Brunel's response to the FCA's CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels

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About Brunel Pension Partnership Limited (Brunel)

Brunel is a designated investment manager for the pooled LGPS' funds in the southwest of England. Our 10 clients are our shareholders, and our scope is limited to providing investment solutions in the listed and private market space for our clients to manage the long-term pension liabilities of their members. We are captured in our capacity as investment manager (portfolio management) in the ESG sourcebook, however, given our relationship with our clients we have a unique position in the market to '*traditional*' asset managers.

We are therefore framing our response with reference to the unique relationship with our clients, in which we build products and reporting together, in which incorporating climate and sustainability risks and opportunities are central to our strategies. We do however have a view to the wider financial services industry, including the scope of pension providers.

Executive Summary

Brunel are very supportive of the ambition of the FCA's proposed SDR and labelling regime. We agree that accurate and transparent market information on sustainability is vital to build trust in the financial services sector and steering capital towards sustainable investments, which will in-turn help the UK achieve net-zero by 2050. A well-thought out, proportionate and carefully sequenced regime will be vital in achieving the FCA and UK government's overarching goals for sustainable finance.

We highlight the risk of unintended consequences of the naming, marketing and anti-greenwashing rules, mutually exclusive investment labels and not having minimum sustainability reporting requirements:

Brunel are strongly supportive of implementing a regime that seeks to protect clients and consumers from greenwashing; we are highly supportive of the spirit behind the naming & marketing and anti-greenwashing rules. We raise the concern that the application of the rules may disincentivise ESG integration and stewardship activities in funds which do not yet qualify for a label.

We also raise concern with mutual exclusivity between investment labels, particularly for funds/portfolio's which are available solely to institutional investors. Investment strategies such as Paris-alignment do not clearly fit into a category, and we raise concerns regarding the label-implications over the life-cycle of these forms of products. Moreover, we raise that many funds use blended strategies to achieve sustainable objectives. We therefore recommend more flexibility is given to funds/portfolio's for institutional investors, as there is the risk that complex, changing and innovative products may be disincentivised, alongside exposing investors to disproportionate levels of concentration-risk.

Brunel particularly support the proposals to incorporate the ISSB standards and recommend these be used for setting minimum KPI requirements. We raise concern however regarding not requiring a minimum standard of sustainability metric reporting. Without minimum sustainability reporting standards, non-labelled products may be free to not consider the sustainability of an investment decision, especially for products tailored and marketed as long-term investment opportunities. Brunel considers sustainability considerations to be part of fiduciary duty. As such, though we agree with the proposals not to use a 'non-sustainable' investment label, we believe the FCA should maintain levers to prevent regression of the wider market on sustainability factors for investment strategies. Clients and consumers should be made aware of the impact of sustainability factors on their investments and vice versa (double materiality), in order to be able to make informed decisions with their capital.

Brunel also raises concerns regarding nuances in the scope of the proposals, both for portfolio management companies and 'pension products'. For the former, we highlight that the current draft regulations are not clear regarding the 'on demand' regime for sustainability product reports, and raise some discrepancies between the narrative of the consultation paper and the proposed instrument. For the latter, we raise that the consultation paper fails to provide sufficient nuance in its terminology and therefore implied scope of proposals. We highlight that there are many nuances to consider for pension products, including different regulators. We strongly suggest the FCA exercise caution and collaborate closely with potentially in-scope firms and regulators, to ensure the regime is proportionate, efficient, and well- sequenced to work well for stakeholders.

Concerning portfolio management and pension products, we recommend that there is increased consistency between the TCFD regulations and SDR. For TCFD, the FCA addressed Occupational Pension Scheme and FCA regulated LGPS pools directly in the narrative of the policy statement, we would be encouraged to see this in the follow-up policy statement, fostering consistency in the ESG sourcebook.

Please find below our detailed responses to the questions we have chosen to respond to. If you have any questions please contact Katherine Farrell, Head of Operational Risk and Compliance or Faith Ward, Chief Responsible Investment Officer.

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Question 1: Do you agree with the proposed scope of firms? If not, what alternative scope would you prefer and why?

Brunel broadly agrees with the proposed scope of firms. However, as discretionary portfolio managers for institutional clients, we raise opaqueness around the some of the technical aspects of the requirements for portfolio management companies.

For example, currently under TCFD requirements, portfolio management services and products are in-scope of the full disclosure requirements (including publishing TCFD-product reports). For SDR however, the requirements are for portfolio management companies to make the underlying Parts A and B of sustainability product reports available for retail and institutional investors 'on-demand'.

