TISA

Good practice guide

Responsible and Sustainable Investing

March 2021

TISA

About TISA

The Investing and Saving Alliance (TISA) is a unique, rapidly growing membership organisation for UK financial services.

Our ambition is to improve the financial wellbeing of all UK consumers. We do this by focusing the convening the power of our broad industry membership base around the key issues to deliver practical solutions and devise innovative, evidence-based strategic proposals for government, policy makers and regulators that address major consumer issues.

TISA membership is representative of **all sectors of the financial services industry.** We have **over 200-member firms involved in the supply and distribution of savings, investment products and associated services**, including the UK's major investment managers, retail banks, online platforms, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, Fintech businesses, financial consultants, financial advisers, industry infrastructure providers and stockbrokers.

As consumers, the financial services industry and the economy react to and recover from the effects of the pandemic, the importance of the three key pillars of work that TISA prioritises has never been more apparent:

- **Strategic policy initiatives that influence policymakers** regarding the financial wellbeing of UK consumers & thereby enhancing the environment within which the industry operates in the key areas of **consumer guidance, retirement planning, later lifetime lending, vulnerable customers, financial education, savings and investments**.

- TISA is recognised for the **expert technical support provided to members** on a range of operational and regulatory issues targeted at improving infrastructure and processes, establishing standards of good practice and the interpretation and implementation of new rules and regulations covering **MiFID II, CASS, ESG/RSI, operational resilience, Cyber Risk, SM&CR** and a range of other areas.

- **Digital transformation initiatives** that are driving ground-breaking innovation and the development of industry infrastructure for greater operational effectiveness and revenue promoting opportunity for firms. TISA has become a major industry delivery organisation for consumer focused, digital industry infrastructure initiatives – **TISAtech** (a digital marketplace that brings together financial institutions and FinTechs for greater collaboration and innovation) and **TURN** (TISA Universal Reporting Network – a digital platform providing a secure data exchange for financial services using blockchain technology) – alongside projects **Digital ID** and **Open Savings, Investments & Pensions**. This reflects TISA's commitment to open standards and independent governance.

Contents

1. Foreword

ESG is important. TISA's Good Practice Guide will help firms, especially distribution businesses, meet the regulatory and reporting challenges for firms implementing ESG in their businesses.

This Good Practice Guide is intended to help firms understand their reporting obligations under SFDR as well as applicable regulation for UK domestic firms, including those not subject to SFDR.

Appropriate disclosures to customers and investors of key information around sustainability, particularly climate change, but also governance and social impact (ESG), will help drive flows from customers and investors, as can be seen from the popularity of explicit ESG funds across Europe and the UK. These flows will influence investors in companies and the companies themselves. It is therefore important for disclosures to be consistent, comparable and based on objective data.

As the new CEO of the FCA says *Better disclosures will, in turn, help consumers understand and compare the products they are offered.*[1]

TISA will be continuing its work on what disclosures to customers should look like to achieve this objective **and** take account of the impact of the draft RTS on reporting.

This Guide uses examples and case studies to illustrate how firms might apply the requirements of the regulations and, in section 3, discusses the regulatory background that firms need to consider, including that of the FCA and Government.

In section 4, the Guide provides handy checklists, including references to more detailed information.

Section 5 is an important section of the Guide. In it we introduce standard terminologies and a glossary. This Guide uses the Investment Association terminology from its Responsible Investment Framework[2], which we recommend. This section also discusses the Bridges Spectrum of Capital and analyses and compares the PRI framework. In addition the section also discusses:

- Impact Investing (and we're grateful for the help we have had from the Impact Investing Institute),
- UN Sustainable Development Goals,
- Sustainability risk versus Adverse Impact, and
- Active ownership versus Stewardship.

Section 6 covers the provision of information to clients, covering:

- Financial promotion
- SFDR and EU Taxonomy Regulation
- Shareholder Rights
- Stewardship Code
- Prudential disclosures

[1] https://www.fca.org.uk/news/speeches/green-horizon-summit-rising-climate-challenge
[2] https://www.theia.org/sites/default/files/2019-11/20191118-iaresponsibleinvestmentframework.pdf

- Climate Financial Risk Forum disclosures

Section 7 sets out a brief guide to SFDR, noting that the Level 2 RTS are still in draft.
If your firm distributes in EU, you need to read this, as EU Directives apply in full.

Section 8 discusses suitability and draws attention to Sustainability preferences and ESG preferences, and recommends alignment with the IA Responsible Investment Framework.

Section 9 covers data – necessary if the industry and customers are going to produce objective comparable reporting to customers. It also covers:

- TCFD,
- Factoring climate change into firm's research, and
- The Climate Financial Risk Forum

Section 10 discusses Suitability and periodic reports, including MiFID reports.

Section 11 addresses Stewardship and engagement, including the UK Stewardship Code, Shareholder Rights Directive II, UNPRI, and BSI.

The Appendices include:

- a useful overview of forthcoming implementation dates,
- an analysis of what Article 8 means, and
- The TISA Glossary.

This Guide is the work of the industry, and many firms and individuals have contributed to it. But I'd like to acknowledge in particular the work of the chair, Robert Howard of Charles Stanley, and the deputy chair, Phil Spyropoulos of Eversheds Sutherland.

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2. General information

2.1 Purpose and status of guidance

This guide has been drafted in anticipation of the EU Sustainable Finance Action Plan coming into force from 2021 onwards. It aims to assist firms in preparing for implementation of the Action Plan, on the assumption that the Action Plan, or a close variant of it, may be adopted in the UK. The guide considers the regulations as drafted as at the date of publication and it will be updated in due course to accommodate changes to draft regulations and, in due course, the confirmation of any FCA consultation on Rules and/or guidance.

The guide sets out proposed industry good practice, together with a list of resources in the Appendix at the back. These are not intended to be exhaustive but represent those standards and resources that participant firms found useful in the drafting of this guide.

TISA wishes to point out that this guide neither reduces nor extends any binding legal or supervisory requirements as regards Responsible and Sustainable Investment.

2.2 Sectoral application

The guide has a primary focus on the obligations of distributors, as defined in MiFID and the IDD, but by detailing the interpretation and possible approaches to implementation by distributors it is hoped that the guide will also be of use to other firms, including product manufacturers and data providers.

The term 'distributor' includes different types of firm, such as discretionary investment managers (DIMs), financial advisers and platform service providers. Implementation at the individual entity level should reflect appropriately any characteristics specific to that type of firm. The guidance included in this document can only serve as an indication for firms if relevant to their actual business models. For example, requirements specifically relating to DIMs will apply differently to financial advisers when implementing procedures to address sustainability risks.

2.3 Proportionality

Importantly, there is no one-size-fits-all in relation to Responsible and Sustainable Investment. Firms should design their processes and practices appropriately and proportionately, taking into account the nature of the clients or potential clients, the investment service provided, and the financial instruments involved.

This proportionality principle is engrained in firms' organisational requirements under MiFID:

When complying with the requirements set out in this paragraph, investment firms shall take into account the nature, scale and complexity of the business of the firm, and the nature and range of investment services and activities undertaken in the course of that business.[3]

In dealing with the issue of Responsible and Sustainable Investment, firms are required to develop an appropriate documented approach for their business model and risk profile, and this should be adjusted over time for any change in circumstances. With regards to the principle of proportionality, this means that simpler structures, processes and methods may be sufficient for a more limited business scope or lower risk profile. However, more extensive structures, processes and methods are required for firms with more significant sustainability risks – or as firms grow and develop. The principle of proportionality applies on a sector-specific basis, as incorporated in the respective relevant legal requirements.

2.4 Examples and case studies

The examples, case studies and potential questions detailed in this guide are for the purposes of illustrating a proportionate application of the requirements. They provide firms with guidance on the issue of integrating sustainability risks into their specific strategies, business organisations and risk management. They are neither exhaustive nor cumulative, and do not represent a definitive assessment.

2.5 Definitions

A Glossary of key terms relevant to Responsible and Sustainable Investment is in the Appendix at the end of this document. A significant number of alternative definitions have emerged in recent years and, rather than add to this proliferation, the preferred TISA approach has been to collate a non-exhaustive anthology of definitions from other organisations that participant firms found to be the clearest and most useful in the drafting of this guide. The Glossary was prepared as of 30th September 2020 and may be updated from time to time.

In addition, in this document the following definitions apply:

Client: means the end investor, regardless of the firm's position within the distribution chain.

Product manufacturer: means an investment firm that creates, develops, issues and/or designs financial instruments, including when advising corporate issuers on the launch of new financial instruments.

Distributor: means investment firms that offer or sell financial instruments and services to clients.

Intermediary: means any firm acting between the product manufacturer and the end client (such as a platform).

[3] Delegated regulation (EU) 2017/565 Article 21 (1) General organisational requirements

Discretionary investment manager (DIM): means a firm that manages investment portfolios with discretion to make investment decisions on behalf of clients.

Platform or platform service provider: means a firm through which clients may buy, sell and hold funds and other investments, either without advice (often referred to as D2C, or direct to customer) or on an advised basis using a financial adviser.

Financial adviser: means a firm or individual that provides advice to clients on financial matters, including their investments.

3. The regulatory position

3.1 A note on the position in the UK of EU regulatory changes

Very broadly, under the EU (Withdrawal) Act 2018 (the 'Act') the only directly applicable EU legislation (such as the EU Sustainability-related Financial Disclosures Regulation, or SFDR) which forms part of 'retained EU law' after the end of the transition period is EU legislation 'so far as operative' immediately before the end of the transition period. The Act defines what 'so far as operative' means: very broadly, if a provision of EU legislation is not in force immediately before the end of the transition period, it is not retained. But the Act also excludes any provisions that, despite being in force before the end of the transition period, are expressly stated to apply on a date that falls after the end of the transition period.

In terms of the SFDR, the proposed EU changes to MiFID and the introduction of the EU Taxonomy:

- Most of the provisions of the SFDR only apply from 10th March 2021 (and some provisions only apply from 1st January 2022), after the end of the transition period, which means none of those provisions form part of 'retained EU law'.

- The only provisions of the original SFDR which applied before the end of the transition period and which could have formed part of retained EU law were articles 4(6) and (7), 8(3), 9(5), 10(2), 11(4) and 13(2), i.e. the provisions which empowered the European Supervisory Authorities (ESAs) to make relevant technical standards. These were repealed by SI 2020/628[4].

- The EU Taxonomy Regulation then inserted further provisions into the SFDR (articles 2a, 8(4), 9(6) and 11(5) and these applied from 12th July 2020. But again, these related to things to be done by the ESAs. Our understanding is that these will also be expressly revoked in the UK, but this is a matter for HM Treasury.

- The changes currently proposed relating to MiFID suitability are not expected to be approved prior to the end of the transition period and, in any event, would not take effect in the EU until at least 12 months after publication in the EU Official Journal, which, as at the date of publication of this Guide, has not yet happened.

- The EU Taxonomy Regulation, which takes effect after the end of the Brexit transition period, will not apply to UK firms and funds.

As a result, as at the date of this Guide, our current understanding is that none of the EU SFDR or proposed MiFID changes, or the EU Taxonomy, will apply in the UK after the end of the transition period. There are also no technical standards under SFDR which apply before 31st December 2020.

[4] https://www.legislation.gov.uk/uksi/2020/628/pdfs/uksi_20200628_en.pdf

The approach to implementation of EU regulations that take effect after the Implementation Period is a decision for Government. In its Green Finance Strategy[5] in July 2019, the Government stated its commitment to at least matching the ambition of the objectives of the EU's Sustainable Finance Action Plan. This public commitment has been seen as a strong indicator that the UK would implement a UK domestic regime which is the same as or equivalent to SFDR.

The FCA remains in discussions with HM Treasury and other regulators on what actions might be necessary to meet that commitment in the specific case of the SFDR (including associated RTSs) and the proposed MiFID changes. If and when the Government decides to introduce legislation in relation to SFDR, the FCA will be required to consult on any proposed changes to the FCA Handbook, so industry will have sufficient time to prepare to meet the necessary obligations.

Firms can refer to this Simmons & Simmons briefing note[6] which was written prior to Brexit in the knowledge that SFDR might not come into law. It illustrates how the SFDR can continue to be relevant for UK firms, particularly those doing certain types of cross-border business into the EU.

3.2 The current UK regulatory position

In the meantime, the FCA has published papers and speeches on climate change and sustainable finance matters, which provide an indication to firms of the FCA's next steps in 2021. Firms are encouraged to read:

- DP18/8[7] (Climate Change and Green Finance) and the feedback to it in FS19/6[8].

- CP20/3[9] (Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations) and the ensuing Policy Statement PS20/17[10].

- The speech given in October 2020 by Richard Monks, FCA Director of Strategy[11], a key excerpt of which is quoted in section 6 of this Guide.

- The speech given in November 2020 by FCA CEO Nikhil Rathi[12]:

  In the funds space, we have been considering measures to combat potential 'greenwashing'. We have developed a set of principles to help firms interpret existing rules requiring that disclosures are 'fair, clear and not misleading', including when they submit new products to us for authorisation.

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[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf

[6] https://www.simmons-simmons.com/en/publications/ckgw9in3yeupe0944mi3r4hyb/what-if-the-uk-doesn-t-implement-the-sfdr-a-client-note

[7] https://www.fca.org.uk/publication/discussion/dp18-08.pdf

[8] https://www.fca.org.uk/publications/feedback-statements/fs19-6-climate-change-and-green-finance

[9] https://www.fca.org.uk/publication/consultation/cp20-3.pdf

[10] https://www.fca.org.uk/publication/policy/ps20-17.pdf

[11] https://www.fca.org.uk/news/speeches/building-trust-sustainable-investments

[12] https://www.fca.org.uk/news/speeches/green-horizon-summit-rising-climate-challenge

> *Better disclosures will, in turn, help consumers understand and compare the products they are offered.*
>
> *We will shortly start discussing these principles with industry with a view to finalising them in the new year. And later this year we plan to run some consumer experiments to help us better understand what information influences consumers' choices in sustainable products. This will help us refine our disclosure rules and guidance to meet consumers' needs.*

In November 2020, the Chancellor set out the government's intentions on the Taxonomy[13]:

> *The UK will also implement a green taxonomy – a common framework for determining which activities can be defined as environmentally sustainable – which will improve understanding of the impact of firms' activities and investments on the environment and support our transition to a sustainable economy. The UK taxonomy will take the scientific metrics in the EU taxonomy as its basis and a UK Green Technical Advisory Group will be established to review these metrics to ensure they are right for the UK market.*

Given the probability that some UK firms may be subject to EU regulations (for example, where they have operations in the EEA or market their services and/or products cross-border), and because any regulatory changes introduced in the UK may follow to a greater or lesser extent the incoming EU regulations, this Guide covers these regulations so as to promote an understanding amongst firms as to the likely (or at least possible) requirements.

However, firms should be aware that compliance with EU regulations such as the SFDR will be supervised and regulated by the EU authorities and the relevant national competent authorities in the EU, not the FCA.

In each section we draw your attention to the implementation deadlines of the EU regulations, as understood at the date of publication, whilst noting that any equivalent UK regulations, if introduced, may have different timings.

[13] https://www.gov.uk/government/news/chancellor-sets-out-ambition-for-future-of-uk-financial-services

4. Checklists for Discretionary Investment Managers and Advisers

This section provides a quick summary of the key questions that firms should be asking themselves on the topic of Responsible and Sustainable Investing (R&SI). In each case, where relevant it is shown where further information can be found in this Guide to help support your firm's decisions.

1. Following the end of the Brexit transition, is your firm in scope for EU regulation? If so, the sections outlining these requirements will be directly relevant. [*Please refer to sections 7, 8 and 10*]

2. Even if not, are there aspects of the incoming EU regulation – the Sustainable Finance Disclosures Regulation (SFDR) and the possible changes to MiFID Suitability requirements – that you would still want to implement?

3. Are you confident that your firm is describing its products and/or services in a "clear, fair and not misleading" manner? [*Please refer to section 6*]

4. When performing a Suitability Assessment, how does your firm assure itself that all the risks – including the non-financial Environmental, Social and Governance (ESG) risks – of an investment have been properly considered? [*Please refer to section 8*]

5. Have you considered how you will obtain the necessary information on:

    a. any client preferences? [*Please refer to section 8*]

    b. the characteristics and risks of the investment? [*Please refer to section 9*]

6. How will your firm reflect all of the above in its Suitability Reports and/or periodic client reporting? [*Please refer to section 10*]

7. Are your staff adequately trained on Responsible and Sustainable Investing (R&SI) matters? [*Please refer to section 14*]

8. For DIMs: how does your firm vote and/or engage with corporate issuers on R&SI matters? [*Please refer to section 11*]

9. For Advisers: where you refer your clients to a DIM for the management of the client's investment portfolio, how will you reflect R&SI matters in any due diligence assessment you perform on the DIM? [*Please refer to section 12*]

10. Does your firm have the appropriate policies, procedures and governance structures in place? [*Please refer to section 13*]

5. Introduction to Responsible and Sustainable Investment

This section aims to provide a quick summary of the key terms associated with Responsible and Sustainable Investment, particularly those terms which sometimes appear to be used interchangeably and, by addressing how they differ from each other, we hope that this clarity leads to better dialogue and common language on ESG matters between distributors and investors.

Sustainability has become an increasingly fundamental aspect of investing and correspondingly, there has been a rise in terminologies (including acronyms) being used to describe various approaches. We understand how these terminologies can be confusing even to more sophisticated investors.

There are many ways to approach this topic and it is important that the industry tries to adopt a consistent approach to ensure that is it clear about what a strategy or product offers. Clarity will hopefully go some way to ensuring that greenwashing is reduced.

This section is complemented by a TISA Glossary which aims to provide a common selection of definitions that distributors can use in fulfilling their responsibilities to understand their clients' ESG preferences.

Three key frameworks are useful for an understanding of the terms most commonly used to describe the approaches taken by asset managers and asset owners and the differences between them:

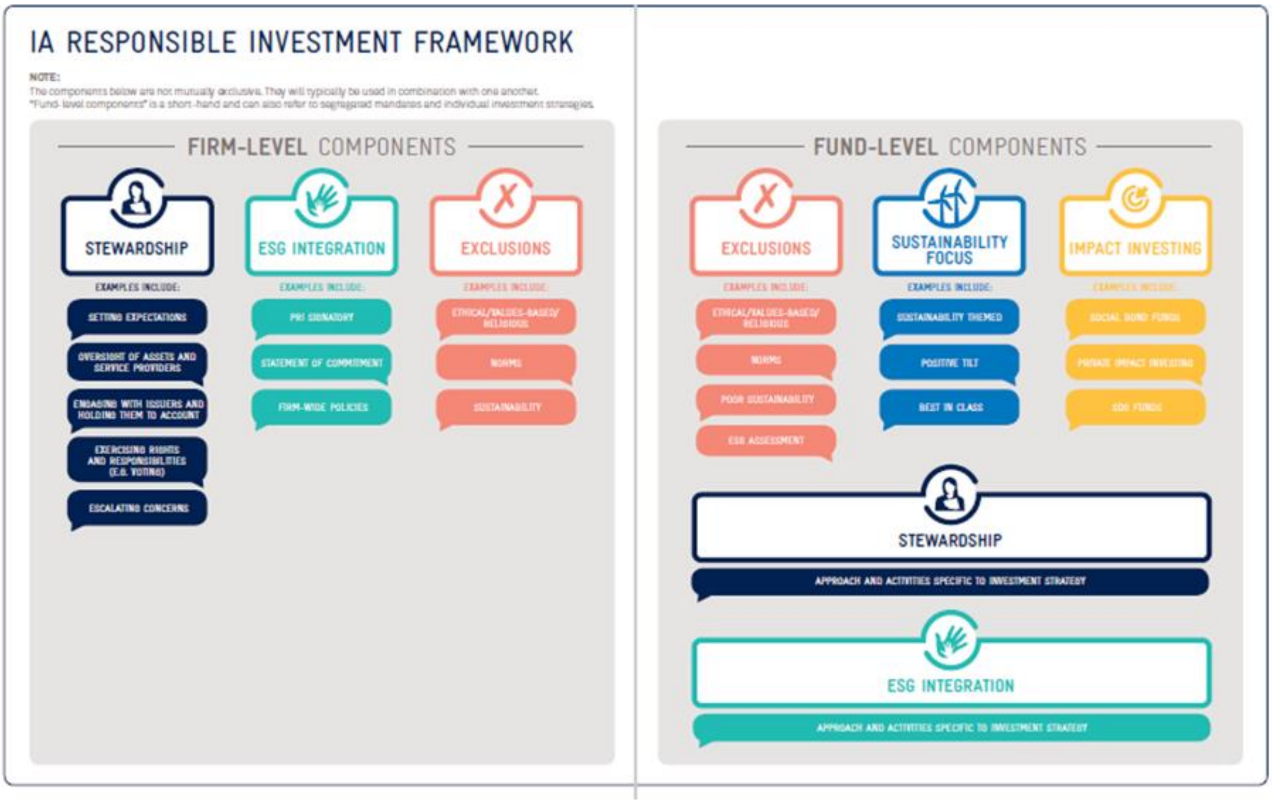
1. The Investment Association's ('IA') Responsible Investment Framework
2. The Bridges Spectrum of Capital
3. The British Standard Institution's ('BSI') standards

A description of these frameworks, together with the relevant charts, are set out below. Throughout this section we will use the IA terminology.

