking their sustainable derivatives trades⁵.

Sustainability-Linked Derivatives (SLD's) have only recently started being used as a tool for channeling capital towards companies focused on ESG issues and typically entail incentives to hit ESG targets, linking the size of payment obligations to sustainability performance and impact.⁶ They generally build upon conventional hedging products, using various Key Performance Indicators (KPIs) to set sustainability targets. The exact mechanics of these products vary. Some SLD's incentivize improved ESG performance through keeping a counterparty's payment low, upon the achievement of certain sustainability targets.

³ [ICE Nature-Based Carbon Credit Futures Contract](#)

⁴ [LSEG Voluntary Carbon Markets Initiative](#)

⁵ [CME Sustainable Derivatives Clearing](#)

⁶ The First ESG-linked sustainability improvement derivative (SID) was launched in 2019. The obligations associated with such a derivative are linked not only to interest rates but also to the counterparty's ESG performance.