Brunel would support additional clarification on this, as this appears to be a large deviation of industry scope between SDR and TCFD.

Furthermore, the technical regulations regarding the scope of portfolio management companies for institutional investors could use clarification.

From our interpretation, firms providing 'clients' and 'consumers' with portfolio management services (including investment management under the ESG definition), are only in-scope for product reporting for institutional investors 'on-demand', via making underlying product disclosures available:

4.5.14 R (1): *A client who requires on-demand sustainability information in order to satisfy sustainability-related disclosure obligations, whether under this chapter or as a result of other legal or regulatory requirements, is entitled to request such information from, and be provided with it by, the firm and to receive a response to that request.*

(4) *If a firm receives a request for an on-demand sustainability report from a person who is entitled to make such request, it must prepare and provide the on-demand sustainability information for the person:*

(ii) *a firm that is undertaking portfolio management in relation to the relevant person, that firm provides the information set out at* ***ESG 4.4.1R(3)(b).***

4.4.1 R (3): *A firm that is undertaking sustainability in-scope business in relation to a sustainability product that is an agreement or arrangement to provide a client with portfolio management must provide* ***retail clients*** *with* ***easy access*** *(for example, by providing hyperlinks) to the following information in relation to each sustainability product in which the relevant portfolio invests:*

(b) *Part B of the public product-level sustainability report (if any) for the relevant sustainability product.*

From these regulations, it is not clear what the obligations for portfolio management companies with institutional clients are. We therefore recommend clarity in the regulations and narrative.

This is compounded by the narrative of the consultation paper:

> *'Firms that are providing portfolio management (…) will be required to provide information equivalent to the content of a Part A (pre-contractual disclosures) as applicable and Part B sustainability product report to clients on demand, where those clients require the information to meet their own legal obligations.'*

> *'Where firms decide to use a label for these products, and their clients need the information to satisfy their own (or their clients' or customers') sustainability-related disclosure obligations, we are proposing that disclosures be made to the client upon request, once a year. The client cannot make such a request before 1 July 2025, specifying a calculation date no earlier than 30 June 2024 (ie 12 months after our rules enter into force).'*

From this narrative, it suggests that the scope for 'on-demand' requests for information is only applicable to products which choose to use an investment label, which raises concern where an underlying client may be under regulations which are not limited in the same way. There is also seemingly a lack of clarity between the narrative and regulations regarding the 'on-demand' regime for product reporting, as it relates to defining '*making available*' and '*provide information equivalent to*'.

The consultation highlights the goal of succinct sequencing between TCFD and SDR. However, as reflected, there are unexplained discrepancies regarding the scope of LGPS pools (and OPS) which are addressed in the FCA's PS21/24 (page 27-28). If the intention is for portfolio management companies in particular to be able to rely on making underlying product reports available to their clients, then this should be brought out more for TCFD reporting requirements.

In any case, we recommend that there is more explicit description of the scope of 'Pension product providers' and portfolio management companies for institutional investors, allowing for general increased cohesion between the TCFD and SDR requirements within the ESG sourcebook.

We also raise potential scope for flexibility for labelling for Sustainable investment labels, alongside naming and marketing rules for products which are available only to institutional investors. Please see Question 6 for more details.

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

Brunel broadly agrees with the proposed implementation timeline, although we flag our concerns regarding the implementation of the 'anti-green washing' rule relating to market materials. Further feedback is provided in our response to question 20.

We support the FCA linking specific KPI reporting to the roll out of corporate reporting standards inline with the development and implementation of ISSB.

When such KPI specificity is implemented, we raise that disclosure and labelling requirements will need to be implemented with consideration to sequencing linked to corporate disclosures, an issue that has impacted the effectiveness of other reporting regimes.

Question 4: Do you agree with our characterisation of what constitutes a sustainable investment, and our description of the channels by which positive sustainability outcomes may be pursued? If not, what alternatives do you suggest and why?

Brunel broadly agrees with the FCA's characterisation of a sustainable investment, and the channels by which investments can have sustainability outcomes, though we raise that there are additional ways in which an investment could be considered sustainable which are not fully articulated.