5.1 The Investment Association's Responsible Investment Framework

The Investment Association (IA) has developed the following [Responsible Investment Framework](https://www.theia.org/sites/default/files/2019-11/20191118-iaresponsibleinvestmentframework.pdf) which we have found very helpful. Chapter 4 of the IA report sets out the framework[14].

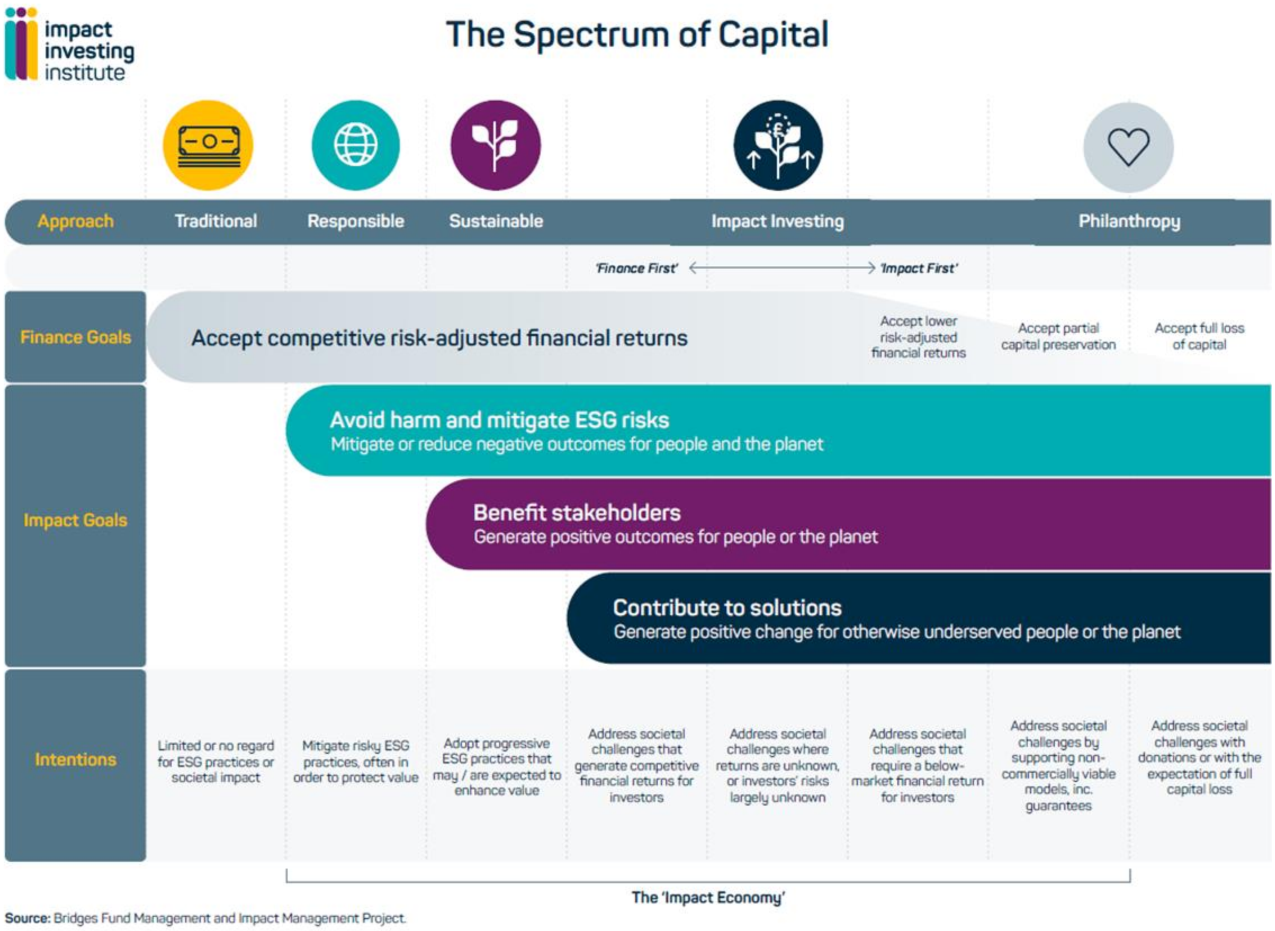
The full report is only 20 pages and the framework can be summarised as follows:



[14]https://www.theia.org/sites/default/files/2019-11/20191118-iaresponsibleinvestmentframework.pdf

5.2 The Bridges Spectrum of Capital

A widely used diagram in explaining key differences between responsible, sustainable and impact investing is The Bridges Spectrum of Capital[15], which is an attempt to map out the broad range of risk/return strategies that exist between these approaches:



5.3 The British Standard Institution's standards: Sustainable versus Responsible Investment

The British Standard Institution's ('BSI') Publicly Available Specifications (PASs) aim to establish a baseline for delivering responsible and/or sustainable investment management, both within the firm's organisation and within funds, and support an organisation's move towards sustainable investment. The standards' use of the terms 'responsible' and 'sustainable' is broadly in line with the IA Framework, but the standards provide a greater level of granular detail on the criteria for qualifying for the standards. These standards

[15] https://www.bridgesfundmanagement.com/wp-content/uploads/2017/08/Bridges-Spectrum-of-Capital-print.pdf

are voluntary and there is no legal or regulatory requirement for a firm or fund to comply with them. As at the date of this Guide, work on the standards is ongoing[16].

As with the IA Framework, responsible investment is a broad umbrella term used to describe a wide range of approaches to managing assets, including the management of ESG risks ('ESG integration'), exclusions, impact investing, sustainable investing and stewardship. These approaches are not necessarily mutually exclusive and can be deployed by a firm alongside each other in a complementary fashion.

Within responsible investment, ESG integration and stewardship can be employed to combine better risk management with improved long-term risk-adjusted portfolio returns. This is in contrast to the commonly held view of exclusionary approaches which, by reducing the investible universe, are often perceived (rightly or wrongly) as presenting a potential trade-off against portfolio returns. The potential for improved portfolio returns together with incentives for issuers to improve their corporate behaviours helps to explain the current growth of investor interest in a wider adoption of ESG integration approaches.

Within the IA framework, a sustainability-focused / sustainable investment approach is a sub-sector of responsible investment. Sustainable investment usually builds on the foundation of an ESG integration approach, whereas responsible investment focuses on the better management of ESG risk factors not as an objective in its own right but as a means of protecting and/or improving portfolio returns through a fuller consideration of the risks to which an investee company is exposed to by its poor corporate behaviours. A sustainable investment approach takes this and then goes significantly further in integrating the environmental and/or social impacts (both positive and negative) within its investment process.

Sustainable investment is an approach which invests in companies that are creating solutions to combat the challenges that the planet and society face. This is often on a thematic basis with example themes being water scarcity, low carbon energy, aging populations. Within the IA framework, this would also include strategies which have a positive tilt or best in class approach (please refer to the Glossary for further information on these approaches).

In contrast to the broader IA Framework, in the Spectrum of Capital responsible investing focuses primarily on the use of ESG integration as a means of protecting portfolio value and improving long-term returns, whereas sustainable investing goes further along the spectrum by also having environmental and social objectives - pursuing environmental, social and governance opportunities as per the chart above.

5.4 Responsible Investment versus ESG Integration

In accordance with the IA Framework:

- Responsible Investment is defined as an appropriate term to encompass the full suite of approaches within the Framework; and
- ESG integration has been aligned with the United Nations Principles for Responsible Investment's (UN PRI or PRI) definition, namely "the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions."

[16] https://www.bsigroup.com/en-GB/about-bsi/uk-national-standards-body/BIS-Exploring-new-areas-with-government-funding/projects/Sustainability/sustainable-finance/sustainable-finance-programme-structure-and-work-streams/

The IA's Framework highlights that ESG integration is just one approach within responsible investing but illustrates this can be undertaken at a firm level as well as acknowledging practical applications of ESG integration to specific funds, mandates or strategies:

- Firm level: ESG integration can be adopted as a firm-wide policy and, in such instances, reflects a firm's commitment to integrate ESG considerations, which will include both risk and opportunities.

- Fund level: the precise ways in which ESG considerations will be taken into account in investment analysis and in the investment decision-making process will differ in practice between different investment funds, mandates and strategies.

The term Responsible Investment is closely associated with the PRI. The PRI is an international network of investors and asset managers working together to put the six Principles for Responsible Investment into practice. Although we have chosen to adopt the IA's Framework in this section, we are presenting the PRI's responsible investment framework below for information.

CONSIDERING ESG ISSUES WHEN BUILDING A PORTFOLIO (known as: ESG incorporation)			IMPROVING INVESTEES' ESG PERFORMANCE (known as: active ownership or stewardship)	
ESG issues can be incorporated into existing investment practices using a combination of three approaches: integration, screening and thematic.			Investors can encourage the companies they are already invested in to improve their ESG risk management or develop more sustainable business practices.	
Integration	**Screening**	**Thematic**	**Engagement**	**Proxy voting**
Explicitly and systematically including ESG issues in investment analysis and decisions, to better manage risks and improve returns.	Applying filters to lists of potential investments to rule companies in or out of contention for investment, based on an investor's preferences, values or ethics.	Seeking to combine attractive risk-return profiles with an intention to contribute to a specific environmental or social outcome. Includes impact investing.	Discussing ESG issues with companies to improve their handling, including disclosure, of such issues. Can be done individually, or in collaboration with other investors.	Formally expressing approval or disapproval through voting on resolutions and proposing shareholder resolutions on specific ESG issues.

It is worth noting that the IA framework and the PRI refer to the same concepts but using different terminology:

IA Framework	PRI
Exclusions	Screening
Sustainability Focus and Impact Investing	These two concepts in the IA Framework are grouped together under the heading Thematic
Positive tilt	Positive screening

PRI also uses the term 'ESG incorporation', which is not replicated in the IA Framework but is simply just a collective term for ESG integration, exclusions and sustainability focus/impact investing. For a full list of PRI definitions and how they align with the terminology used by other organisations, please refer to this PRI document[17].

5.5 ESG Integration versus Ethical/Values-based Investing

Ethical or values-based investing is often associated with exclusions, an approach that incorporates an investor's moral principles, values or religious beliefs by screening out investments with particular features. This can be applied at a firm and/or fund or portfolio level on a variety of issues. For example, excluding manufacturers of controversial weapons, tobacco or alcohol.

This screening, as with ESG Integration, is one of several approaches that can be used within the responsible investment umbrella. However, ethical investing is a values-driven approach to investing focused on excluding assets that do not match the values of the investor. ESG integration, on the other hand, considers the impact that an investee company's environmental, social and governance practices might have on the future financial prospects of the investee company, how the company is managing those factors and how they are priced into the investment. This can mean that ESG Integration alone does not prohibit any investments, more that it conveys ESG risks are identified and taken into account - for example, whilst it may assess exposure to fossil fuels, it is an ethical screen which would ensure this is excluded.

5.6 Thematic Investing versus Impact Investing

Thematic investing is an investment approach that includes investments on the basis of a specific theme. This is not necessarily ESG based (for example it could apply to a technology theme), but in this context it means an environmental and/or social theme or themes which may include the likes of renewable/clean energy, waste and water management, sustainable forestry and agriculture, health products and inclusive finance. To clarify this point, thematic investing is referred to as 'Sustainability Themed Investing' in the IA Framework and is defined as an investment approach that specifies investments on the basis of a sustainability theme/themes which include climate change mitigation, pollution prevention, human rights and sustainability solutions and approaches that relate to one or more of the UN Sustainable Development Goals (SDGs), the UN framework developed to help address key global challenges, which we discuss below. As described earlier, thematic investing is one of the approaches that can be used in sustainable investing.

Impact Investing is defined by the Global Impact Investing Network ('GIIN') as investing with the intention to generate positive, measurable social and environmental impact alongside a financial return. According to GIIN, there are four key elements: (a) intentionality (b) financial returns (c) range of asset class and (d) impact measurement. The IA has endorsed this definition.

Impact investing does not have to be associated with potential trade-offs between financial return and a measurable environmental or social impact, although, as the Spectrum of Capital above shows, the term can encapsulate all financial motivations, including those where commercial rates of return feature less prominently. However, impact investments can deliver a market return and otherwise contribute to a wider

[17] https://www.unpri.org/an-introduction-to-responsible-investment/what-is-responsible-investment/4780.article

investment strategy by, for example, contributing positively to portfolio diversification or lowering overall volatility.

The SDGs are part of a widely adopted reference point[18] that can be used in determining themes. The UN believes that the SDGs are the blueprint to achieve a better and more sustainable future for all, through its 17 goals. They address the global challenges we face, including those related to poverty, inequality, climate change, environmental degradation, peace and justice. SDGs were originally designed to be used by governments however, they have been adopted increasingly by companies and the investment community.

Frameworks for measuring, managing and reporting on impact against the SDGs have been developed. Unfortunately, while we have seen an increase in thematic funds aligning themselves with specific SDGs, we have yet to see a standard framework that thematic funds can use to report progress against their thematic goals. This can make it difficult to compare funds trying to address the same thematic goals.

5.7 ESG risks/sustainability risk versus climate-related risk

Sustainability risk is defined in the EU Regulation on "Sustainability-related disclosures in the financial services sector" (2019)[19], commonly known as the Sustainable Finance Disclosures Regulation ("SFDR"), as "an environmental, social or governance event or condition that, if it occurs, could cause negative material impact on the value of the investment". In other words, the risk being considered here is to the value of the investment portfolio, rather than to the environment or to society.

[18] https://www.un.org/sustainabledevelopment/sustainable-development-goals/

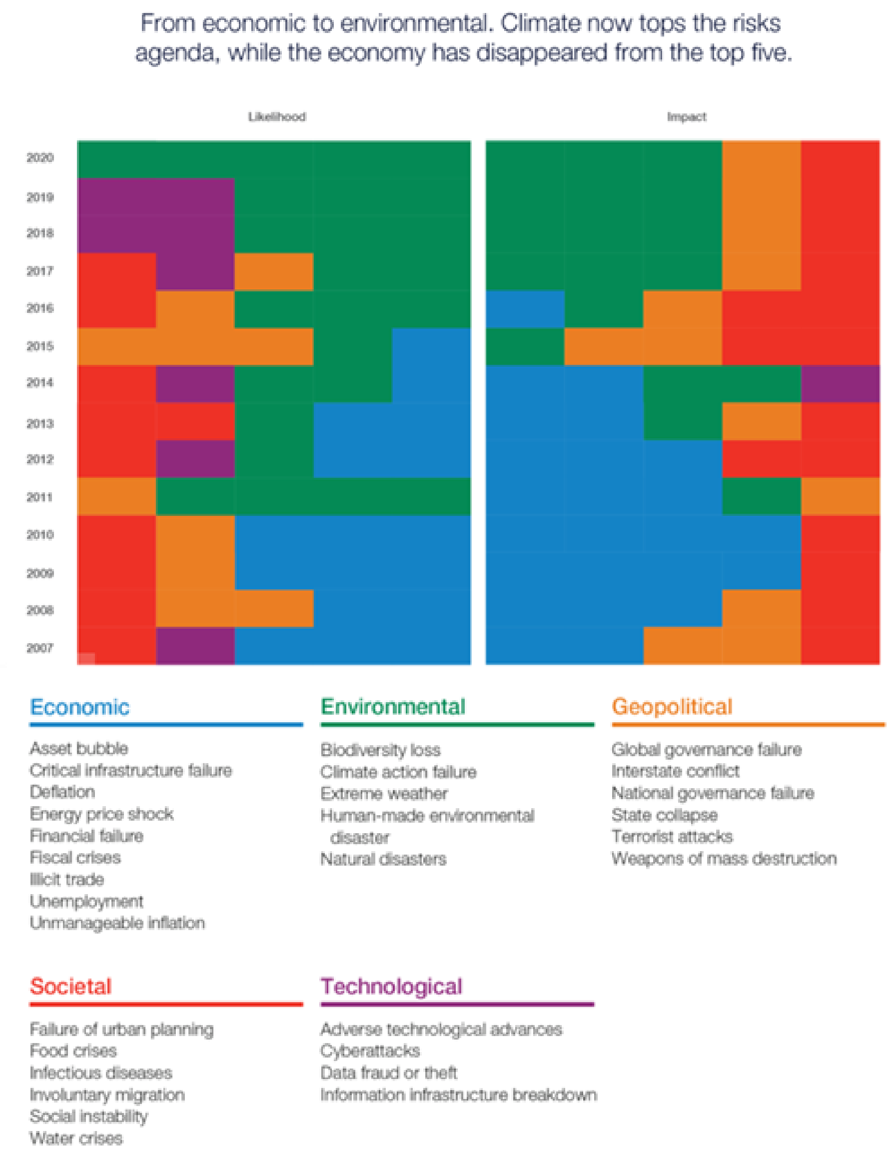
[19] https://eur-lex.europa.eu/eli/reg/2019/2088/oj

Climate-related risk is an environmental risk and a specific example of sustainability risk. According to the Task Force on Climate-related Financial Disclosures ('TCFD'), climate-related risk is divided into two categories: transitional and physical.

- Transitional risk comprises a combination of policy, legal, technological, market and reputational risks associated with the adoption of a lower-carbon economy and the seismic economic and social changes required to give effect to such a transition. For example, the risks a traditional car manufacturer faces in transitioning to electric vehicles.

- Physical risk is split between acute risks, which are event-driven and include the increased severity of extreme weather events (such as cyclones, droughts, floods and fires), and chronic risks, longer-term shifts in patterns such as changes in precipitation and rises in temperatures and sea levels. For example, a manufacturer with a large proportion of their factories built on flood plains has high physical risks.

Risks to biodiversity are also an important consideration, albeit currently less popular as an investment topic than climate-related risk. The implications of the destruction of the natural habitat are long-ranging and severe. Deforestation, for example, has well-established links to climate-related changes but, more significantly, also to infectious diseases. It is estimated that 60% of existing infectious diseases and 75% of emerging infectious diseases are zoonotic, meaning they originate from animals. Studies point to land use changes, agricultural industry changes and international travel and commerce as the primary drivers behind the emergence of infectious diseases.



***Source: WEF's Global Risks Report 2020**
(http://reports.weforum.org/global-risks-report-2020/shareable-infographics/?doing_wp_cron=1597846284.4247100353240966796875)

5.8 Sustainability risk versus Adverse Impact

While sustainability risk relates to the negative impact of ESG factors on the value of an investment, adverse impact is the reverse and relates to the negative impact of the investment on the environment and society as a whole. More specifically, Recital 20 of the SFDR describes adverse impact as "…the impacts of investment decisions and advice that result in negative effects on sustainability factors". Sustainability factors are defined as "environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters".

Consideration of both sustainability risk and adverse impact is consistent with the 'double-materiality' concept that exists within the EC's Non-Financial Reporting Directive (2014), or NFRD, which defines each materiality as follows:

- Financial materiality, which includes risks to the development, performance and position of a company resulting from climate change; and

- Environmental and social materiality, which comprise the principal risks of a negative impact on the climate resulting from a company's activities.

Whilst the former is of most interest to investors, the latter has wider implications and thus is of interest to a broader set of external parties, including "citizens, consumers, employees, business partners, communities and civil society organisations". We would note however that at present the NFRD focus on climate is limited in scope.

A practical example of the above is the oil and gas sector, where the financial materiality could be a potential increase in operating costs to comply with legislation adopted to meet certain climate targets; and the environmental and social materiality the resulting emissions and their impact on the environment. Investors holding a company in this sector are subject to:

- Sustainability risk in relation to the company being affected by legislation adopted to meet climate targets, and

- Adverse impact from greenhouse emissions generated by the company's continuing operations during the period of investment.

Linking back to earlier terms, ESG integration seeks to manage sustainability risk whereas sustainability focus and impact investing seek to generate positive impact as well as managing adverse impact.

5.9 Active ownership versus Stewardship

Stewardship, as defined by the Financial Reporting Council (FRC) in the UK Stewardship Code (2020), is "the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society". Strong stewardship encourages engagement between shareholders and company executives to ensure that a company's strategy and management are aligned with shareholders' interests.

Active ownership, a standard proposed by the PRI to improve stewardship, is the action taken by investors to address concerns around a corporation's policies and practices, including on ESG matters. The approach may differ depending on the asset class. For listed equities, investors may vote, or may engage directly with company executives or the board of directors to scrutinise a company's strategy and the decisions made in seeking to reduce risk and enhance sustainable long-term shareholder value.

Whilst active ownership is a responsible investment strategy with a strong sustainability focus, this does not have to be limited to dialogue on ESG issues. As such, the PRI is of the view that active ownership can equally be defined as stewardship; the terms can be, and often are, used interchangeably.

6. Providing information to clients

This section lists the precontractual and website information that Financial Advisers and DIMs may be obliged to provide to clients and prospective clients on Responsible and Sustainable Investment, whether in the firm's client terms of business or via websites.

The list below sets out the main types of disclosure obligations for product manufacturers and distributors under existing regulations and the various initiatives identified elsewhere in this Guide, to which readers are referred. This list does not, for example, capture the obligations that arise under the EU Taxonomy in relation to firms in scope of the Non-Financial Reporting Directive. We have not sought to focus on obligations that apply to specific types of asset owner nor investee companies.

1. **Financial promotions** (Chapter 4 of the FCA's Conduct of Business Sourcebook (COBS 4): the overarching requirement that financial promotions be "clear, fair and not misleading" applies no less to claims by firms that services and products are "green" or "sustainable" or "incorporate ESG". In a speech[20] given in October 2020, FCA Director of Strategy Richard Monks said:

   We are considering whether it would be helpful to articulate a set of guiding principles to help firms with ESG product design and disclosure. This could help to tackle the concerns I've already outlined and ensure that consumers are protected from potential greenwashing. We have 5 areas for potential principles in mind.

   - *Consistency in messaging and approach. A product's ESG focus should be clearly stated in its name. And then reflected consistently in its objectives, its investment strategy, and its holdings. This is all about ensuring that a product really does do what it says on the tin and matches consumers' expectations.*
   - *A product's ESG focus should be clearly and fairly reflected in its objectives. Where a product claims to target certain sustainability characteristics, or a real-world sustainability impact, its objectives should set these out in a clear and measurable way.*
   - *A product's documented investment strategy should set out clearly how its sustainability objectives will be met. This should include describing clearly any constraints on the investible universe. This includes any screening criteria and anticipated portfolio holdings. This should also include the fund's stewardship approach and actions the fund manager will take if investee companies are failing to make the desired progress.*
   - *The firm should report on an ongoing basis its performance against its sustainability objectives. This is about giving consumers the information they need to understand whether the stated objectives have been achieved in a quantifiable and measurable way.*

   The FCA is currently discussing these principles with industry with a view to finalising them in 2021.

2. **Sustainable Finance Disclosure Regulation** (SFDR) and the **EU Taxonomy Regulation**: please refer to section 7 for the requirements applicable to firms within the scope of this EU regulation following the end of the Brexit transition period. Such firms should note that there are also

[20] https://www.fca.org.uk/news/speeches/building-trust-sustainable-investments/printable/print

additional disclosure requirements not just for “products” – which includes discretionary investment portfolios as well as investment products –with ESG characteristics (Article 8) or a sustainability elements (Article 9), but also for products that are neither (Article 6).

3. **Shareholder Rights Directive**, as amended (SRD II): please refer to section 11 for the requirement, already transposed into the FCA Rules, for an Engagement Policy to be published on DIM websites.

4. **UK Stewardship Code**: please refer to section 11 for the requirements for signatories to publish statements on websites along with annual reports.

5. **Prudential disclosures**: please refer to section 13 for incoming firm-level disclosures under the Investment Firms Regulation and Directive (IFR/IFD). As explained by the FCA in its discussion paper, DP20/2, this requirement will apply to whose 4-year average value of their on- and off-balance sheet assets is more than EUR 100 million for the period immediately before the relevant financial year.

6. **Climate Financial Risk Forum disclosures**: please refer to sections 9 and 10 for an explanation of the voluntary disclosures suggested in the Disclosures chapter of the CFRF’s good practice guide (June 2020).

7. A brief guide to the EU Sustainable Finance Disclosure Regulation (SFDR)

This section provides a quick summary of the key requirements arising from this EU regulation and the potential impact on UK firms providing advisory and portfolio management services to retail investors. Please see section 4 for an explanation of the UK position on incoming EU regulation. This section has been drafted on the basis that the EU requirements apply in accordance with the timeline envisaged by the EU, however at the date of publication it is not yet known whether this is in fact the case.

Please note: as at the date of publication, the Level 2 Regulatory Technical Standards (RTS) are still in draft form and may be subject to further changes.

Additional regulations apply to institutional investors, such as pension funds, however these are not the focus of this Guide and are not included here.

The EU's Sustainable Finance Disclosure Regulation (SFDR) comes into effect in stages from 10th March 2021 onwards. The various components of the SFDR are set out in the tables in this section. In reviewing the potential application of the SFDR[21], firms will need to consider:

- Whether your firm is potentially in scope for these new EU requirements. For example, where it is present in or marketing into the EEA. The current position is that **UK firms that are not present in or marketing into the EEA will not be subject to the SFDR**.

- Where your firm may be in scope, whether your firms is acting as a Financial Market Participant and/or a Financial Adviser (please see the section on Scope below).

- Where your firm may be in scope, how to comply with the high-level confirmed requirements of Level 1 versus the still unconfirmed and far more granular detail of Level 2, where the latter is still subject to change and may have a later implementation date than the former.

- Where your firm is not in scope, whether there is anything in the SFDR with which you would still wish to comply.

- Whether a product name is accurate or misleading in light of the Article 8 and 9 definitions.

7.1 Scope of the SFDR

The scope of the SFDR will apply to a variety of financial firms including, but not limited to, MiFID firms, AIFMs and UCITS management companies.

[21] https://eur-lex.europa.eu/eli/reg/2019/2088/oj

The Regulation does not set different specific requirements for these different types of firm but rather refers to 'financial market participants' and 'financial advisers' (defined in Article 2). Under the SFDR, the definition of 'product' includes not just products in the sense normally understood in the UK – such as collective investment funds – but also discretionary managed segregated portfolios; firms providing "portfolio management" services, as defined by MiFID, will be fulfilling the role of a financial market participant (FMP), although when the same MiFID firm is providing investment advice it will also be deemed to be a financial adviser (FA) in respect of those activities, and would therefore need to comply with the requirements as they apply to both FMPs and FAs.

Financial market participants (FMPs)

a) an insurance undertaking which makes available an insurance-based investment product (IBIP)
b) an investment firm ('MiFID firm') which provides portfolio management
c) an institution for occupational retirement provision (IORP)
d) a manufacturer of a pension product
e) an alternative investment fund manager (AIFM)
f) a pan-European personal pension product (PEPP) provider
g) a manager of a qualifying venture capital fund registered in accordance with Article 14 of Regulation (EU) No 345/2013 ('EuVECA Regulation')
h) a manager of a qualifying social entrepreneurship fund registered in accordance with Article 15 of Regulation (EU) No 346/2013 ('EuSEF Regulation')
i) a management company of an undertaking for collective investment in transferable securities (UCITS management company)
j) a credit institution which provides portfolio management

Financial Advisers (FAs)

a) an insurance intermediary which provides insurance advice with regard to IBIPs
b) an insurance undertaking which provides insurance advice with regard to IBIPs
c) a credit institution which provides investment advice
d) an investment firm ('MiFID firm') which provides investment advice
e) an AIFM which provides investment advice in accordance with point (b)(i) of Article 6(4) of Directive 2011/61/EU ('AIFMD')
f) a UCITS management company which provides investment advice in accordance with point (b)(i) of Article 6(3) of Directive 2009/65/EC ('UCITS')

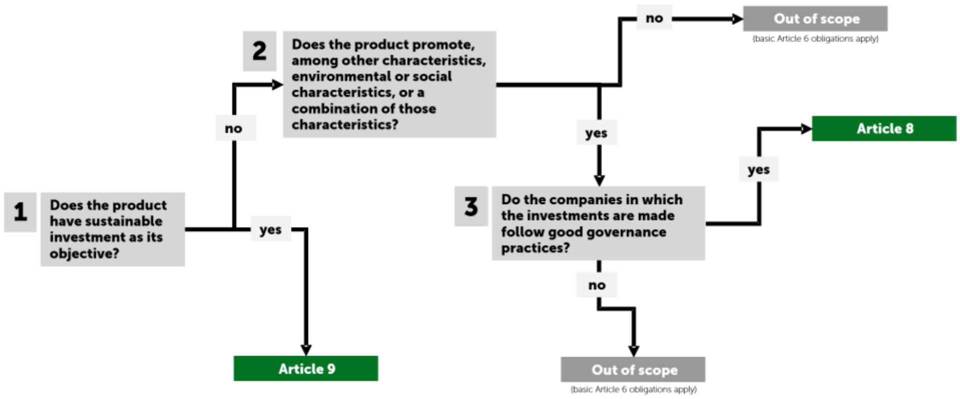
Financial product

a) a portfolio that is managed ('portfolio management')
b) an alternative investment fund (AIF)
c) an IBIP
d) a pension product
e) a pension scheme
f) a UCITS
g) a PEPP

7.2 The different 'product' types under the SFDR

Under the SFDR, all 'products' are considered to be subject to Article 6, but some that claim to have "ESG characteristics" or to be "sustainable" in addition to Article 6 will trigger the requirements of Article 8 or 9. Please note: a product cannot be both an Article 8 product *and* an Article 9 product – it will be one or the other or neither.

The flowchart below summarises:



Broadly speaking, the SFDR product categories are:

All products and Article 6 only	• Product with no ESG characteristics or claims in their product literature • Products managed using basic ESG integration (i.e. ESG risk management) • Products whose managers are considering the adverse impacts of their investment decisions on sustainability • Product-level screening that is necessary to comply with national legal requirements (e.g. exposure to investment in cluster munitions) • Products that are subject to an approach at manager-level, but which is not promoted in product-level documentation • Products making activism, engagement or other stewardship claims that do not speak specifically to environmental or social matters • Products that target companies with good governance but do not reference environmental or social matters
Article 8 (and Article 6)	• Traditional financial investment objective combined with: – (voluntary) screening promoted at portfolio level which is referenced in product literature; or – an investment policy which refers to environmental or social considerations (other than ESG risk) such as ESG opportunities, impact investing, best-in-class environmental or social performance • Traditional financial investment objective that includes a reference to achieving its return through a [sustainable][ESG][green] portfolio • Products that do not themselves have an environmental or social objective but state they invest in something else that does

Article 9 (and Article 6)	• Investment objective that states the product is seeking to achieve an environmental or social outcome as well as (or, potentially, rather than) a financial investment return (e.g. reduction in carbon emissions)

7.3 EU Taxonomy for Sustainable Activities[22]

Firms in scope of the SFDR should also bear in mind the requirements of this Regulation, which provides a framework under which it can be determined how sustainable the things a business does are, and in turn, how sustainable a whole company is and how sustainable a portfolio of companies is.

For FMPs with Article 8/9 products (under SFDR) which invest in an economic activity which contributes to an environmental objective, these firms must include in pre-contractual and periodic disclosures:

- information about which (taxonomy) environmental objective the economic activity relates to; and
- a description of how and to what extent the investments underlying the financial product are taxonomy aligned

For all other FMPs:

- add a negative statement to contractual and periodic disclosure.

[22] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN

7.4 The requirements of the SFDR

As implied in its name, the consequences of being in scope of the SFDR are a series of disclosures that vary depending on whether the firm is acting as a Financial Market Participant (a discretionary manager) or a Financial Adviser.

Regulatory Technical Standards, or RTSs, are the proposals made by the European Supervisory Authorities (ESAs) for adoption as secondary (Level 2) legislation. They provide substantial additional detail on how the concepts and obligations in the main Level 1 regulations are to be applied. Please note that:

- As at the date of publication, the RTSs are still in draft form[23] and may be subject to further changes.
- When approved, the RTSs will not commence from 10 March 2021, when the SFDR Level 1 requirements listed below start to come into effect. The RTSs will instead take effect from 2022 onwards, meaning that for firms and/or funds in scope there will be a period when the Level 1 requirements are in effect, but the Level 2 requirements are not.

Obligation				**Category**	**Applies to**		**Applies from**
					FMP	**FA**	
Art 3(1)	FMPs to publish information on their website about policies on the integration of sustainability risks in their investment decision-making process.		FIRM LEVEL	WEBSITE DISCLOSURE Transparency of sustainability risk policies	✓		10 March 2021
Art 3(2)	FAs to publish on their websites information about their policies on the integration of sustainability risks in their investment advice or insurance advice		FIRM LEVEL	WEBSITE DISCLOSURE Transparency of sustainability risk policies		✓	10 March 2021
Art (4)(1) and (2)	**If FMP considers principal adverse impacts of investment decisions on sustainability factors**… a statement on due diligence policies with respect to those impacts, taking due account of their size, the nature and scale of their activities and the types of financial products they make available. To include at least the following:	**If FMP does not consider adverse impacts of investment decisions on sustainability factors**… clear reasons for why they do not do so, including, where relevant, information as to whether and when they intend to	FIRM LEVEL	WEBSITE DISCLOSURE Transparency of adverse sustainability impacts at entity level	✓		10 March 2021

[23] https://www.eba.europa.eu/three-european-supervisory-authorities-publish-final-report-and-draft-rts-disclosures-under-sfdr

Obligation			Category		Applies to		Applies from
					FMP	FA	
	(a) information about their policies on the identification and prioritisation of principal adverse sustainability impacts and indicators; (b) a description of the principal adverse sustainability impacts and of any actions in relation thereto taken or, where relevant, planned; (c) brief summaries of engagement policies in accordance with Article 3g of Directive 2007/36/EC, where applicable (d) a reference to their adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris Agreement.	consider such adverse impacts.					
Art 4(3) and 4(4)	FMPs with an average of 500 employees in the financial year (or which are parents of a large group meeting that criterion), to publish and maintain on their websites a statement on their due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors. Including at least: (a) information about their policies on the identification and prioritisation of principal adverse sustainability impacts and indicators; (b) a description of the principal adverse sustainability impacts and of any actions in relation thereto taken or, where relevant, planned; (c) brief summaries of engagement policies in accordance with Article 3g of Directive 2007/36/EC, where applicable (d) a reference to their adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris		FIRM LEVEL	WEBSITE DISCLOSURE Transparency of adverse sustainability impacts at entity level	✓		30 June 2021

Obligation			Category	Applies to		Applies from
				FMP	FA	
	Agreement. **PLEASE REFER TO THE DRAFT RTS**					
Art 4(5)	Financial advisers shall publish and maintain on their websites: (a) information as to whether, taking due account of their size, the nature and scale of their activities and the types of financial products they advise on, they consider in their investment advice or insurance advice the principal adverse impacts on sustainability factors; or (b) information as to why they do not to consider adverse impacts of investment decisions on sustainability factors in their investment advice or insurance advice, and, where relevant, including information as to whether and when they intend to consider such adverse impacts. **PLEASE REFER TO THE DRAFT RTS**	FIRM LEVEL	WEBSITE DISCLOSURE Transparency of adverse sustainability impacts at entity level		✓	10 March 2021
Art 5	As a supplement to existing remuneration policies required under existing sectoral legislation, firms to include information on how those policies are consistent with the integration of sustainability risks and shall publish that information on their websites.	FIRM LEVEL	WEBSITE DISCLOSURE Transparency of remuneration policies in relation to the integration of sustainability risks	✓	✓	10 March 2021
Art 6(1)(a)	Include in pre-contractual disclosures[24], descriptions of the manner in which sustainability risks are integrated into investment decisions (and a clear and concise explanation of the reasons [any] sustainability risks are not relevant).	FIRM LEVEL	PRE-CONTRACT DISCLOSURE Transparency of the integration of sustainability risks	✓		10 March 2021
Art 6(1)(b)	Include in pre-contractual disclosures[25], the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available.	FIRM LEVEL	PRE-CONTRACT DISCLOSURE Transparency of the integration of sustainability risks	✓		10 March 2021
Art 6(2)(a)	Include in pre-contractual disclosures, the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products on the	FIRM LEVEL	PRE-CONTRACT DISCLOSURE		✓	10 March 2021

[24] See Art 6(3) for full list of where to disclose. E.g. for AIFMs, in their Article 23 disclosures, for UCITS ManCos, in the prospectus, for MiFID firms in their Art 24(4) disclosures

[25] See Art 6(3) for full list of where to disclose. E.g. for AIFMs, in their Article 23 disclosures, for UCITS ManCos, in the prospectus, for MiFID firms in their Art 24(4) disclosures

Obligation			Category	Applies to FMP	Applies to FA	Applies from
	return of the products they advise on.		Transparency of the integration of sustainability risks			
Art 6(2)(b)	Include in pre-contractual disclosures, the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products on the return of the products they advise on.	FIRM LEVEL	PRE-CONTRACT DISCLOSURE Transparency of the integration of sustainability risks		✓	10 March 2021
Art 7	**In relation to the pre-contractual disclosures above, also include:** (a) a clear and reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts on sustainability factors; (b) a statement that information on principal adverse impacts on sustainability factors is available **AND… If FMP does not consider adverse impacts of investment decisions on sustainability factors…** a statement that it does not consider the adverse impacts of investment decisions on sustainability factors and the reasons therefor.	PRODUCT LEVEL	PRE-CONTRACT DISCLOSURE Transparency of adverse sustainability impacts at financial product level	✓		30 Dec 2022
Art 8	Where a financial product promotes environmental and/or social characteristics[26], in relation to the pre-contractual disclosures above, also include: (a) information on how those characteristics are met (b) if an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics **AND** an indication of where the methodology used for the calculation of the index is to be found. **PLEASE REFER TO THE DRAFT RTS**	PRODUCT LEVEL	PRE-CONTRACT DISCLOSURE Transparency of the promotion of environmental or social characteristics in pre-contractual disclosures	✓		10 March 2021 (Article 8(3) applies from 1 January 2022)
Art 9(1)-(2) and (4)-(5)	Where a financial product has sustainable investment as its objective… **and an index has been designated as a reference benchmark**, the pre-contractual disclosure to be supplemented with: ǀ **and no index has been designated as a reference benchmark**, the pre-contractual disclosure shall	PRODUCT LEVEL	PRE-CONTRACT DISCLOSURE Transparency of sustainable investments in pre-contractual disclosures	✓		10 March 2021; (Article 9(5) applies from 1 January 2022)

[26] Note the sentence "(provided that the companies in which the investments are made follow good governance practices)", it reads as though the disclosure rule only applies where this is the case. More likely that this is intended to preclude promotion of E+S characteristics unless the underlying follow good governance practices.