Brunel believes that the key considerations of a sustainable investment label include:

- The where and with whom, i.e where a company/project is operating (underserved markets);
- The what, i.e what a company is doing either in terms of good and services which hare intrinsically sustainable or via its operations (delivering the same good and services but in materially more sustainable way;
- The change over time (or delta), i.e, how the above change over time, and what the capacity/likelihood for changes to happen (implicit in improvers)

Currently the proposals do not easily accommodate companies who may not produce products or services that are, in-of-itself defined as sustainable but produce (or undertaking research and development to enable) it to be produced in a materially more sustainable than its competitors (alternative input (replacing rare or controversial inputs), use less resources or produce less waste output). This is particularly important for companies who have yet to prove the outcomes of the innovation. We believe these could form part of 'Sustainable Focus' if definitions/ guidance allowed.

We raise that there are nuances in what could be considered when measuring/comparing the sustainability profile of multiple investments. How a company may be considered sustainable may not always be overtly obvious.

Aligned portfolios, (for example using NZIF framework), strategic asset allocation and policy advocacy and lobbying are also key ways institutional investors can influence the economy to achieve net-zero. The latter method may be particularly difficult to convey as a sustainability characteristic of an investment product in the interim period before entity-level sustainability requirements come into effect.

Please refer to Question 5 and 6 for how nuance of bottom-up sustainability characteristics of securities or portfolio-construction can be problematic for the translation of sustainability mechanisms into investment labels at a fund/portfolio level.

Question 5: Do you agree with the proposed approach to the labelling and classifications of sustainable investment products, in particular the emphasis on intentionality? If not, what alternatives do you suggest and why?

Brunel broadly supports the approach of using investment labels for sustainable investment products.

We raise the problems of requiring the labels to be mutually exclusive. As accepted by the FCA, the channels by which an investment can have positive and material impact on environmental/social outcomes are not mutually exclusive, and are therefore blended together in investment strategies.

As such, we believe that mutually exclusive investment labels for products designed for institutional investors in particular, do not provide the necessary flexibility to maximise real-world positive impact of the overall investment strategy.

Though we strongly support the spirit of the requirements to avoid greenwashing and provide clarity for retail clients in particular to be able to differentiate between the different characteristics of sustainable investment products, unintended consequences and challenges are of concern.

Many funds and institutional investors in particular use blended strategies for the managing climate and sustainability risks and opportunities in their funds. Furthermore, depending on the nature of the relationship, portfolio and fund strategies may change over time. Mutually exclusive and inflexible percentage requirements of underlying assets to qualify for a particular label may therefore impractically restrict certain funds from achieving sustainability objectives using particularly complex and flexible strategies.

As raised in our response to question 4, it is currently unclear where a fund or portfolio using an NZIF framework for alignment would fall. An aligned portfolio may consist of underlying assets which would qualify as 'sustainable improvers' and 'sustainable focus', the ratio of which will change over time as a product and underlying methodologies mature.

The other risk of mutually exclusive investment labels is the increased concentration risk that particular funds may be exposed to. If an investing strategy focuses on a particular geographic location, or particular sustainable universe, economic cycles and contractions may cause undue harm on those funds, which may expose investors to a disproportionate amount of economic risk.

Brunel acknowledges that more binary requirements may be more prudent for retail clients, to maintain the overall objective of protecting consumers and giving them sufficient sustainability information to make informed decisions, boost competition and place capital in a well-informed manner. However, we would recommend that the FCA apply a level of proportionality to products designed for institutional clients, which considers the propensity for greater understanding and demand for more sophisticated and 'blended' strategies which may change over time.

We therefore recommend that the FCA retain an element of flexibility for investment products for institutional investors in particular. We are not necessarily disagreeing with the proposed percentage requirements, for example 90% of the underlying funds of a portfolio, or 70% of assets in the sustainable focus strategy, but we recommend that the FCA remain

sensitive to industry perspectives, and do not impose static requirements that limit innovation and complexity in the sustainable investment space.

We specifically flag the difficulties many investors focused in secondary markets will have in evidencing 'additional outcomes' attributable to the investors contribution. We note the FCA awareness of the challenges of evidencing additionality in collective engagement activities (Box 4 – detailing response to the DP21/4) and request the FCA ensure that the regulations do not disincentives participation in such activities

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?**

Brunel supports the categorisation of investment products which a 'reasonably investor' would consider sustainable. We raise that the methodological challenges associated with defining an asset with sufficient overarching sustainable characteristics from the bottom-up. Many companies are very large and complex, which may have contradictory sustainable characteristics.

Company A, for example, may have a number of subsidiaries which are making material positive impacts on social and/or environmental sustainability and others which are not, and would not in-of-themselves qualify as a 'sustainable focus' security.