Obligation			Category	Applies to		Applies from
				FMP	FA	
	(a) information on how the designated index is aligned with that objective; (b) an explanation as to why and how the designated index aligned with that objective differs from a broad market index. **AND** an indication of where the methodology used for the calculation of the index is to be found. / include an explanation on how that objective is to be attained.					
Art 9(3)-(5)	Where a financial product has a reduction in carbon emissions as its objective… **if an EU Climate Transition Benchmark or EU Paris-aligned Benchmark is available**, the pre-contractual disclosure should include the objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement **AND** an indication of where the methodology used for the calculation of the index is to be found. **if no EU Climate Transition Benchmark or EU Paris-aligned Benchmark is available**, the pre-contractual disclosure shall include a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement. **PLEASE REFER TO THE DRAFT RTS**	PRODUCT LEVEL	PRE-CONTRACT DISCLOSURE Transparency of sustainable investments in pre-contractual disclosures	✓		10 Mar 2021
Art 10	For FMPs with financial products that: • promote environmental and/or social characteristics; • has sustainable investment as its objective; or • has a reduction in carbon emissions as its objective …publish on a prominent and easily accessible area of	PRODUCT LEVEL	WEBSITE DISCLOSURE Transparency of the promotion of environmental or social characteristics	✓		10 March 2021

Obligation			Category	Applies to		Applies from
				FMP	FA	
	the website, in an accurate, fair, clear, not misleading, simple and concise way: a clear, succinct and understandable disclosure of the following… (a) a description of the environmental or social characteristics or the sustainable investment objective; (b) information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product, including its data sources, screening criteria for the underlying assets and the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product; (c) the pre-contractual disclosure referred to above; (d) the post-contractual disclosure referred to below. **PLEASE REFER TO THE DRAFT RTS**		and of sustainable investments on websites			
Art 11	A description of the following in periodic reports[27]… For FMPs with financial products that promote environmental and/or social characteristics, the extent to which environmental or social characteristics are met For FMPs with financial products that have sustainable investment **OR** reduction in carbon emissions as their objectives: (i) the overall sustainability-related impact of the financial product by means of relevant sustainability indicators; or (ii) where an index has been designated as a reference benchmark, a comparison between the overall sustainability-related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators. **PLEASE REFER TO THE DRAFT RTS**	PRODUCT LEVEL	PERIODIC REPORTING DISCLOSURE Transparency of the promotion of environmental or social characteristics and of sustainable investments in periodic reports	✓		1 January 2022
Art 12	Information on the following must be kept up to date: • the firm's sustainability risk policy; • the firm's remuneration policy vis-à-vis substantiality risks; and • (for FMPs) the website disclosure for products	MIXED	UPDATES	✓	✓	10 March 2021

[27] See Art 11(2) for full list of where to disclose. E.g. for AIFMs and UCITS ManCos, in the annual report

Obligation			Category	Applies to		Applies from
				FMP	FA	
	with E+S characteristics/sustainable investment/carbon-reduction objectives (see Art 10 above). A clear explanation of any amendment must also be published					
Art 13	No marketing communications may contradict the information disclosed pursuant to this Regulation. **PLEASE REFER TO THE DRAFT RTS**	MIXED	CONSISTENCY OF DISCLOSURE	✓	✓	10 March 2021

TISA

8. Suitability

This section aims to provide a quick summary of the requirements for Financial Advisers and DIMs to collect additional Know Your Customer Information on sustainability and other preferences and from clients, and how this can be incorporated into the Suitability Assessment process.

The key date for the incoming regulation is:

- **Q1 2022: for firms in scope of the proposed changes to MiFID Suitability to have in place procedures for collecting client "sustainability preferences".**

At the present time, there is no *express* regulatory requirement to ask clients about their preferences in respect of either sustainability or ESG matters, or to incorporate these into the advice given or the way in which a portfolio is managed. However, firms will be aware that there is currently a general overarching requirement in the FCA Rules (Chapter 9 and 9A of the FCA's Conduct of Business Sourcebook (COBS 9 and 9A) to consider the investor's investment objectives, which may include preferences on sustainability or ESG topics. Retail investors, wishing to express their values through their investments, often do so as preferences for exclusions covering, for example, mining, tobacco, arms manufacturing. Such exclusions are relatively straightforward to monitor as part of the suitability process.

The current interest in sustainability and ESG has had a number of effects:

- Clients are more aware of such factors and therefore are more likely to register an interest.
- Data providers are offering services which claim to quantify how individual investments perform in these areas, allowing a portfolio to be measured by reference to objective standards.
- EU regulators are proposing that firms must ask clients about their 'sustainability preferences' and are developing a taxonomy of terms to ensure that common definitions are used across the financial sector.

8.1 Know Your Customer information regarding client preferences

As a result of the latter, for firms in scope of the EU regulatory changes it is anticipated that from Q1 2022 where they are providing Advisory and/or Discretionary services, firms will be required[28] to collect their clients' and potential clients' individual sustainability preferences:

> *(Recital 5) Investment firms that provide investment advice and portfolio management should be able to recommend suitable products to their clients and should therefore be able to* ***ask questions to identify the client's individual sustainability preferences****. In accordance with the investment*

[28] Draft delegated regulation amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms. See Ares(2020)2955205.

firm's obligation to act in the best interest of its client, recommendations to clients should reflect both the financial objectives and any sustainability preferences expressed by those clients…

Please note however that compliance with EU regulations that have not been transposed into UK rulebooks will be supervised and regulated only by the EU regulators and not by the FCA.

For a firm not in scope of the EU's proposed changes to MiFID Suitability, there is an open question as to whether and to what extent the firm would want to comply with its requirements on a voluntary basis. It is generally regarded as good practice for firms to invite clients to express any preferences and to discuss these with the client before agreeing whether the firm is able to provide advice or management services on that basis.

It is always important to inform the client, either through discussion or via explanations in client documentation, of the potential impact that the client's preferences may have on expected financial returns or more widely on the firm's ability to advise or manage the portfolio.

8.2 "Sustainability preferences" and "ESG preferences"

As above, these definitions are only formally relevant to firms that will be in scope for the EU regulatory changes after the end of the Brexit transition period. Firms not in scope have more freedom to define these terms themselves, however it is recommended that consideration is given to aligning terminology with the Investment Association's Responsible Investment Framework.

In the draft EU regulation, 'sustainability preferences' means:

a client's or potential client's choice as to whether either of the following financial instruments should be integrated into his or her investment strategy:

(a) a financial instrument that has as its objective sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088 of the European Parliament and of the Council [**Sustainable Finance Disclosure Regulation**[29], or **SFDR**]*;*

(b) a financial instrument that promotes environmental or social characteristics as referred to in Article 8 of [the SFDR] and that either:
  - *(i) pursues, among others, sustainable investments as defined in Article 2, point (17), of that Regulation; or*
  - *(ii) as of 30 December 2022, considers principal adverse impacts on sustainability factors, as referred to in Article 7(1), point (a), of that Regulation;*

Expressed more simply, these are:

(a) sustainable investments (Article 9 products, in the jargon of the SFDR), and

[29] https://eur-lex.europa.eu/eli/reg/2019/2088/oj

(b) ESG investments (Article 8 products) that either pursue sustainable investments or, from 30 December 2022, consider the principal adverse impacts of their investment activity on sustainability factors (defined in the SFDR as 'environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters').

Please refer to section 7 and Appendix 2 for a more detailed examination of Article 6, 8 and 9 products, as defined in the SFDR.

It is noted that the proposed regulatory requirement has changed over time. In earlier drafts, it was proposed instead that firms should collect clients' 'ESG preferences', meaning *a client's or potential client's choice as to whether and which environmentally sustainable investments, social investments or good governance investments should be integrated into his or her investment strategy*.

The current draft SFDR Delegated Regulation, with its specific references to Article 8 and 9 products, is potentially narrower in scope than the earlier 'ESG preferences' formulation, in that there may be potentially suitable investments for a client that, whilst they have an ESG, sustainability or impact aspect to them, for whatever reason do not meet the formal qualifying criteria for an Article 8 or 9 products.

This does not mean that firms cannot gather KYC information on a client's preferences more widely than just Article 8 and 9 products. So long as a firm complies with the formal requirement to collect KYC information on the client's 'sustainability preferences', as defined, it could also gather information on other non-Article 8/9 preferences or requirements that the client may have – for example, in relation to positive or negative screening, or for impact investments.

It should also be clear that a client's sustainability preference is unrelated to whether a firm integrates ESG factors into its investment analysis, advice and decision making. 'ESG integration', as explained in Section 5, is a risk management approach that firms may use to improve long-term risk-adjusted financial returns through the consideration of non-financial risks to an investment that, if they crystallise, would impact on the financial performance of the investment. To the extent that a firm choose to adopt (or not to adopt) such an ESG integration approach, this would not ordinarily be something that a client could opt in or out of at service or product level, based on their own personal preferences. Instead firms should be clear in their client-facing documentation how they integrate ESG into their services and products, so that clients and potential clients can make an informed choice as to whether to invest in the services and products in the first place.

8.3 Direct clients vs. Indirect (Agent as Client, Reliance on Others)

Under the 'Reliance on others' and 'Agent as Client' models the Financial Adviser is typically responsible for the suitability assessment, the identification of sustainability preferences and the suitability of the recommendation made to client.

The DIM is responsible for portfolio construction that is aligned to the client's sustainability preferences on an ongoing basis. Where DIMs offer portfolios that cannot be tailored to individual preferences, it is the responsibility of the Adviser to recommend that a mandate is suitable taking into consideration the client's sustainability preferences. It is the responsibility of the DIM to manage the portfolio in line with the agreed mandate.

Where the Adviser acts solely as an introducer and DIM has a direct relationship with the client (with responsibility for suitability) the DIM will be responsible for collecting client sustainability preferences and ensuring portfolios are suitable on that basis.

8.4 KYC questionnaires

Firms within the scope of regulatory changes implemented by the EU after the end of the Brexit transition period will need to gauge how much information they ask clients about their sustainability and ESG preferences. Based on the suitability provisions, the minimum requirement is to ask about clients 'sustainability preferences' as explained earlier.

Interpreting the regulations to cover just this question with a binary answer does, however, seem at odds with the regulatory intent of the international initiative on sustainable finance which is to "reorient capital flows towards sustainable investments to achieve sustainable and inclusive growth"[30]. This requires educating clients to enable them to understand what financial products are available and therefore to make effective informed decisions.

> "*Central to the recommendations made is the concept that climate-related financial disclosure by financial firms should provide audiences with useful information, typically to inform decision making*".[31]

It follows that firms in scope of these EU regulations that just ask about Article 8 and 9 products may be considered to be avoiding the spirit of the regulation and therefore exhibiting poor culture. The new regulations require firms to make disclosures on matters such as sustainability factors and sustainability risks. Bare disclosure without attempting to engage with clients to help them relate it to their own values and objectives could be taken as purely formal, rather than substantive, compliance. On the other hand, it will be important not to overload clients with information in this area that might distract them from their primary financial objectives.

Consequently, firms need to decide how to address the wider sustainability issue in their conversations with clients. By way of example, one firm is proposing the following series of client-facing questions:

1. General ESG question – are you interested in ESG (Y/N)?
    a. If Y: include headline ESG metrics in quarterly periodic reports
    b. If N: no additional metrics
2. Values-based preferences – provide client with list of topics:
    a. If any topics are of interest to client, include relevant metrics in quarterly client report
    b. If none are of interest, no additional metrics
3. Values-based exclusions – does the client require any exclusions related to the above preferences?
    a. If Y: apply exclusion

[30] Recital 2, Draft Amending regulation to EU 2017/565

[31] CFR Forum Guide p4

b. If N: no further action required

4. [MiFID II draft requirement and subject to change] To what extent are you happy that we include ESG funds and sustainable funds in your portfolio?

There is no right answer here. The important aspect is to show that the firm is aware of the policy intent behind the new regulations and that this has been embedded in firm governance and product disclosure.

8.5 Location of R&SI questions in KYC process

Firms should ask for client 'sustainability preferences' only after the necessary information regarding the client's investment objectives, time horizon and individual circumstances has been collected:

> *"Investment firms that provide investment advice and portfolio management should be able to recommend suitable products to their clients and should therefore be able to ask questions to identify the client's individual sustainability preferences. In accordance with the investment firm's obligation to act in the best interest of its client, recommendations to clients should reflect both the financial objectives and any sustainability preferences expressed by those clients. It is therefore necessary to clarify that investment firms should have in place appropriate arrangements to ensure that the inclusion of sustainability factors in the advisory process and portfolio management does not lead to mis-selling practices or to the misrepresentation of instruments or strategies as fulfilling sustainability preferences where they do not. In order to avoid such practices or misrepresentations, investment firms providing investment advice should first assess the investor's' investment objectives, time horizon and individual circumstances, before asking their clients for their potential sustainability preferences."*[32]

8.6 Repapering existing clients and refreshing KYC

Whilst such preferences may be ascertained at the outset for a new client relationship, the European Commission has clarified that for existing clients a new suitability assessment to establish any sustainability preferences is not necessary.

Where firms provide ongoing advice or portfolio management, however, it is recommended that client sustainability preferences are assessed as part of regular ongoing reviews to ensure existing investments remain suitable.

Firms should therefore seek to include the establishment of a client's suitability preferences as part of their existing processes, whether annual (or other) as part of an ongoing review of suitability for firms providing investment advice or as part of the established frequency of rebalancing for firms providing discretionary portfolio management.

[32] Recital 5, Draft Amending regulation to EU 2017/565

8.7 Integration into investment advice and decision-making: the priority of existing Suitability requirements

If sustainability factors were to take precedence over a client's personal investment objective, there could be an enhanced risk of mis-selling by firms advising the client or managing his or her portfolio. An example of mis-selling may include where a client, classified by the firm as requiring a Lower risk investment, is recommended a High-risk investment in order to satisfy a sustainability preference the client may have.

Consequently, the proposed regulation requires a two-step process within the Know Your Customer information gathering and the suitability assessment processes.

- First, in accordance with current COBS 9A.2 the firm should follow its KYC processes, collecting the necessary information on the client's:
    - knowledge and experience in the investment field relevant to the specific type of financial instrument, insurance-based investment product or service;
    - financial situation including his ability to bear losses; and
    - investment objectives including his risk tolerance.
- Secondly, having established the client's investment objective and risk profile, the firm should establish any sustainability preferences that the client might have.

This has the effect of ensuring that firms are required only to consider how best to satisfy any sustainability preferences <u>within</u> the client's mandate (his or her investment objective and risk profile), rather than (for example) exceeding the acceptable risk taken within a portfolio where a sustainability preference cannot be met within the client's existing risk profile.

The draft Delegated Regulation[33] acknowledges this two-step process:

> *As regards some of the objectives within the suitability assessment process, the Commission included some modifications in order to allow for the necessary differentiation between investment objectives on the one hand and sustainability preferences on the other hand.* ***This differentiation is important in order to avoid mis-selling, which may happen should a sustainability factors take precedence over a client's personal investment objective****. Another recital should then clarify that the sustainability preferences should only be addressed within the suitability process once the client's investment objective has been identified.*
>
> *(**Recital 5**) Investment firms that provide investment advice and portfolio management should be able to recommend suitable products to their clients and should therefore be able to ask questions to identify the client's individual sustainability preferences. In accordance with the investment firm's obligation to act in the best interest of its client, recommendations to clients should reflect both the*

[33] Draft delegated regulation amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms. See Ares(2020)2955205.

financial objectives and any sustainability preferences expressed by those clients. ***It is therefore necessary to clarify that investment firms should have in place appropriate arrangements to ensure that the inclusion of sustainability factors in the advisory process and portfolio management does not lead to mis-selling practices or to the misrepresentation of instruments or strategies as fulfilling sustainability preferences where they do not. In order to avoid such practices or misrepresentations, investment firms providing investment advice should first assess the investor's' investment objectives, time horizon and individual circumstances, before asking their clients for their potential sustainability preferences****.*

9. Data and research options for distributors

This section aims to provide distributors with useful information on how to obtain ESG and R&I data on funds and other investments.

9.1 In-house and third-party sources of ESG/R&I data and research

The demand for high-quality ESG related data and information continues to grow across the investment industry. Financial services firms have a huge dependency on source data from issuer companies; whether it is asset managers monitoring ESG risks in the construction of their portfolios, funds seeking to make positive sustainable impacts or advisers seeking to match their clients' sustainability preferences to suitable investments.

While corporate reporting and disclosure efforts have progressed over the last several years, disclosure practices remain inconsistent and incomplete. As a result, ESG data struggles to be considered on par with financial market data, which is underpinned by structured, consistent and mandatory disclosure. In-progress work by the European Commission on the Non-Financial Reporting Directive may go some way to addressing this, whilst the FCA has introduced a new TCFD-aligned disclosure rule for commercial companies with a UK premium listing. The FCA's new rule comes into force for accounting periods beginning on or after 1 January 2021.
These needs will be exacerbated by the new disclosure requirements on financial market product manufacturers and financial advisers being introduced in 2021 by the Sustainable Finance Disclosures Regulation (or equivalent UK legislation).

With this backdrop, investors will use some combination of their own resources and those of ESG research and ratings firms to transform unstructured and inconsistent data into comparable and useable information.

Those decisions will be informed by a range of factors including costs, internal structure and experience, the types of data required and the uses it is put to: Asset managers may require data to inform investment decisions and to fulfil reporting requirements; fund of fund constructors may want to conduct portfolio attribution analysis or compare the engagement policies of various candidate funds; and investment advisers may want to analyse various ESG attributes of funds to identify short-lists of investments whose focus matches both the financial and sustainability preferences of their client.

9.2 Data considerations by asset class:

Data on equities is by far the most established and available, though increasing focus is being seen on fixed income. Also evident is more discussion about disclosures from private equity firms, with the European Commission mooting the possibility of extending Non-Financial Reporting Directive obligations to some subset of private companies.

The range of potential data indicators across the environmental, social and governance spectrum is vast. Rather than replicate them here, the Joint Consultation paper[34] on the Sustainability-related Disclosures Regulation (Joint Consultation) provides a good example of the extent of them. Table 1 in Annex 1 of the Joint Consultation proposes the many different indicators that firms will have to consider in their assessment of principal adverse impacts that their investment decisions may have on ESG factors.

Given this scale of assessment and disclosure, investors face the challenge of identifying the most material and decision-useful indicators for each investment that they are considering. This is particularly acute at the level of financial products, where investors will be looking for key indicators that apply across the range of securities held by each product.

The IA's work on a Responsible Investment Framework[35] seeks to help with this. Many terms and descriptions are used to describe different ESG approaches and features, to which the framework aims to bring some level of standardization, as illustrated in the graphic in section 5.

The European industry body FinDatEx, which has oversight of the development of the European MiFID Template (EMT), the accepted industry mechanism for transmitting costs/charges and target market data from product manufacturers to distributors, is currently reviewing the extent to which ESG approaches can be added to the EMT and/or a new template for this purpose.

Aided by legislation such as the SRD II, a newer data set that is expected to grow is related to the engagement policies and voting records of investment firms.

In the fixed income arena, credit rating agencies are currently required to explain any ESG factors that contribute to a rating change. Going forward, the EU Taxonomy reporting obligations and Green Bond Standards are likely to be catalysts for more granular data about the uses to which the proceeds of bond issues are put.

9.3 Useful sources of R&SI data for distributors

1. Commercial data providers

The Climate Financial Risk Forum (CFRF), co-chaired by the FCA and the Prudential Regulation Authority (PRA) published its guide to climate-related financial risk management in June 2020. The guide aims to help financial firms understand the risks and opportunities that arise from climate change and provides support for how to integrate them into their risk, strategy and decision-making processes. Amongst the resources included in the guide is a list of providers of climate related and ESG data providers, which may prove to be a useful place for firms to start when considering how to source data[36].

[34] https://www.esma.europa.eu/sites/default/files/jc_2020_16_-_joint_consultation_paper_on_esg_disclosures.pdf

[35] https://www.theia.org/campaigns/sustainability-and-responsible-investment

[36] https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-data-tools-providers.pdf

2. Directly from issuers

Current corporate issuer reporting requirements

The Disclosures chapter of the CFRF guide also lists in detail a number of the current reporting requirements faced by issuers of securities that result in the publication by them of relevant ESG related data. Please refer to Appendix 1 of the Disclosures chapter[37].

Financial Reporting Council and International Financial Reporting Standards consultations

The Financial Reporting Council (FRC) published a discussion paper[38] on October 2020 on its proposal to unbundle corporate Annual Report & Accounts into a series of separate reports, including a new stakeholder focused Public Interest Report, made available via the corporate website. Any changes would likely be effective from 2022.

Separately, the International Financial Reporting Standards (IFRS) has issued a consultation[39] on the development of a global sustainability reporting standard.

> *The Consultation Paper sets out possible ways the Foundation might contribute to the development of global sustainability standards by broadening its current remit beyond the development of financial reporting standards and using its experience in international standard-setting, its well-established and supported standard-setting processes and its governance structure.*
>
> *One possible option outlined in the paper is for the Foundation to establish a new sustainability standards board. The new board could operate alongside the International Accounting Standards Board under the same three-tier governance structure, build on existing developments and collaborate with other bodies and initiatives in sustainability, focusing initially on climate-related matters.*

The IFRS suggestion has met with uniform support across UK government and regulators, with a letter of support[40] jointly signed by the Bank of England, PRA, FCA, HMT, BEIS, TPR, DWP and BEIS. The FCA has also responded[41] at greater length to the consultation in support of the proposals.

IFRS is not itself a regulatory body. But Its governance arrangements do provide independence, due process and transparency, whilst IOSCO chairs its Monitoring Board, which is a public accountability layer within IFR governance. Housing a global sustainability reporting standard under the IFRS is seen a way to address fragmentation and to promote widespread market acceptance. Individual jurisdictions would then need to endorse the standards within their regulatory frameworks.

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[37] https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-disclosures-chapter.pdf

[38] https://www.frc.org.uk/getattachment/cf85af97-4bd2-4780-a1ec-dc03b6b91fbf/Future-of-Corporate-Reporting-FINAL.pdf

[39] https://www.ifrs.org/news-and-events/2020/09/ifrs-foundation-trustees-consult-on-global-approach-to-sustainability-reporting/

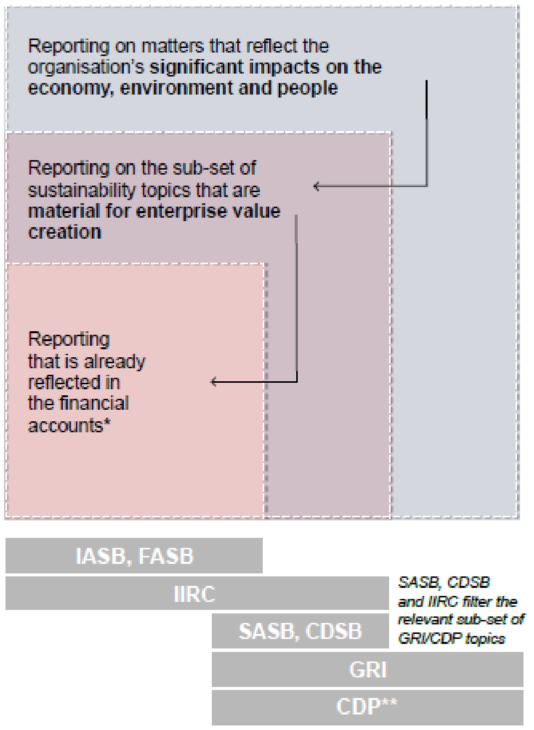
[40] https://www.gov.uk/government/publications/joint-statement-of-support-for-ifrs-foundation-consultation-on-sustainability-reporting/initial-response-to-ifrs-foundation-trustees-consultation

[41] https://www.fca.org.uk/publication/corporate/fca-response-ifrs-foundation-consultation.pdf

SASB, GRI and other reporting standards

At present there is a spaghetti junction of standards and standards bodies without supervisory or enforcement powers (SASB, GRI, CDP, CDSB et al), and although there are initiatives[42] to combine them these may still lack 'teeth'. Nonetheless, corporate issuers currently reporting will likely do so in line with one or more of these existing reporting standards and distributors will want to be aware of them.

Figure 2. Standards address distinctive materiality concepts



* Including assumptions and cash flow projections
** Reflects the scope of the CDP survey, insofar as it functions de facto as a disclosure standard for climate, water and forests, as well as the scope of CDP's data platform

Source: Statement of Intent to Work Together Towards Comprehensive Corporate Reporting - facilitated by the Impact Management Project, World Economic Forum and Deloitte

Standards bodies are increasingly collaborating on the development of core standards, for example, in December 2020, a number of them published a prototype climate-related financial disclosure standard building from TCFD and their various principles, frameworks and standards[43].

[42] https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf

[43] https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Reporting-on-enterprise-value_climate-prototype_Dec20.pdf

The EU Non-Financial Reporting Directive (NFRD)[44]

To further complicate matters, since the development of a unified corporate reporting standard is a while off, the EU has been progressing with its proposals to revise and strengthen the existing NFRD provisions by:

- adding more detail;
- requiring some or all of the companies under the scope of the NFRD to use a non-financial reporting standard;
- modifying the scope of the NFRD (to add certain categories of company not currently covered and/or to exclude certain categories of company that are currently covered);
- strengthening the provisions regarding the assurance of non-financial information;
- strengthening the enforcement and supervision of non-financial reporting requirements; and
- clarifying where the non-financial information should be reported.

During 2019 the EU consulted extensively, and draft legislation is awaited.

TCFD disclosures by corporate issuers

Under the FCA's new Listing rule, confirmed in PS20/17, which applies for accounting periods beginning on or after 1 January 2021, UK premium listed issuers will be required to state whether they have made climate risk disclosures[45] in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD), or explain if they have not done so[46]. These disclosures will be based on the materiality of these risks to the corporate issuer as a business entity, rather than to or the planet or society, and the proposals imply that issuers may need to be collecting any relevant data from 2021 in order to include the disclosures in the 2022 Annual Report & Accounts.

In a speech[47] in November 2020, CEO Nikhil Rathi confirmed the FCA intention to proceed with the proposal:

> *Our consultation closed last month. Feedback has generally been positive and I can confirm that we intend to introduce this rule for reporting periods beginning 1 January next year. Our full Policy Statement and final rules will follow by the end of the year.*
>
> *Our rule will be introduced on a 'comply or explain' basis. We generally expect companies to be able to comply. However, we understand that some may need more time to deal with data, analytical or modelling challenges.*
>
> *And this is just the start. We will follow this up in the first half of next year with proposals to extend the rule to a wider scope of listed issuers. We will also consider further tightening the rule, moving from 'comply or explain' to mandatory disclosure.*

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[44] Non-Financial Reporting Directive 2014/95/EU

[45] https://www.unepfi.org/wordpress/wp-content/uploads/2020/09/UNEP-FI-IIF-TCFD-Report-Playbook.pdf

[46] https://www.fca.org.uk/publication/policy/ps20-17.pdf

[47] https://www.fca.org.uk/news/speeches/green-horizon-summit-rising-climate-challenge

Also in the first half of next year we will release proposed TCFD implementation measures for asset managers, life insurers and FCA-regulated pension providers. We aim to bring in rules for the largest firms by 2022. This will further support information flow along the investment chain.

We want green and sustainable finance to be at the heart of the continued growth of London as a global financial centre.

In developing our approach, we are working with other regulators and the Government through a TCFD Taskforce. This was set up after the Government's Green Finance Strategy was released last year and the interim report will be published later today.

Implementing the TCFD's recommendations in the UK is just the first step. It must be complemented by more detailed climate and sustainability reporting standards that promote consistency and comparability. That is why the FCA is co-chairing a workstream on disclosures under IOSCO's Sustainable Finance Task Force. With IOSCO, we are working with others to drive international progress in this area. We strongly support plans for a new Sustainability Standards Board recently proposed by the Trustees of the IFRS Foundation. Building on TCFD and a harmonisation initiative by an alliance of leading standard-setters, this can deliver a common international standard, within a tried and tested governance model that promotes the public interest.

9.4 Factoring climate change into your firm's research

According to United Nations, climate change is the defining issue of our time and that its impacts are global in scope and unprecedented in scale – from shifting weather patterns that threaten food production, to rising sea levels that increase the risk of catastrophic flooding. The purpose of the CFRF Guide Scenario Analysis chapter[48] is to provide guidance on how to use scenario analysis to assess financial risks arising from climate change. While the chapter is aimed at banks, asset managers and insurers of all sizes, there is recognition that some information may be more relevant for some firms than others.

In its 2019 Status Report, the TCFD recognised through its ongoing discussions with companies and other organisations and analysis of responses to its survey that companies continue to find certain aspects of scenario analysis challenging. Acknowledging the fact that doing scenario analysis for the first time can be daunting, CFRF has developed the following three-stage approach to help firms in their implementation of climate scenario analysis (based on a case study by Aberdeen Standard Investments):

- Stage one: Define
    - Key drivers of the climate scenario analysis: client demand, regulatory expectations or to support strategic analysis
    - Resources required and availability of these resources: extent of resources required will largely be dependent on key drivers of the climate scenario analysis
    - Materiality: it is important focus on efforts where it matters

[48] https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-scenario-analysis-chapter.pdf

- Stage two: Identify
  - Appropriate scenarios and risk metrics: selecting appropriate Greenhouse gas emission and temperature pathways and define suitable risk metrics. If using an external provider, the focus should be on understanding the choices made by the potential vendor.
  - Data and tools to be used to conduct climate scenario analysis: internal or external

- Stage three: Define
  - Translation of impacts into financial metrics
  - Actions to be taken: actions required including any follow-up analysis

9.5 The Climate Financial Risk Forum

The CFRF[49] was set up in March 2019 to build knowledge and share best practice across financial regulators and industry to advance financial sector responses to the financial risks from climate change. More than a year after its first meeting, the CFRF, which is co-chaired by the FCA and the PRA, issued their guide to climate-related financial risk management. The guide aims to help financial firms understand the risks and opportunities that arise from climate change and provide support for how to integrate them into their risk, strategy and decision-making processes. In addition to the guide summary, there are four industry-produced chapters – Disclosures, Innovation, Scenario Analysis and Risk Management (and a corresponding Annex)[50].

Each chapter includes specific sections for banks, insurers and asset managers, the latter including discretionary managers of segregated accounts for both institutional and retail investors. As such, although adherence to the recommendations set out in the CFRF guide is voluntary, it is a useful source of information for discretionary investment managers, as much as for fund managers.

Having published its Guide in June 2020, the CFRF continues to develop its guidance through the continuation of its four working groups.

[49] https://www.fca.org.uk/transparency/climate-financial-risk-forum

[50] https://www.fca.org.uk/transparency/climate-financial-risk-forum

10. Client reporting and disclosures

This section aims to provide a quick summary of key considerations for Financial Advisers and DIMs in respect of client reporting obligations, including Suitability Reports and Periodic Reports, arising from the incoming regulations. This section does not cover pre-contractual and website disclosures, for which please refer instead to section 6.

Key dates for firms in scope of the EU regulations are:

- **Q1 2022:** suitability reports include references to client sustainability preferences
- **31 December 2022:** date by which first periodic report must include additional content specified under the SFDR.
- **2022:** 'large' asset managers, including DIMs, to publish TCFD disclosures.
- **2023**: all other asset managers to publish TCFD disclosures.

10.1 Suitability reports – inclusion of client preferences in reports

Applicable to: Distributors providing investment advice.

A suitability report is required when an adviser provides a personal recommendation to a client. Under FCA rules[51], the report should state how the advice meets the preferences, objectives and other characteristics of the client. These would be determined when the account was opened or from ongoing discussions between the firm and the client.

In accordance with the proposed EU changes, for firms in scope of changes to EU regulation following the end of the Brexit transition period, the following underlined text would be added to the existing suitability report requirement:

> *"When providing investment advice, investment firms shall provide a report to the retail client that includes an outline of the advice given and explains how the recommendation provided is suitable for the retail client, including how the recommendation meets the client's investment objectives, his or her personal circumstances with reference to the investment term required, the client's knowledge and experience, the client's attitude to risk, his or her capacity to sustain losses <u>and his or her sustainability preferences</u>."*

Please refer to section 8 and Appendix 2 for a more detailed examination of the meaning of sustainability preferences, as well as Article 8 and 9 products, as defined in the SFDR. These definitions are narrower than many in the industry expected and are still subject to consultation. TISA has endorsed the Investment Association's detailed consultation response[52].

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[51] COBS 9A.3

[52] https://www.theia.org/sites/default/files/2020-07/IA%20Response%20-%20amendments%20to%20the%20Delegated%20Regulation%20%28EU%29%202017_565%20.pdf

Pending the outcome of the final drafting, it is worth noting the following points:

- Clients may well specify additional ESG and sustainability preferences and objectives which may need to be addressed in a suitability report, distinct from the regulatory definition, a reference to which may need to be included under current FCA rules[53] in a suitability report, regardless of whether or not a firm is in scope for the MiFID Suitability changes; and

- A client's expression of a sustainability preference does not preclude an adviser from making alternative recommendations so long as these meet the client's wider needs, circumstances and objectives. This approach – that suitability preferences do not override the client's other considerations, and that an adviser is free to consider other relevant factors – is consistent with proposed amendments to the current regulation.

10.2 Periodic reports - MiFID requirements

Applicable to: Distributors providing discretionary portfolio management

There are currently no requirements in the FCA Rules to report periodically on how a client's investment portfolio has performed against any client preferences on ESG or sustainability issues, although arguably the overarching rule that firms should "provide a client with adequate reports on the service provided… taking into account… the nature of the service provided to the client"[54] may be seen as requiring a firm to include such information in its periodic reporting where the service expressly claims ESG or sustainability as a core feature of the service.

For firms that will be in scope for the SFDR, Article 11 covers transparency of the promotion of environmental or social characteristics and sustainable investment in periodic reports in respect of Article 8 and 9 products. Periodic reports in the case of a portfolio managed under a discretionary management agreement is referenced back to "periodic report" as referred to in Article 25 (6) of MiFID II Directive. However, based on the draft Regulatory Technical Standards (RTS)[55] at the date of this Guide, it is expected that investment firms will be required to use a mandatory reporting template (currently under consultation, see the draft RTS) for the presentation of the requirements as opposed to inclusion in existing MiFID periodic reports.

The draft RTS includes a granular list of items to be included in the reporting. These items include:

- The success of the product in attaining its environmental or social characteristics (or combination thereof) or sustainable investment objective including actions taken to attain this;

[53] COBS 9A.3.2: report should specify "the advice given and how that advice meets the preferences, objectives and other characteristics of the client".

[54] https://www.handbook.fca.org.uk/handbook/COBS/16A/2.html

[55] JC 2021 03 - Joint ESAs Final Report on RTS under SFDR.pdf (europa.eu)

- Listing the underlying investments of the financial product in descending order of size to identify the top 25 investments during the reference period, including the sector and location of those investments;

- Details on the proportion of sustainability-related investments; this requires both a graphical representation and a narrative explanation; and

- For a financial product with a sustainable investment, an explanation of how that sustainable investment has not harmed significantly the sustainable investment objectives during the reference period with reference to the principal adverse impact indicators in Annex I of the draft RTS.

The above requirements are taken from a draft RTS and as such are still subject to change. The publication date for the final version remains unconfirmed. Article 11 does not apply until 1 January 2022 and we view this as meaning periodic reports will now be expected to be issued until a year after that to cover a full a year (e.g. 1 January 2022 to 31 December 2022).

DIMs in scope of the SFDR must also bear in mind the requirements of the EU Taxonomy Regulation. A DIM with Article 8 or 9 products (under SFDR) that invest in an economic activity which contributes to an environmental objective must include in periodic disclosures:

- information about which (taxonomy) environmental objective the economic activity relates to; and
- a description of how and to what extent the investments underlying the financial product are taxonomy aligned

For all other products (including discretionary portfolios), a negative statement must be added to the periodic disclosure.

10.3 Climate Financial Risk Forum disclosures

Applicable to: Distributors providing discretionary portfolio management

The Climate Financial Risk Forum (CFRF) published its voluntary industry guide to climate-related financial risk management on 29 June 2020[56]. The guide contains four chapters, including Disclosures[57], which sets out best practice for asset managers (including discretionary investment managers) in its Chapter 5.

Disclosures are at an emergent stage and fall into two main categories: firm level and product level. Whilst current disclosures are noted to be qualitative (and thus more climate-related disclosures than climate-related financial disclosures), the intent is that, over time, a combination of qualitative and quantitative factors will combine to achieve the appropriate climate-related financial disclosures to comply with TCFD in 2022 (see the later section in this section).

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[56] https://www.fca.org.uk/transparency/climate-financial-risk-forum

[57] https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-disclosures-chapter.pdf

1. **Firm level disclosures**

Firm level disclosures should set out a firm's approach to the management of climate-related risk, grouped into three categories: operational risk, public engagement risk and investment risk.

1.1 Risk management disclosures

Asset managers should disclose how climate-change related financial risks have been identified, assessed and managed, including how such processes have been incorporated into their mainstream risk management processes. The disclosure should describe the processes in place and how different metrics are used to assess the risks.

1.1.1 Operational risk management disclosures

A firm should disclose qualitative and quantitative information on its business operations, including its risk management processes and reducing its own operational GHG emissions. Key Risk Indicators (KRIs) can be used to set benchmarks and track progress.

1.1.2 Public engagement risk management disclosures

A firm should disclose efforts on advocacy to change the market framework and on engagement with investee companies (whether collaborative or bilateral). The firm may signpost to other documents, such as a stewardship report, annual report or a sustainability report for more information.

1.1.3 Investment risk management disclosures

A firm's approach to scenario analysis (e.g. using off-the-shelf, proprietary or industry-defined scenarios) should be disclosed along with how, and for what purpose, the resulting information is used.

Whether risk management processes are applied across strategies on a uniform basis or not should be disclosed. In the case of the former, the methodology, results and usage should be included. The guidance suggests that a "heatmap" of bottom-up analysis should be created to show climate-related financial risks across the firm's strategies.

2. **Product level disclosures**

Product-level disclosures cover strategies, funds and segregated mandates.

2.1 Where to disclose

Guidance suggests that disclosures should be included in key fund documents and in information provided to clients directly. A distinction is made between static information, such as investment approach, governance arrangements and key "green" targets, which do not have to be updated on a regular basis; and dynamic information, which is more variable and short-term, such as data and reporting against KRIs. Static data would be included for new products at inception and dynamic data would be updated regularly, for example in audited fund report and accounts, factsheets and periodic fund commentaries. Documents should be publicly available, although additional information could be provided to institutional clients via bespoke client reports.

2.2 What to disclose

Risk assessments applied at a product level should be disclosed along with the processes, tools and results. The selection of scenarios should be included along with the reasons for selection, whether these are proprietary or otherwise, what inputs and assumptions underpin these, and how these are used in the business. The frequency of scenario review should also be noted along with any limitations.

Public engagement undertaken at a product level may also be disclosed using the same metrics used for firm level disclosure.

3. Suggested metrics

The guidelines suggest metrics which asset managers could take into consideration on an annual basis. However, as no standardised set of metrics to enable comparison across asset managers exists, this remains an evolving area which each firm should evaluate as new information becomes available.

10.4 Implementation timeline

The guidelines set out a suggested timeline for implementation in two phases as follows:

i. Phase 1 – By mid-2021
   Preparation for, and disclosure of, high level, mainly qualitative aspects of governance, strategy and risk management processes in preparation for further disclosure.

ii. Phase 2 – Mid 2021 to the end of 2022
   Inclusion of quantitative elements along with financial resilience and targets (including on executive remuneration) in disclosures; final rollout ahead of implementation date.

Gaps

A number of gaps currently affect the planning, drafting and production of appropriate disclosures. These include the following:

- Limited and/or poor-quality data;
- Inadequate or misleading risk assessment tools;
- The lack of standardisation across useful metrics and methodologies;
- Considerations of materiality; and
- Competitiveness concerns.

All of the above have significant implications for the production of suitable, compliant disclosures in line with the guidelines. The lack of standardisation is a particular concern as this will affect the comparability of different companies operating in the same sector. Nonetheless, the UK government remains committed to implementing TCFD by 2022.

The Climate Financial Risk Forum Guide

The CFRF was set up in March 2019 to build knowledge and share best practice across financial regulators and industry to advance financial sector responses to the financial risks from climate change. More than a year after its first meeting, the CFRF, which is co-chaired by the FCA and the PRA, issued its guide to climate-related financial risk management. The guide aims to help financial firms understand the risks and opportunities that arise from climate change and provide support on how to integrate them into their risk, strategy and decision-making processes. In addition to the guide summary, there are four industry-produced chapters – Disclosures, Innovation, Scenario Analysis and Risk Management (and a corresponding Annex).

Each chapter includes specific sections for banks, insurers and asset managers, the latter including discretionary managers of segregated accounts for both institutional and retail investors. As such, although adherence to the recommendations set out in the CFRF guide is voluntary, it is a useful source of information for discretionary investment managers.

Having published its Guide in June 2020, the CFRF continues to develop its guidance and extend its uptake through the continuation of its four working groups during 2021.

10.5 TCFD disclosures by discretionary managers

In a speech[58] in November 2020, FCA CEO Nikhil Rathi confirmed the FCA's intention to implement the TCFD recommendations for asset managers:

> *Also in the first half of next year we will release proposed TCFD implementation measures for asset managers, life insurers and FCA-regulated pension providers. We aim to bring in rules for the largest firms by 2022. This will further support information flow along the investment chain.*

Separately, the Department for Work and Pensions (DWP) has been consulting on a requirement for occupational pension schemes to set climate targets and track progress towards them, meaning that schemes will in turn need climate data from their asset managers. In October 2020, Christopher Woolard of the FCA clarified in an open letter[59] to Guy Opperman MP that the FCA intends to consult on a client-focused TCFD aligned disclosures for asset managers in the first half of 2021. Subject to consultation and other statutory requirements, the FCA would aim to finalise rules by the end of 2021, with these coming into force in 2022.