The inverse of that broad example may also be true, in which consumers may face greenwashing via the investment in company B, which is an oil company which invests an amount of capital in green-energy projects. We also raise the work our CRIO Faith Ward has done on 'just transition', in which companies progressing decarbonisation may be causing direct or indirect harm to social sustainability by drawing production and economic resources from underdeveloped regions and countries.

Given this challenge, we would advise that the FCA provide or make available further guidance for firms eligible to use an investment label with an approach to these forms of investment. This will be particularly pertinent in managing: the risk of greenwashing; the complexity and at times conflicting components of ESG; steering the broader UK economy into net-zero by 2050. This will also be particularly important for the transitional period before entity-level reporting is produced.

We understand that 'unexpected investments' are expected in consumer facing and pre-contractual (Part-B), however this does not take into consideration the application of investment labels for particularly complex firms.

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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?**

Brunel particularly supports the use of an investment product label which recognises and encourages investment in industries which will be pivotal in transitioning the UK and global economy to net-zero by 2050. We do however flag the concern that this definition is at most risk from 'green washing' without very clear guidance and robust FCA scrutiny.

We reiterate our response to question 5 regarding use of blended strategies being commonplace and raise the question of where an 'aligned' portfolio would sit, where fund/portfolio matures to contain sufficient 'aligned' holdings which qualify for the 'sustainable focus' label.

Whilst we support more prescription for retail investors, the extension of the regulations to institutional clients needs very careful consideration. We would support more flexibility in definitions to allow more complex situations to be part of an investment product. Conversely, being too prescriptive could deter vital investment and may have negative unintended consequences.

Question 7: 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 and why?

Brunel broadly agrees with not using a defining label for 'non-sustainable' investment products. However, we highlight the importance of setting minimum standard, or additional levers for fund/portfolio managers not using a label to disclose and factor sustainability in their investment decisions as part of their ongoing fiduciary duty to their clients.

It is important that any labelling regime (and corresponding reporting requirements) which draws sharp distinctions between products which have sustainability as a key component of the product profile and those which do not, do not allow the latter to be able to not consider long-term sustainability in their risk and suitability assessments of underlying holdings, as consumers should be aware of the potential sustainability risks of their investments making investment decisions.

We therefore recommend more broadly, that the FCA implement minimum standards for in-scope firms to ensure that clients and consumers are adequately protected and informed regarding the sustainability risks and characteristics (including negative) of the investment products marketed and available to them. We support the FCA commitment to consider the work of the ISSB/SASB in setting these minimum reporting standards.

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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

Brunel supports the FCA qualifying criteria proposed and broadly supportive of the different components to the criteria.

We highlight the importance of using KPIs for measuring the sustainability profile of the product's performance against defined goals and strategy, especially to prevent greenwashing and to provide investors with credible science-based information to make investment decisions. These forms of measurement will be vital for all products using investment labels.

We highlight the importance of not being overly prescriptive on the nature of the KPIs, as products' strategies which are particularly innovative in the sustainability space are best placed to self-define KPIs, and the FCA will be better placed to review the suitability of these on a case-by-case/thematic basis.

We support a two-tier approach with specific, consistent KPIs based on core areas of sustainability for which there is data available and product specific KPIs defined by the provider.

Though we believe that the regulations are not currently over-prescriptive, we would invite the FCA to exercise caution when developing SDR requirements. Notwithstanding our support of minimum KPI requirements using ISSB/SASB guidelines, firms should retain the flexibility to self-define product-specific KPIs to provide investors with the most materially decision-useful information they deem appropriate for a product.

Question 10: 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?

We agree with these proposals. Brunel has often flagged concern in the current capacity of firms to fulfil the verification requirements. We do think that managers should be encouraged, or even mandated, to disclose what assurance process have been undertaken. Furthermore, we support managers being transparent about aspects of the investment thesis that might be hard to 'prove' (possibly due to lack of a suitable metric or data) and what steps they are taking to overcome such barriers.

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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?

Yes, as outlined in earlier responses. We believe that the onboarding of ISSB standards for disclosures will promote international interoperability and cohesion, which will best serve stakeholders of the global financial services market.

Question 14: Do you agree with the proposal that we should not mandate use of a template at this stage, but that industry may develop one if useful? If not, what alternative do you suggest and why?