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[58] https://www.fca.org.uk/news/speeches/green-horizon-summit-rising-climate-challenge

[59] https://www.gov.uk/government/publications/financial-conduct-authoritys-plans-for-climate-related-financial-disclosures/letter-from-christopher-woolard-financial-conduct-authority-to-the-minister-for-pensions-and-financial-inclusion-climate-related-financial-disclosu

We expect to do further work to adopt the TCFD's recommendations more widely within our rules, including as they apply to asset managers and contract-based pension schemes, in coordination with the Taskforce. Institutional and retail investors increasingly demand information on how their asset managers take climate into account in their investment decisions, and the outcomes they achieve.

We intend to consult on implementing client-focused TCFD-aligned disclosures for asset managers and contract-based pension schemes in the first half of 2021. Subject to consultation and cost-benefit analysis as required under the Financial Services and Markets Act, we aim to finalise rules by the end of 2021, with new obligations coming into force in 2022. We will consider phasing the obligations, beginning with the largest or most interconnected firms.

Given the global nature of the industry, we will be mindful of the interaction with related international initiatives, including those that derive from the EU's Sustainable Finance Action Plan, but consider that taking forward TCFD-aligned requirements is consistent with and complementary to those initiatives. In developing our detailed proposals, we will consider guidance on climate-related financial disclosures recently published by the Climate Financial Risk Forum, which we co-chair with the Bank of England. This guidance is also grounded in the TCFD's recommendations.

The FCA is considering the appropriate scope of its proposed TCFD-aligned disclosure rules directed at clients and end-investors.

The HM Treasury TCFD Roadmap [60] overleaf presents an illustrative scope of application, beginning in 2022 with the largest and most interconnected UK-authorised asset managers (those with AUM in excess of £50 billion), with smaller asset managers disclosing by 2023.

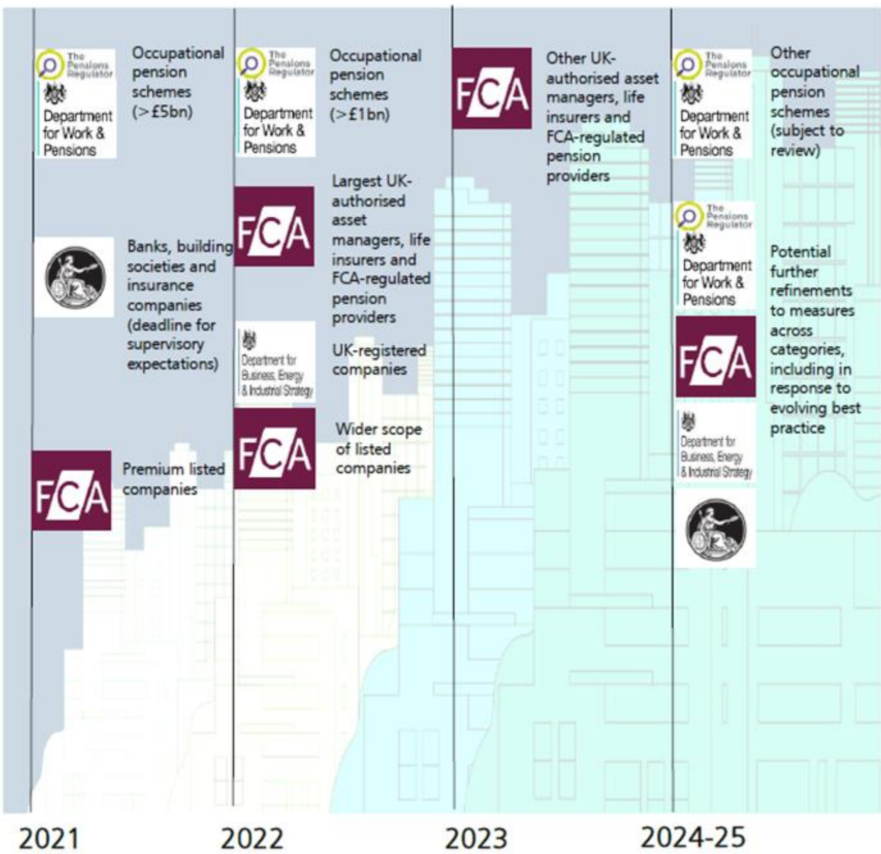
As for which climate metrics these will be, in his role as UN Special Envoy and PM Adviser on COP26, Mark Carney published a report[61] in November 2020 saying that, rather than government or regulators deciding on a metric, the best outcome would be for industry to develop a 'portfolio warming' or 'implied temperature rise' metric (see chapter 4 of this report), with an accompanying paper[62] going into more detail. TCFD is also consulting[63] on the development of such metrics.

[60] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933783/FINAL_TCFD_ROADMAP.pdf

[61] https://custom.cvent.com/8644FD66069649369747A352DBAB07C3/files/d59172883a85415fb14311fd6eecb072.pdf

[62] https://www.tcfdhub.org/wp-content/uploads/2020/10/PAT-Report-20201109-Final.pdf

[63] https://www.moodysanalytics.com/regulatory-news/oct-29-20-fsb-consults-on-forward-looking-climate-metrics-for-financial-sector



The thinking is that other metrics commonly in use – like carbon footprint or carbon intensity – are snapshots and backwards looking, whereas investors ought to be interested in the future trajectory of a corporate's path to net zero. A 'portfolio warming' metric means that investors would be able to see whether their portfolio is Paris aligned (2 degrees or less), or if it is contributing to excessive climate change with an implied warming exceeding the Paris target. The HMT roadmap suggests that the UK government's intention is for all corporates to be publishing relevant data by 2024-25.

The Climate Financial Risk Forum, which is an industry group albeit heavily supported by the Bank/PRA/FCA, has established a Disclosure Working Group looking at developing metrics for client reporting.

TISA

11. Stewardship and engagement

This section aims to provide a brief summary of key considerations for DIMs and other asset managers arising in respect of Stewardship and Engagement Codes. Knowledge of these requirements may also assist Financial Advisers in the selection of DIMs and asset managers. **Key dates are:** • **Currently: the Shareholder Rights Directive requirement for DIMs to publish online their Engagement Policies.** • **31 March 2021: deadline for firms wanting to be a signatory to the FRC Stewardship Code submit an annual stewardship report compliant with the revised 2020 Code.**

11.1 UK Stewardship Code (Financial Reporting Council)

According to the FCA Rules[64], a firm that is managing investments for a professional client that is not a natural person must disclose clearly on its website, or if it does not have a website, in another accessible form:

> (1) the nature of its commitment to the Financial Reporting Council's Stewardship Code; or
> (2) where it does not commit to the Code, its alternative investment strategy.

As such, the Code only applies to discretionary investment managers of professional clients and is voluntary in nature.

The FRC launched a new Stewardship Code for 2020 which represents a significant revision to the existing 2012 Code. The new 2020 Code[65] has an "apply and explain" approach rather than the previous "comply or explain" framework, as well as changing the focus from policy to outcomes. There are twelve principles for asset owners and managers, whilst for service providers there are six principles.

The 2020 Code has defined stewardship as:

> *Responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.*

The new Code has a number of changes which may be summed up as 'actions instead of words':

- A more targeted approach to include asset owners in order to align the investment community
- Annual reporting (see below for more detail on this) rather than the previous approach which was a statement detailing how the signatory incorporated the Code's principles
- A greater focus on ESG factors including climate change

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[64] COBS 2.2.3 and 2.2A.5

[65] https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf

- An expanded asset class universe, previously listed equities were the main focus and the new Code covers all asset classes
- Organisations must evidence their commitment to this through a wide-ranging statement covering (amongst other areas) investment beliefs, purpose, strategy, culture and resourcing
- Finally, and probably most importantly, the 2020 Code is focussed on outcomes rather than policies

The annual report should be a single document which allows anyone to read it and understand how the Code has been applied:

- It should not just be FRC friendly but user-friendly
- It must address all the relevant principles, but it does not have address each one separately
- It should not be policy heavy, instead it should provide links to those policies which underpin the organisation's stewardship approach
- The full voting record does not have to be included but there should be a purposeful summary as well as a link to the full voting record (see SRD II)

Within the reporting expectations there is flexibility for a number of the principles based on the investment approach that the reporting organisation takes. For example, those who engage directly with issues will report differently to those who delegate engagement to others. Additionally, the Code appreciates that there may be practical and legal obstacles to effective stewardship and organisations should explain this as well as any actions taken as a result of this.

Each principle has reporting expectations under two categories: activity and outcomes; some also have a further category of context. The latter refers to the disclosure of policies or additional information which will help the reader understand the stewardship approach being employed.

Timeline

By 31/03/2021:	submit annual report for the 2020 year
April onwards:	FRC will evaluate the reports
Summer 2021:	FRC will publish a list of signatories

If your firm is currently a signatory to the 2012 Code, it remains so until the list of 2020 signatories is published.

The Stewardship Code states that the new Code sets high expectations for those investing money on behalf of UK savers and pensioners. However, as previously, the focus is on institutional investors applying the Code rather than the wealth management segment of the market. Where active ownership is of importance to advisers and other interested parties, a firm's response to the Code would be of relevance in determining how effectively active ownership is addressed.

UK Stewardship Code	• Purpose, culture and strategy ✓ how their purpose and investment beliefs have guided their stewardship, investment strategy and decision-making; and ✓ an assessment of how effective they have been in serving the best interests of clients and beneficiaries.
	• Governance, resources and incentives ✓ how effective their chosen governance structures and processes have been in supporting stewardship ✓ how they may be improved.
	• Conflicts of interest ✓ examples of how they have addressed actual or potential conflicts.
	• Promoting well-functioning markets ✓ an assessment of their effectiveness in identifying and responding to market-wide and systemic risks and promoting well-functioning financial markets.
	• Review and assurance ✓ how their review and assurance has led to the continuous improvement of stewardship policies and processes.
	• Client and beneficiary needs ✓ Multiple either/or disclosures
	• Stewardship, investment and ESG integration ✓ how information gathered through stewardship has informed acquisition, monitoring and exit decisions, either directly or on their behalf, and with reference to how they have best served clients and/or beneficiaries.
	• Monitoring managers and service providers ✓ Either how services have been delivered to their needs ✓ Or the action they have taken where signatories' expectations of their managers and/or service providers have not been met.
	• Engagement ✓ describe the outcomes of engagement that is ongoing or has concluded in the preceding 12 months, undertaken directly or by others on their behalf.
	• Collaboration ✓ describe the outcomes of collaborative engagement.
	• Escalation ✓ describe the outcomes of escalation either undertaken directly or by others on their behalf.
	• Exercising rights and responsibilities ✓ provide examples of the outcomes of resolutions they have voted on over the past 12 months

11.2 Shareholder Rights Directive II[66]

For the purpose of this guide, the Shareholder Rights Directive II (SRD II) applies to investment firms that provide discretionary investment management services to investors – retail as well as professional and institutional. For 'SRD asset managers', the requirements of SRD II are mandatory, unlike the FRC Stewardship Code. As a result, all discretionary investment managers must have regard to these requirements, whilst advisers may find the disclosures made by DIMs in their Engagement Policies to be a useful source of information.

[66] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017L0828

The SRD II was created as a response to issues with the original Shareholder Rights Directive which came to light primarily during the financial crisis of 2007-2008. During the crisis, shareholders supported short-term risk-taking by firms' management, whilst institutional investors and asset managers were poorly engaged, focussing on short-term returns.

SRD II seeks to address shortcomings in the original directive by encouraging long-term shareholder engagement, enhancing transparency in the voting process, and improving the dialogue between companies and investors. it imposes obligations variously on companies, asset managers and asset owners. For companies, the regime applies to all issuers with a registered office in the UK whose (voting) shares are admitted to a regulated marked in the UK or elsewhere in the EU. Further information can be found in the COBS 2.2B.

Whilst adherence to the Stewardship Code 2020 is voluntary, it should be noted that this builds on the regulatory minimum of SRD II. A summary of the areas covered in SRD II is set out below.

I. Identification of shareholders

All companies have the right to identify their shareholders. Companies may seek information about the identity of their shareholders from intermediaries. Practical interpretations of this requirement have resulted in two differing industry approaches. However, whichever approach is adopted, it is the company which remains responsible for ensuring regulatory and legal compliance.

1. a company may seek information on individual shareholders in line with the regulations but appoints a proxy to fulfil the obligation of transmitting information to and from the company and shareholders as an intermediary.

2. the company receives and maintains information on its shareholders directly but also operates its own mechanism to disseminate and receive information. Whichever approach is adopted, it is the company which remains responsible for ensuring regulatory and legal compliance.

II. Transmission of information

Companies may place obligations on intermediaries to transfer information to and from the company and its shareholders.

III. Facilitation of the exercise of shareholder rights

Intermediaries are obliged to facilitate the exercise of rights by shareholders, including through a nominated third party.

Practical interpretations of this requirement include the appointment of a proxy to manage the exercise of shareholder rights as a third party. Other approaches include the use of proprietary resources and staff to assess, track and action voting.

IV. Engagement policy

Asset managers and institutional investors are required to put in place a shareholder engagement policy. (Further information can be found below.)

V. Investment strategy of institutional investors and arrangements with asset managers

Asset managers and institutional investors are obliged to publicly disclose, on an annual basis, how their investment strategy contributes to the medium and long-term performance of the assets they invest in. Institutional investors must disclose any arrangements they have with asset managers which invest on their behalf. (Further information can be found below.)

VI. Transparency of asset managers

Asset managers are required to disclose annually how their investment strategy and implementation complies with their arrangements with an institutional investor. (Further information can be found below.)

VII. Transparency of proxy advisers

Proxy advisers are also subject to transparency requirements and must either apply a code of conduct and report on the application of that code, or explain why one is not applied. Proxy advisers should also disclose information relating to the preparation of their research, advice and voting recommendations and any actual or potential conflicts of interest, making that information available for a period of at least three years.

VIII. Director remuneration

Companies are obliged to publish a remuneration policy and to give shareholders a vote which, in the UK, is binding.

IX. Transparency and approval of related party transactions

Board approval must be sought for material related party transactions, which must be publicly disclosed at the latest on conclusion of the transaction.

Further information on specific elements of the FCA rules which may be relevant in a responsible and sustainable investment context may be found below.

Engagement policy

In accordance with SYSC 3.4, since 10 June 2019 institutional investors and asset managers (which includes discretionary investment managers of retail client accounts) may choose to either develop and publish an engagement policy or not to do so. If the latter, the reasons why must be publicly disclosed.

		Website disclosure	Periodic disclosure
Shareholder Rights Directive (SRD II)	Comply/explain: Publish engagement policy	Firm	
	Implementation of engagement policy	Firm	
	Institutional investor transparency	Firm	
	Asset manager transparency		Firm (private disclosure)

The content of the engagement policy includes information on how a firm integrates shareholder engagement into its investment strategy, monitors investee companies on financial, strategy, capital and ESG matters, exercises voting rights and manages conflicts of interest relating to its engagement.

Firms choosing to publish an engagement policy must also disclose, on an annual basis, how this policy has been implemented. This disclosure must include a summary of the firm's voting behaviour, including significant votes and how the firm has voted in the general meetings of companies in which it is a shareholder. The disclosure should also contain information on the firm's use of proxy advisers.

The engagement policy and the annual disclosure must be published on a firm's website and be made available free of charge. Where an asset manager implements an engagement policy on behalf of an institutional investor, the institutional investor should make reference to where the voting information has been published by the asset manager.

Investment strategy of institutional investors and arrangements with asset managers

Institutional investors must publicly disclose how their equity investment strategy is consistent with the profile and duration of their liabilities, particularly their long-term liabilities, and how these contribute to the medium- to long-term performance of their assets.

Where an asset manager invests on behalf of an institutional investor, whether on a discretionary client-by-client basis, or via a collective arrangement, the institutional investor must provide an annual disclosure regarding its arrangement with the asset manager which sets out the following (which links to the requirement of "Transparency of asset managers"):

a. The key medium- and long-term risks of the investments;
b. The composition of the portfolio;
c. Turnover and turnover costs;
d. Information on the use of proxy advisers;
e. The asset manager's policy on securities lending and the application of the policy to support engagement;
f. The impact on investment decisions from the firm's evaluation of an investee company's medium- to long-term performance;
g. Any conflicts of interest along with the action taken;
h. The duration of the arrangement with the asset manager.

The above information should be available, free of charge, on the institutional investor's website, and should be updated annually.

11.3 Principles for Responsible Investment

The United Nations backed Principles for Responsible Investment was launched by the then UN Secretary General Kofi Annan in 2006. The PRI is a non-profit membership organisation that aims to promote responsible investment globally. As of 2020, it has approximately 3,000 signatory organisations covering over $100trn in assets under management. Investment managers, asset owners and service providers can become signatory members of the PRI by committing to follow six aspiration principles:

1) We will incorporate ESG issues into investment analysis and decision-making processes.

2) We will be active owners and incorporate ESG issues into our ownership policies and practices.
3) We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4) We will promote acceptance and implementation of the Principles within the investment industry.
5) We will work together to enhance our effectiveness in implementing the Principles.
6) We will each report on our activities and progress towards implementing the Principles.

Being a PRI signatory means you undertake a mandatory assessment of your firm wide approach to responsible investment and adherence to the six principles. Firms are given a rating on a scale from A+ to E on various modules that are most relevant to their products and specialisms, including from the end of 2020 a mandatory module on ESG (previously optional). The PRI continues to raise the bar with its assessment and tolerance for reporting submissions, with signatories being delisted if they do not meet the minimum requirements, and the PRI has signaled that the minimum requirements will be regularly reviewed. The PRI also creates a collaborative environment for financial institutions to share best practice, engage on industry issues and can be an important foundation for new firms looking for support on their responsible investment journey.

The PRI report as well as the scores awarded to signatories, where disclosed, can be a useful tool for advisers and other interested parties in ascertaining how well the firm is performing. However, there are qualitative considerations as well – a firm that has a strong intent to improve its responsible investment approach may not score so well versus more established peers in the first few years.

The minimum requirements are relatively broad and cover:

- An organisational responsible investment policy document
- Internal or external staff tasked with executing that policy
- Senior-level commitment and accountability mechanisms for responsible investment implementation.

There is no formal auditing process but questions in the annual reporting submission measure whether minimum requirements have been met.

Following engagement with signatories, the UN backed PRI has launched its new redesigned reporting framework. The framework has evolved since its launch as a survey in 2006, and the drive behind the change is to ensure that signatories remain accountable and that being a signatory is meaningful and green-washing is avoided. Hence the new framework has more challenging reporting requirements. However, the PRI believes the new approach will reduce the complexity around reporting and also lead to more helpful and material outcomes.

To this end the number of questions has been reduced by around 50% and there is now a split within the framework between core and plus questions. The balance will be towards the core elements and these will be mandatory for signatories to report on, and these will be publicly disclosed and assessed. The plus elements will be voluntary and won't be assessed, the PRI sees these as an opportunity for signatories to show the depth of their responsible investment work. Similar to the new UK Stewardship Code 2020, there is a new focus on asking signatories to report outcomes and how they measure these. Finally, there will be a series of questions on sustainability and climate change will be introduced to align with the PRI's aim to 'enable real-world impact in line with the SDGs' as well as meeting its aim to champion climate action.

For more information, including the PRI's assessment reports on signatories, visit the PRI's website: https://www.unpri.org/

11.4 British Standards Institute – Publicly Available Specifications

The BSI is introducing three new Publicly Available Specifications (PAS) focused on responsible and sustainable investment.

These are voluntary standards, however even if not intending to sign up to them firms may find it useful to review them as a potentially interesting guide to expectations in these areas.

1. *PAS 7340:2020 Framework for embedding the principles of sustainable finance in financial services organizations*[67]
   Published in January 2020, this defines sustainable finance as the application of financial services to achieve the goal of sustainability including the consideration of ESG criteria in business or investment decisions.

2. *PAS 7341:2020 Responsible and sustainable investment management*[68]
   Published in October 2020, the aim of this is to establish a threshold for delivering responsible investment management and support an organisation's move to responsible and/or sustainable investment management at a firm level across all investment styles.

3. *PAS 7342:2020 Product Fund – assessment, monitoring and labelling of investment funds*
   The aim of this planned PAS is to establish a framework for the consistent labelling of funds as sustainable.

Engagement collaboration

A number of fora now exist to assist investors with collaborative efforts on engagement with corporate issuers. Here we list a few:

Climate Action 100+

Climate Action 100+ is an investor initiative to ensure the world's largest corporate greenhouse gas emitters act on climate change. It targets medium-term objectives to reduce emissions by 45% by 2030 compared with 2010 levels, which would be consistent with movement towards Paris Agreement targets. The companies include 100 'systemically important emitters', accounting for two-thirds of annual global industrial emissions, alongside more than 60 others with significant opportunity to drive the clean energy transition.

[67] https://shop.bsigroup.com/ProductDetail?pid=000000000030387840

[68] https://shop.bsigroup.com/ProductDetail?pid=000000000030387841&_ga=2.183414369.698410543.1604597133-1654208003.1593531177

Launched in December 2017 at the One Planet Summit, Climate Action 100+ garnered worldwide attention as it was highlighted as one of 12 key global initiatives to tackle climate change. The organisation represents investors with more than $47tn in assets.

Institutional Investors Group on Climate Change (IIGCC)

In its own words, the IIGCC is the European membership body for investor collaboration on climate change and the voice of investors taking action for a prosperous, low carbon future. IIGCC has more than 270 members, mainly pension funds and asset managers, across 16 countries, with over €35 trillion in assets under management.

IIGCC's mission is to mobilise capital for the low carbon transition and to ensure resilience to the impacts of a changing climate by collaborating with business, policy makers and fellow investors. IIGCC works to support and help define the public policies, investment practices and corporate behaviours that address the long-term risks and opportunities associated with climate change.

TISA

12. Financial Advisers: selecting discretionary investment managers (DIM)

This section aims to provide a brief summary of key considerations for Financial Advisers potentially arising from the incoming EU Sustainable Finance Disclosure Regulation and the changes proposed to Suitability under MiFID II, together with some considerations when it comes to choosing a discretionary investment manager.

These considerations are in themselves not regulatory requirements, but rather are suggestive of the issues on which Advisers may wish to satisfy themselves.

When recommending discretionary management portfolio services or funds, Financial Advisers that are in scope for EU regulation following the end of the Brexit transition period will in due course have to consider their client's sustainability preferences and evidence that the recommendation is suitable taking into account these preferences[69]. Please see section 8 for an explanation of these requirements, which will require analysis of the responsible investment (RI) / sustainability-related objectives and features of the product or service that is being recommended.

Proposed rules will require consideration of sustainability risks irrespective of whether clients have sustainability preferences[70]. To do this Advisers will likely have to conduct due diligence on DIMs/ fund managers and ensure sustainability risks are considered and evidenced in investment processes. Advisers not in scope of the incoming EU regulations may still wish to reflect some of the considerations listed below in any existing due diligence questionnaires.

Where Advisers use a panelling process, the sustainability preferences of their target market should be a consideration in the research process to ensure a range of appropriate solutions are included on the panel.

Section 1 below recommends firm-level considerations that Advisers may wish to include in their due diligence on DIMs / fund managers to assess how sustainability risks are considered.

Sections 2 below suggests fund or portfolio service considerations Advisers should take to account to ensure that recommendations meet client sustainability preferences.

1. Firm-level considerations

External accreditation/ associations

- Is the firm a UN Principles for Responsible Investment (PRI) signatory? If so, does it disclose any assessment scores?
- Is the firm a FRC Stewardship Code signatory?

[69] Article 1(6) of Regulation XXX amending Delegated Regulation (EU) 2017/565

[70] Article 4 (5) of Regulation (EU) 2019/2088.

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- Does the firm support and comply with the principles of the UN Global Compact?
- Is the firm a member of any other ESG/RI associations?

ESG integration
- Is there a firm-wide policy that incorporates sustainability / ESG issues into the investment decision-making process?
- Does the DIM publish firm-level disclosures in accordance with the Sustainable Finance Disclosures Regulation (SFDR), see the DIM checklist in section 4?
- Are external sources used for ESG research /data?
- Are there staff dedicated to integrating ESG factors into the investment policy and teams?
- Is remuneration linked to achieving ESG objectives/ the integration of sustainability risks?
- Are the adverse impacts of investment decisions on sustainability factors considered and reported at entity level?
- Are climate related risks and opportunities considered in investment decisions?
- Does the firm publish TCFD aligned disclosures[71] for Asset Managers?

Stewardship
- Has the firm published a stewardship or engagement policy? Does the firm publish an annual stewardship report?
- To what extent does the firm engage on ESG issues with the companies in which it invests? On what types of issues does it engage? What is its approach to engagement? Is it able to give examples? Does it take part in any collaborative engagement?
- Does the firm use a third-party proxy voting adviser? If so, does it use the proxy adviser's voting policy or their own? Is its voting record published?
- Can it provide examples of when it has voted against management?

Corporate/ Company Level Sustainability (note: this relates to the DIM as a corporate entity, rather than to any services or products it might offer)
- Is there a corporate level sustainability policy for overall business operations?
- Are there corporate level sustainability targets in place?

2. Fund / portfolio service considerations

RI approach/ ESG Integration
- How is external research used within the investment process for the product?
- What monitoring and assessment of ESG factors is undertaken in relation to underlying investments?
- How are ESG factors incorporated into investment analysis and decision-making process at the product level?
- What approach to responsible investing are offered and how does this align with client's preferences? For example:
    - *Exclusions e.g. ethical, negative screening, norms-based screening, poor sustainability, ESG assessment*
    - *Sustainability focus e.g. sustainability themed, positive tilt, best in class impact investing e.g. social bond fund*

[71] These are not yet mandatory, but asset managers will be subject to these requirements from 2022 onwards.

- *Impact investing e.g. social bond funds, private impact investing, SDG funds*

- What ESG issues are considered / addressed at the product level and do these align with identified client preferences?
- Within environmental, social and governance issues, is greater weight placed in any particular areas?

Measurability / Client Impact reporting

- How clear are the RI/ sustainability-related objectives of the product? Are they easily understandable in client documentation?
- How is the sustainability-related impact of the product measured and evidence? Is it clearly demonstrated how the social and environmental characteristics are met?
- Where there is a specific commitment to low carbon investing, how is this evidenced?
- How are sustainability matters incorporated into client reporting? Is there a sustainability impact report that can be shared with client? What is the quality of the information provided?

DIMs

- Is there a bespoke offering that can be tailored to client's sustainability preference? If so, what is the methodology for incorporating client preferences into portfolios? How are portfolios monitored to ensure the portfolio remains suitable and sustainability preferences continue to be met on an ongoing basis?
- Where DIMs use a centralised investment process / model portfolio that cannot be tailored to individual client preferences - how clear are the objectives of the service? Where clients have specific sustainability preferences are the objectives of the service sufficiently granular to evidence suitability? Is there scope for the sustainability-related characteristics of the service to vary over time? Could this result in the service becoming unsuitable? What will happen if the client's preferences change over time?

Sustainable Finance Disclosures Regulation (SFDR) and related considerations

- Is the product/portfolio classified as an Article 8 or Article 9 product under SFDR (please refer to Appendix 2 for an explanation of these terms)?
- Does the product/portfolio have an ESG or Eco-fund label?
- Does the product pursue specific environmentally sustainable economic activities?
- Are the adverse impacts of investment decisions on sustainability factors considered and reported on at the product level?

3. Responsibility for suitability under different modes of interacting with DIMs

For the respective responsibilities of firms where there is an indirect relationship, please see Section 8.

4. Repapering for existing clients

Please see Section 8.

TISA

13. Governance, prudential, systems and controls

This section aims to provide a quick summary of key considerations for Financial Advisers and DIMs.

Key dates are:

- **Best practice is arguably set by the Climate Financial Risk Forum guidance, which was published in 2020 and therefore applies now, albeit on a voluntary basis**
- **Changes to MiFID are expected to apply in the EU from [early 2022] for firms subject to the EU regulation and, as a variant, potentially in the UK from a date dependent on further consultation**

The introduction of obligations for sustainable or responsible investing into the regulatory framework for investment firms necessarily requires adaption of their governance structures. There is, however, no single template governance structure that firms can adopt; it is necessary to consider carefully how these concepts affect their businesses, the 'best practice' promulgated by institutions and the minimum requirements of regulators.

As of the time of writing, there has been little prescriptive change in FCA's rulebook (SYSC) on governance. This is in contrast to the PRA which requires an appropriate Senior Management Function to have specific responsibility for identifying and managing climate risks[72]. PRA authorised firms are expected to consider climate change in their governance arrangements, financial risk management practices (including scenario analysis) and to develop an approach to disclosure financial risks.

There are, however, a number of FCA publications that demonstrate that FCA expects climate change-related matters to be central to the governance arrangements of firms with investment and advisory permissions. This is because FCA sees climate change as "likely to have a significant impact on the UK's economy and financial services markets" and accordingly, overseeing how firms and the markets respond forms part of its statutory objectives.[73] With regard to investment firms, it is particularly concerned:

- as a prudential regulator, that they have adequate controls for considering risks from climate change and the transition to a low carbon economy;

- as a consumer guardian, that the market for green finance products has integrity.[74]

The FCA has indicated that any steps taken in this area could be informed by the PRA's Supervisory Statement (SS3/19)[75]. In the meantime, the CFRF gives a sense of the standard expected by FCA. Climate change risk should have the same governance process as financial risks, and firms, subject to their business model, should decide whether to treat climate risk as a standalone issue or one that affects other risks.

[72] SS3/19

[73] DP18-08, 1.1, 1.2

[74] DP18-08, 1.7,1.8

[75] FS19-6, 4.34; FS 19-7

Either way, climate change should be front and central within the risk management and governance framework.

In the meantime, the principal areas where firms should consider their governance structure are as follows:

Investment Oversight

Firms need to show that they consider sustainability issues in their processes for evaluating investments. This oversight should take place either at board level or at the relevant committee which has been appointed to oversee the investment process. This will require data for metrics on the environmental, social and governmental qualities of either direct or collective investments within their universe. This is driven by the FCA's desire to promote effective stewardship by firms and for this to be transparent to clients. The nature of the disclosures that firms will have to make in respect of portfolio management and advisory businesses depends on the whether the UK adopts the EU's disclosure regime and taxonomy of environmentally sustainable activities.

Investment Process

In addition, metrics on sustainability will become essential as revisions to MiFID, expected Q1 2022, will require firms in scope for the EU regulation to ask clients for their investment preferences concerning sustainability. Firms will need to identify whether a portfolio is consistent with those preferences and accordingly, boards will need management information on outliers and the steps being taken to rectify matters. It should be noted that the fundamental obligation will be to ensure that investments are suitable for their needs. Should there be conflict between 'traditional' suitability and sustainability preference, the former takes precedence.

Product Governance

MiFID codifies specific governance obligations over the design of financial products and their intended target market. These rules apply to both manufacturers, who are required to take steps to ensure that a product continues to meet the needs of its target market, and distributors, who are required to collect data on whether they are in fact distributing products to that target market The EU is proposing to amend MiFID, expected from Q1 2022, to require manufacturers to consider in addition whether the investment is consistent with the 'sustainability preferences' of the target market. Likewise, distributors must also consider whether their products and services are consistent with the 'sustainability preferences' of the target market. If these rules are confirmed, then, for firms in scope for these MiFID changes, management information about these new requirements will need to be presented to the board or the relevant committee.

In a speech[76] given in October 2020, FCA Director of Strategy Richard Monks said:

> *We are considering whether it would be helpful to articulate a set of guiding principles to help firms with ESG product design and disclosure. This could help to tackle the concerns I've already outlined and*

[76] https://www.fca.org.uk/news/speeches/building-trust-sustainable-investments/printable/print

ensure that consumers are protected from potential greenwashing. We have 5 areas for potential principles in mind.

- *Consistency in messaging and approach. A product's ESG focus should be clearly stated in its name. And then reflected consistently in its objectives, its investment strategy, and its holdings. This is all about ensuring that a product really does do what it says on the tin and matches consumers' expectations.*
- *A product's ESG focus should be clearly and fairly reflected in its objectives. Where a product claims to target certain sustainability characteristics, or a real-world sustainability impact, its objectives should set these out in a clear and measurable way.*
- *A product's documented investment strategy should set out clearly how its sustainability objectives will be met. This should include describing clearly any constraints on the investible universe. This includes any screening criteria and anticipated portfolio holdings. This should also include the fund's stewardship approach and actions the fund manager will take if investee companies are failing to make the desired progress.*
- *The firm should report on an ongoing basis its performance against its sustainability objectives. This is about giving consumers the information they need to understand whether the stated objectives have been achieved in a quantifiable and measurable way.*
- *The firm should assure ESG data quality, understand their source and derivation, and articulate clearly and accessibly how it is used. This includes the use of ESG ratings in the investment process.*

Conflicts of interest

For firms in scope for the proposed MiFID changes, expected from Q1 2022, firms' policies and procedures on conflicts of interest should incorporate any potential or actual conflicts that arise from the distribution of sustainable investments:

> *To maintain a high standard of investor protection, investment firms should, when identifying the types of conflicts of interest the existence of which may damage the interests of a client, include those types of conflicts of interest that stem from the distribution of sustainable investments or from investments that promote environmental or social characteristics.*[77]

Risk Management

MiFID II requires firms to implement proportionate governance and internal control frameworks. The proposed EU amendments take a broad-brush approach by stating that firms must take into account sustainability risks to investments when designing their processes.

A more comprehensive account of approaches to managing risk from climate change is provided by in the Climate Financial Risk Forum guide 2020. Risks are classified as either physical, such as extreme weather events, or transitional risks where business is disrupted by in the journey to a net-zero carbon economy by extensive policy, legal technological, market and behavioural changes.[78] This guidance should be

[77] Recital 4, Draft Amending regulation to EU 2017/565

[78] FS19-6, 2.2

interpreted based on the scale and nature of each firm's business. The appropriate use of scenario analysis[79] will depend on the extent to which firms use their own balance sheet to make investments or take credit risk. Nevertheless, even investment firms, which are only either designing or distributing financial products, should factor climate change into their risk frameworks.

Prudential requirements

As explained by the FCA in its discussion paper, DP20/2:

> *From 26 December 2022, certain investment firms subject to the IFD will need to disclose information on ESG-related risks, physical risks and transition risks every 6 months (Article 53 of the IFR). This requirement applies to firms which do not meet the criteria in paragraph 4 of Article 32 of the IFD. That is, investment firms whose 4-year average value of their on- and off-balance sheet assets is more than EUR 100 million for the period immediately before the relevant financial year. The intention is that disclosing these risks will help the market to price assets appropriately and make informed decisions.*
>
> *All investment firms in the UK are encouraged to consider material ESG-related risks when calculating their capital and liquidity requirements. For example, there may be a risk that assets become illiquid or of minimal value. In these cases, we may consider imposing additional individual requirements on firms if we do not think they have adequately considered these risks.*

Please refer to Appendix 1 for further information.

Senior management function

At present, there is no FCA Senior Management Function for climate change. There is nothing to stop firms assigning an Overall Responsibility for climate change, otherwise it will default to the CEO. The FCA has, however, stated that it is considering the role of firms' culture, governance and leadership in managing climate change and any steps it takes will be guided by the PRA which has created such a function.[80]

Firm's own carbon footprint

The steps being taken by firms to reduce their carbon footprint should be discussed at board or committee level as part of its corporate social responsibility agenda. This could include issues such as paper usage, travel policy and energy saving initiatives. In terms of public disclosures, firms may wish to inform themselves about the leading SASB and GRI disclosure standards. Firms that are part of listed groups should be aware of the FCA's policy development around TCFD, (e.g. the introduction following PS20/17 of the new rule requiring UK companies with a premium listing to state whether they have made disclosures consistent with TCFD recommendations, or explain if they have not done so) [81], and will also want to

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[79] "Scenario analysis: By appropriately modelling and considering a range of potential futures, a firm can better understand and manage future risks today, whilst capturing opportunities to support the transition to a net-zero carbon economy". Climate Financial Risk Forum guide 2020, Summary, p11

[80] FS19-6. 4.34; SS3/19;

[81] https://www.fca.org.uk/publications/consultation-papers/cp20-3-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing

familiarise themselves with the public disclosure standards of the SASB and GRI, compliance with which may help in improving their ESG ratings and thus cost of capital.

14. Training and Competence

This section aims to provide a brief summary of key Training and competency considerations for Financial Advisers and DIMs.

The following is part of a much wider Training and Competency (T and C) scheme with reference to the FCA's requirements in respect of Treating Customers Fairly (TCF) and their Training and Competence requirements. The rules and guidance encompass:

- Assessing and maintaining competency of Advisers (TC 2.1)
- Supervision (TC 2.1.2, TC2.1.3)
- The coaching and assessment skills of Supervisors (TC 2.1.4)
- Appropriate examinations (TC 2.1.8A)
- The regular assessment of competence (TC 2.1.12 and TC2.1.13)
- The regular evaluation of Partners' training needs (TC 2.1.11)
- Record keeping (TC 3.1.1)
- Continuous Professional Development (CPD) (TC 2.1.15)

Specifically, in relation to Responsible and Sustainable Investment DIM or an Adviser must:

- Understand the current environment and work being undertaken regarding Responsible & Sustainable Investing
- Understand the importance of Responsible and Sustainable Investing
- Gain the required knowledge to feel comfortable incorporating Responsible and Sustainable Investing into client conversations

This should be considered potentially as a mandatory requirement for all new Advisers or DIMs prior to them being granted client contact and any nominated Supervisor prior to them being assigned a team.

You should also consider:

- Completion of a minimum number of CPD hours, each year, in relation to Responsible and Sustainable Investments.
- Completion of a professional qualification linked to ESG Investing, once they become available.[82]

The above should also form part of the wider advice process where it could be expected that an adviser records and documents on Responsible and Sustainable Investment, detailing this in fact finds and suitability reports.

[82] See for example: https://www.cii.co.uk/news-insight/media/press-releases/articles/cii-works-with-international-association-for-sustainable-economy/94321

Appropriate demonstration and documentation of the details outlined above would form part of the FCA's Annual Declaration (TC 2.1.26)

Appendix 1 Governing rules and regulations

This section provides a brief summary of the key regulations potentially impacting UK firms providing advisory and portfolio management services to retail investors. Please see 'General Information' for an explanation of the UK position on incoming EU regulation.

Additional regulations apply to institutional investors, such as pension funds. However, these are not the focus of this Guide and are not included here.

Summary of forthcoming initiatives

1. EU Taxonomy for Sustainable Activities

from January 2022

Long name	Regulation on the establishment of a framework to facilitate sustainable investment		
Other names	EU Taxonomy Regulation		
Stakeholders	Financial market participants (FMPs)*		
Bite-sized summary	Provides a framework under which it can be determined how sustainable the things a business does are, and in turn, how sustainable a whole company is and how sustainable a portfolio of companies is. For FMPs with Article 8/9 products (under SFDR) which invest in an economic activity which contributes to an environmental objective[83], these firms must include in pre-contractual and periodic disclosures: • information about which (taxonomy) environmental objective the economic activity relates to; and • a description of how and to what extent the investments underlying the financial product are taxonomy aligned For all other FMPs: • add a negative statement to contractual and periodic disclosure		
Links	Level 1 Regulation	18 June 2020	FINAL

Financial market participants (FMPs)

A broad 'manufacturer'-type category that includes UCITS management companies, AIFMs, MiFID investment firms - as well as some pension providers, insurers and banks

See Article 2 (1) of the EU Sustainable Finance Disclosure Regulation (SFDR)

83 Awkwardly, this refers to an environmental objective under the definition of 'sustainable investment' under Article 2(17) of the SFDR rather than the six environmental objectives that underpin the EU Taxonomy Regulation itself.