The use of templates could be reductive; we recognise the limitations of metrics in capturing the multi-facet nature of sustainability. Therefore, Brunel supports the proposals to not introduce templates for these disclosures. We believe that firms are best placed to decide the best structure for their disclosures, to facilitate ongoing innovation and change over time in response to consumer preferences and to provide flexibility for varying ranges of investment products and asset classes.

Q17: Do you agree with our proposals for an 'on demand' regime, including the types of products that would be subject to this regime? If not, what alternative do you suggest and why?

Please see our response to question 1 and 27 as it relates to clarity of the regime and wider implications of the scope of SDR for pension companies.

Question 18: Do you agree with our proposals for sustainability entity report disclosures? If not, what alternatives do you suggest and why? In your response, please comment on our proposed scope, location, format, content, frequency of disclosures and updates.

Brunel broadly agrees with the FCA's proposals for sustainability entity report disclosures. However, we raise the importance of building on these reports in time.

In particular, we would like to see firms reporting on the sustainability of their own operations. Disclosures and KPIs on diversity, culture and general management of human capital in a more holistic entity report will be useful for investors to gain insight into an investment manager's approach to social and environmental sustainability beyond investment strategy.

Whilst methodologies for measuring sustainability of investment products are developing, gaining this insight will provide investors with another lens to assess the market to meet their sustainability-related preferences.

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

Whilst Brunel supports the intention behind the 'anti-greenwashing' rule, we are anxious that it could have unintended consequences of disincentivising ESG integration and stewardship activities.

Brunel is a signatory of the FRC Stewardship Code and recognise the standard of stewardship that is required. We would support the FRC's more extensive use of signatory status of Stewardship Code to substantiate claims.

Question 25: What are your views on how labels should be applied to pension products? What would be an appropriate threshold for the overarching product to qualify for a label and why? How should we treat changes in the composition of the product over time?

Please see our response to question 27, which covers our response to the broad application of SDR to pension products.

Question 26: Do you consider the proposed naming and marketing rules set out in Chapter 6 to be appropriate for pension products (subject to a potentially lower threshold of constituent funds qualifying for a label). If not, why? What would be an appropriate threshold for the naming and marketing exemption to apply?

Please see our response to question 27 which covers our response to the broad application of SDR to pension products.

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?

Brunel proposes that the FCA take particular care when considering the usefulness of applying SDR to pension products.

In particular, we raise that the consultation paper has not given sufficient clarity and breadth to the particularities of different forms of pension products and companies that may fall in-scope. Though the paper clarifies that the FCA will consider the interaction between its own label and disclosure regulations and those from other regulatory bodies, it is unclear how these would work in practice, especially to avoid inefficient duplication of costs and requirements. Different pension schemes may be captured by DWP, DLUHC and FCA, and therefore, building in our recommendations regarding sequencing, we believe it is vital to

ensure that close coordination is sustained to ensure efficient and effective implementation of SDR across the economy.

For occupational pensions, the DWP have introduced TCFD-aligned regulations which are likely to expand to SDR as part of the wider national rollout. Our clients, LGPS' are to be required to make TCFD-aligned disclosures under the DLUHC's new proposals and have been encouraged to onboard and become signatories to the FRC's stewardship code.

Pension providers, trustees, OPS investment managers, and Pools have a different relationship structure to 'traditional' asset managers. Pension trustees which outsource investment management are strongly reliant on asset managers who would be captured by the scheme. For defined-benefit schemes, underlying members have a binary opt-in/opt-out relationship with the overarching scheme, which is a different to a defined contribution, which requires materially different decision making.

Brunel for example, will be captured in our capacity of portfolio managers for our underlying clients' assets. However, given the current relationship between ourselves and our clients, where we have a more defined reciprocal relationship (our clients are our shareholders) with institutional investors, of whom we work with extremely closely with, it is unclear where the value-add is for the application of the proposed SDR rules. We reiterate our response to question 1 of this consultation paper, regarding asking for clarity on the relationship between TCFD and SDR for portfolio management companies (LGPS pools) and OPS.

With these nuances in mind, we reiterate our recommendation that the FCA take careful consideration, and exercise caution. We believe in particular that coordination and communication between schemes and the regulators will be vital to implement the SDR regime in a way that best serves the underlying stakeholders.

Question 28: To what extent would the disclosures outlined in Chapter 5 be appropriate for pension providers i.e., do you foresee any challenges or concerns in making consumer-facing disclosures, pre-contractual disclosures and building from the TCFD product and entity-level reports?

Please see our response to question 27.