2. EU Sustainable Finance Disclosure Regulation (SFDR) from March 2021

<table>
<tr><td>Long name</td><td>Regulation on sustainability-related disclosures in the financial services sector</td><td rowspan="3"></td></tr>
<tr><td>Other names</td><td>The Disclosure Regulation</td></tr>
<tr><td>Stakeholders</td><td>Financial market participants*

Investment advisers</td></tr>
<tr><td>Bite-sized summary</td><td>
SFDR aims to harmonise disclosures relating to sustainability risks and the consideration of principal adverse impacts on sustainability factors.
For FMPs:

disclosures to be made on the FMP’s website and in pre-contractual documents about policies on the integration of sustainability risks in their investment decision-making process
disclosures in pre-contractual disclosure of the results of an assessment as to the likely impacts of sustainability risks on the returns of financial products they make available
include information on website as to how remuneration policies are consistent with the integration of sustainability risks
disclosure on opt-in or mandatory basis (depending on firm size) of the principal adverse impacts of investment decisions on sustainability factors

For advisers:

disclosures to be made on the adviser’s website and in pre-contractual documents about policies on the integration of sustainability risks in their investment or insurance advice
disclosures in pre-contractual disclosure of the results of an assessment as to the likely impacts of sustainability risks on the returns of financial products which they advise on
include information on website as to how remuneration policies are consistent with the integration of sustainability risks
disclosure on a comply or explain basis of the principal adverse impacts of investment decisions on sustainability factors

For all products:

disclosure of the principal adverse impacts of investment decisions on sustainability factors (this does not apply if the firm who makes the product available does not need to make a disclosure at firm level and has opted out)

For products which promote environmental and/or social characteristics (‘Article 8 products’):

disclose in pre-contractual documents, a description of the environmental or social characteristics or the sustainable investment objective
disclose in pre-contractual documents, information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product
disclose periodically, the extent to which environmental or social

</td><td>
Sustainability risk
“an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment”
See Article 2 (22) of the EU Sustainable Finance Disclosure Regulation (SFDR)
Sustainability factors
“environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters”
See Article 2 (24) of EU Sustainable Finance Disclosure Regulation (SFDR)
</td></tr>
</table>

TISA

	characteristics are met For products which have a sustainable investment or reduction of carbon emissions objective ('Article 9 products'): • disclose in pre-contractual documents, a description of the environmental or social characteristics or the sustainable investment objective • disclose in pre-contractual documents, information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product • disclose periodically, the overall sustainability-related impact of the financial product by means of relevant sustainability indicators • disclose periodically, a comparison between the overall sustainability-related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators			
Links	Level 1 Regulation	27 November 2019	FINAL	
	Final Report on draft Regulatory Technical Standards		DRAFT	

3. EU sustainable finance updates to MiFID II

Expected from Q1 2022

Long name	Regulation as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms Directive as regards the integration of sustainability factors and preferences into the product governance obligations	
Other names	ESG Amendments to MiFID II	
Stakeholders	MiFID investment firms who are product manufacturers MiFID investment firms who are product distributors	
Bite-sized summary[84]	Member States will be required to enhance their implementation of MiFID 2 (i.e. the PROD Sourcebook in the UK) as follows. All firms: • will need to take account of sustainability risks when making investment decisions • will need to adjust risk management policy to take account of sustainability risks • will need to consider a client's sustainability preferences as part of the process	***Sustainability risk*** *"an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment"* See Article 2 (22) of the EU Sustainable Finance Disclosure

84 To be confirmed that Article 1 (2) does not delete the existing requirement "ensure that their relevant persons are aware of the procedures which must be followed for the proper discharge of their responsibilities"

<table>
<tr><td></td><td colspan="3">of identifying conflicts of interest

- when assessing suitability:
  - consider sustainability preferences as part of obtaining information from clients for that assessment
  - sustainability preferences to be captured with the investment objectives of the client
  - policies and procedures around understanding the investment services and financial instruments selected for clients to include sustainability factors

Investment advisers only:

- will need to include a description of any sustainability factors taken into consideration in the selection process for financial instruments
- suitability report to take account of sustainability preferences

Manufacturers only:

- will need to include the 'sustainability preferences' of clients as part of their target market specification and regular lifecycle review
- will need to consider whether the sustainability factors of a financial instrument are compatible with the target market

Distributors only:

- will need to consider sustainability preferences as part of product governance arrangements that ensure that the products and services they offer are compatible with the identified target market and as part of regular review of services</td><td>Regulation (SFDR)

Sustainability preferences

Refers to a preference for a financial product that (broadly) qualifies as an Article 8 or Article 9 product under SFDR.

See of draft text under consultation

Sustainability factors

"environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters"

See Article 2 (24) of EU Sustainable Finance Disclosure Regulation (SFDR)</td></tr>
<tr><td>Links</td><td>Consultation on Delegated Regulation</td><td></td><td>DRAFT</td><td></td></tr>
<tr><td></td><td>Consultation on Delegated Directive</td><td></td><td>DRAFT</td><td></td></tr>
</table>

4. EU Low Carbon Benchmarks Regulation

January 2022

<table>
<tr><td>Long name</td><td>Regulation as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks</td></tr>
<tr><td>Other names</td><td>EU Low Carbon Benchmarks Regulation</td></tr>
<tr><td>Stakeholders</td><td>Benchmark users[85]</td></tr>
<tr><td>Bite-sized summary</td><td>Largely a supporting piece of regulation. Introduces two new types of benchmark under the EU Benchmark Regulation:

- EU Climate Transition Benchmarks

  Consists of underlying assets which are selected, weighted or excluded in such a way that the resulting benchmark portfolio is on a decarbonisation trajectory in light of the long-term global warming target set out in</td></tr>
</table>

85 There are other stakeholders (such as benchmark administrators) but they are not relevant for the audience of this paper

	the Paris Agreement. A decarbonisation trajectory means a measurable, science-based and time-bound movement towards alignment with the objectives of the Paris Agreement. • EU Paris-Aligned Benchmarks Selects only components which already actively contribute to the attainment of the 2°C temperature reduction target set out in the Paris Agreement. Put simply, this means that the carbon emissions savings of each underlying asset exceed its carbon footprint. Benchmark administrators will need to state for every benchmark that they offer (bar those related to interest rates and foreign exchange) whether or not that benchmark pursues ESG objectives and whether or not the benchmark administrator's wider offering includes such ESG-focused benchmarks. Although some obligations are in force now, the obligation on benchmark administrators to endeavour to make such benchmarks available begins in January 2022.		
Links	Level 1 Regulation	18 June 2020	FINAL

5. Engagement policy under SRD II

September 2020

Long name	Directive as regards the encouragement of long-term shareholder engagement			
Other names	The second Shareholder Rights Directive			
Stakeholders	Institutional investors Asset managers			
Bite-sized summary	Engagement Policy • Firms must develop and publicly disclose an engagement policy which describes how they integrate shareholder involvement in their investment strategy or, if they do not, publicly disclose a clear and reasoned explanation about why they have chosen not to do so. • Firms must also publicly disclose (on their website), on an annual basis, how their engagement policy has been implemented. **Institutional investor transparency** • Institutional investors must publicly disclose (on their website) how the main elements of their equity investment strategy are consistent with their liability profile and duration (and, in particular, their long-term liabilities) and how they contribute to the medium to long-term performance of their assets. • Where an asset manager invests on behalf of an institutional investor (either on a segregated mandate basis or through a collective investment undertaking), the institutional investor must publicly disclose information about its arrangement with the asset manager. **Asset manager transparency** Where asset managers have entered into arrangements with institutional investors, they must disclose to the institutional investor on an annual basis how their investment strategy and its implementation complies with the arrangement they have entered into and contributes to the medium to long-performance of the assets of the institutional investor or of the fund.			***Institutional investors*** *• life assurance companies authorised under the EU's Solvency II Directive* *• occupational pension schemes falling within the scope of the EU's Directive on Institutions for Occupational Retirement Provision* ***Asset managers*** *• MiFID firms that providing portfolio management services* *• Alternative investment fund managers (AIFMs),*
Links	Level 1 Directive	17 May 2017	FINAL	

	FCA and FRC Discussion Paper DP19/1	January 2019	FINAL	*apart from small AIFMs* *• UCITS management companies* *• Self-managed UCITS funds*
	FCA Policy Statement PS19/13	May 2019	FINAL	

6. UK Stewardship Code

31 March 2021

Long name	The UK Stewardship Code 2020		
Stakeholders	Asset managers and asset owners Service providers (e.g. investment consultants, proxy advisors, and data and research providers)		
Bite-sized summary	• Obligations can be flexed depending on the nature of the organisation and the assets in question • Focusses not only on policies but on activities and outcomes Asset managers • 12 'comply or explain' principles for asset owners • Asset owners and asset managers cannot delegate their responsibility and are accountable for effective stewardship including "investment decision-making, monitoring assets and service providers, engaging with issuers and holding them to account on material issues, collaborating with others, and exercising rights and responsibilities". Signatories are expected to "use the resources, rights and influence available to them to exercise stewardship, no matter how capital is invested" Service providers • 6 principles for service providers • Service providers expected to support the stewardship responsibilities of the clients they serve including their engagement activities. This might include providing voting recommendations and execution services, provision of data and research, reporting frameworks and standards		
Links	The UK Stewardship Code 2020	November 2019	FINAL

7. UK duty of care for financial services

Unknown

Long name	A duty of care and potential alternative approaches
Other names	Fiduciary duty
Stakeholders	All FCA regulated firms
Bite-sized summary	• UK firms are subject to many obligations under common law and various regulatory rules. Generally, asset managers are not subject to an unqualified fiduciary duty (fiduciary duties they may owe are

	understood to be modified by contract). • FCA previously consulted in July 2018[86] on the introduction of a new duty (whether as statutory duty or as a duty expressed within the FCA's Principles for Business) • Following feedback, the FCA determined to review how they apply the regulatory framework and consider new/revised Principles for Business and would consult on options for change. The suggestion of the need for a legislative change was cooled • In April this year, the FCA announced that this work was delayed due to the need to prioritise the response to coronavirus and that the FCA is now aiming to consult in Q1 2021. • *Please note also the unrelated draft legislation Financial Services Duty of Care Bill 2019-21*[87]		
Links	FCA Feedback Statement FS19/2	April 2019	FINAL
	Speech by Christopher Woolard	21 October 2019	FINAL

8. Investment Firms Regime/Directive

ESG aspects: 26 December 2022

Long name	A new UK prudential regime for MiFID investment firms
Other names	IFR/IFD, IFPR
Stakeholders	MiFID investment firms
Bite-sized summary	IFR Article 53 • From 26 December 2022, investments firms are subject to ESG disclosure requirements under the IFD/IFR regime: • Investment firms which do not meet the criteria referred to in Art. 32(4) IFD shall disclose information on ESG risks (incl. physical risks and transition risks), as defined in the report referred to in Art. 35 IFD. • The information to be disclosed shall be disclosed once in the first year and biannually thereafter. IFD Article 32(4): • an investment firm, where the value of its on and off-balance sheet assets is on average equal to or less than EUR 100 million over the four-year period immediately preceding the given financial year; • an individual whose annual variable remuneration does not exceed EUR 50,000 and does not represent more than one fourth of that individual's total annual remuneration FCA DP 20/2: A new UK prudential regime for MiFID investment firms 14.2 The EBA will investigate whether any ESG-specific adjustments to the K-factors or their coefficients should be developed in future to ensure the appropriate prudential treatment of ESG-exposed assets. They will submit a report on this to the European Parliament, Council and Commission by 26 December 2021 and, depending on their

86 "DP18/5 Discussion Paper on a duty of care and potential alternative approaches", Financial Conduct Authority, July 2018

87 This is a private member's bill, a proposed piece of legislation introduced by a member of Parliament who is not part of the Government (in this case Lord Sharkey of the House of Lords). The Bill, in its current form, through an amendment to the Financial Services and Markets Act 2000 requires the FCA to introduce "a duty of care owed by authorised persons to consumers in carrying out regulated activities" within 6 months of the date that it is passed. In this context, 'duty of care' means an obligation to exercise reasonable care and skill when providing a product or service, and 'consumer' follows the meaning given in the Consumer Right Act 2015 (not, for example, the retail investor definition under MiFID).

	findings, may introduce further legislation (Article 34 of the IFR). 14.3 The EBA is also required to report and develop, if appropriate, guidelines to introduce criteria related to ESG risks for the SREP (Article 35 of the IFD). 14.4 From 26 December 2022, certain investment firms subject to the IFD will need to disclose information on ESG-related risks, physical risks and transition risks every 6 months (Article 53 of the IFR). This requirement applies to firms which do not meet the criteria in paragraph 4 of Article 32 of the IFD. That is, investment firms whose 4-year average value of their on- and off-balance sheet assets is more than EUR 100 million for the period immediately before the relevant financial year. The intention is that disclosing these risks will help the market to price assets appropriately and make informed decisions. 14.5 To enable the market to work well in the UK, we would want to ensure that all firms integrate consideration of ESG-related risks and opportunities into the business, investment and risk decisions they make, particularly over the long term where appropriate. If firms do this effectively it will help them support the transition to a net-zero emissions economy and promote greater trust in the market. This is strongly aligned with our operational objective to protect and enhance the integrity of the UK financial system. 14.6 All investment firms in the UK are encouraged to consider material ESG-related risks when calculating their capital and liquidity requirements. For example, there may be a risk that assets become illiquid or of minimal value. In these cases, we may consider imposing additional individual requirements on firms if we do not think they have adequately considered these risks. In the EU the EBA will prepare a report on the introduction of technical criteria for ESG exposures to use as part of the supervisory review and evaluation process. These criteria will include impact metrics and a definition of ESG risks. They will submit their findings to the European Parliament, Council and Commission by 26 December 2021. Based on their findings, we may consider introducing our own guidelines for integrating ESG into the supervisory review process.		
Links	Investment Firms Regulation	27 Nov 2019	FINAL
	Investment Firm Directive	27 Nov 2019	FINAL
	FCA DP20/2	June 2020	DRAFT

Appendix 2 SFDR Article 8 products

The following technical analysis was prepared based on SFDR and the April 2020 draft regulatory technical standards (RTSs). Since then, amended RTSs have been published and Eversheds Sutherland has prepared a brief and practical 'cheat sheet' taking account of this and other statements made by the ESAs. This can be accessed at: https://www.eversheds-sutherland.com/documents/services/financial/SFDR-article-8-9-cheatsheet.pdf

Consequently, for an explanation of the anticipated Article 8 perimeter, firms should consider both the analysis below and the 'cheat sheet' in conjunction, noting that the latter takes precedence in the event of a conflict. It should be noted that, at the date of this Guide, considerable uncertainty persists about the precise scope of Article 8 products.

1. Background

1.1 This note is written with a focus on financial market participants in the asset management space.

1.2 We have been asked to consider which financial products would fall within the Scope of Article 8 of the disclosure regulation[88] **(SFDR)** based on the legal text of the regulation and the draft regulatory technical standards (or **Draft RTS**) included in the Joint Consultation Paper[89].

2. Introduction

2.1 For the purposes of answering this question, it is assumed that the types of products within the scope of SFDR generally (**Financial Products**) are sufficiently understood (broadly these include[90] funds, segregated mandates under MiFID, IBIPs and a number of pension products) and do not need to be explained in detail here.

2.2 In SFDR the manufacturers of Financial Products are referred to as 'financial market participants' (**FMPs**).

2.3 While SFDR introduces a number of transparency obligations that apply generally, the subject of this note, Article 8, specifically identifies certain Financial Products that are subject to additional obligations.

2.4 The relevant scoping provisions can be found in Article 8(1) which is extracted below:

> *"Where a financial product promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices, the information to be disclosed pursuant to Article 6(1) and (3) shall include the following...."*

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88 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

89 See Page 11 – "While the ESAs see merit in specifying terms that are currently not defined in level 1 legislation ("promotion of environmental or social characteristics" / "follow good governance practices"), the ESAs concluded that possibilities for defining terms at level 2 are limited, instead chose to provide context for the level 2 articles in the recitals to this RTS."

90 See Article 2(12)

2.5 There has been concern among stakeholders that this definition may capture products unintentionally on the basis of its uncertain drafting. In fact, the breadth of the drafting is actually picked up by the ESAs in their Joint Consultation Paper[91] and is identified as being intentional:

> *"The scope of the category of products with environmental and social characteristics (Article 8) was intentionally drafted as a catch-all category to cover all financial products with different environmental or social ambitions that do not qualify as sustainable investments according to Article 9 SFDR."*

2.6 The ESAs intentionally stopped short of adding definitions into the Draft RTS. However, some further interpretative information is included through the use of recitals. In this case, Recital 21 is relevant:

> *"Financial products with environmental or social characteristics should be considered to be promoting, among other characteristics, environmental or social characteristics, or a combination thereof, when information provided to clients, in marketing communications or in mandatory investor disclosures or as part of a process of automatic enrolment in an IORP, references sustainability factors that are taken in consideration when allocating the capital invested of the product."*

and Recital 18

> *"Financial products promoting environmental or social characteristics can cover various investment approaches and strategies, from best-in-class to specific sectoral exclusions"*

2.7 Based on all of the above, we have set out below a breakdown of the relevant aspects of the Article 8 scope and explore these in further detail in the following paragraphs.

"Where a financial product…"	See 0
"promotes…"	See 0
"environmental or social characteristics…"	See 0
"provided that the companies in which the investments are made follow good governance practices…"	See 3.4
"information provided to clients, in marketing communications or in mandatory investor disclosures"	See 0
"references sustainability factors that are taken in consideration when allocating the capital invested of the product"	See 0

91 Joint Consultation Paper – ESG Disclosures, JC 2020 16, 23 April 2020 (Page 10).

TISA

3. Analysis of Article 8.1

3.1 "Where a financial product…"

The product has to be a 'financial product' within the scope of SFDR (as discussed at 2.1).

3.2 "Promotes"

The SFDR itself uses the phrase 'promotes', which is an interesting phrase that perhaps suggests a proactive approach (for example, it contrasts with language such as 'makes available', 'offers' or 'sells'). It additionally appears that the environmental or social characteristics, and not just the product, need to be the subject of the promotion – the term forms part of the wider sentence "Where a financial product promotes…environmental or social characteristics". So it is not the promotion of the product itself that is caught, as Recital 21 of the Draft RTS (set out above at paragraph 0) confirms, but promotion of those characteristics of the product, although this may often be a technical distinction only if the characteristics are inevitably referenced in relation to the product.

However, the Draft RTS then go further to indicate that the concept of promotion should relate to the information provided to the client (wherever so provided). We therefore suggest that a policy which is applied behind the scenes and not disclosed would not be a characteristic being *promoted* (for example basic negative screening as a house position that is not disclosed for the product). We note here that such policies may end up being disclosed at product level in future as regulators take an increasingly hard-line view on transparency.

3.3 "Environmental or social characteristics"

3.3.1 Characteristics of the product

We read 'characteristics' as being attributes relating to the product itself. Indeed, the longer extract is "where a **financial product promotes** environmental or social characteristics" rather than '*where a financial market participant promotes*…'. We would therefore again suggest that policies applied generically by the financial market participant, unless also incorporated into the product, would not be sufficient to bring a product into scope. In particular, the reference to the *"broad concept of ESG integration not being enough to justify that a product promotes environmental or social characteristics*", as we discuss at 0 below, supports this.

Recital 5 to SFDR actually uses the longer phrase "promotion of environmental or social characteristics, in investment decision-making…" perhaps suggesting that the characteristics must relate to the composition of the financial product's portfolio. Taken to an extreme, this perhaps would exclude passive investments. However, we would be reluctant to read this much into a recital.

In addition, we initially queried whether there is a threshold for the degree of "promotion" which needs to be reached in relation to these characteristics i.e., do the relevant characteristics need to be (or claim to be) a material feature of the product or could this just relate to a small part of the portfolio? This does not seem to be the case which is consistent with the greenwashing concerns underlying SFDR and, specifically, the risk that "over disclosure" as to sustainability could be misleading, particularly if only a small part of the portfolio applies such characteristics.

3.3.2 **Either/or**

The use of 'or' in this phrase means that products promoting either environmental characteristics or social characteristics could be in scope, as well as products which promote a combination of these characteristics (provided they meet the additional limb of the definition, set out in 0).

3.3.3 **The Draft RTS**

The Draft RTS add a further layer and bring into scope products whose literature *"references sustainability factors that are taken in consideration when allocating the capital invested of the product".*

Here, 'sustainability factors' is a term from the SFDR itself. By implication, the scope of Article 8 is potentially broadened from capturing products promoting an environmental or social characteristic to documents that 'refer' to 'environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters". This may prove to be an unhelpful addition.

However, the Draft RTS is useful in that it suggests that only binding requirements should be disclosed for Article 8 financial products – which tends to suggest that these are the requirements which the ESAs think are important (in light of the risk of greenwashing):

> *"Therefore, disclosure of criteria for the selection of underlying assets should be limited to those criteria that financial market participants actually bind themselves with as part of their investment decision making process."*

This is perhaps more explicit in the Joint Consultation Paper:

> *the ESAs have decided to require that only selection criteria for underlying assets that apply on a binding basis should be disclosed as part of pre-contractual disclosures.*

Though it is not clear whether merely being 'bound to consider' something is sufficient or whether the requirement needs to be being 'bound to act upon' it. For example, is it sufficient that the FMP commits to consider social aspects as part of its decision making but prioritises other considerations.

3.3.4 Examples of a floor and ceiling on the definition

On a different tangent, it is this aspect of the Article 8 scope (environmental and social characteristics) that primarily distinguishes Article 8 products from Article 9 products (the latter being those which have an objective seeking "a positive impact on the environment and society"). A product meeting that higher Article 9 threshold would not be considered by the ESAs to also be in scope of Article 8.

If Article 9 provides the ceiling for Article 8, there is also an example in the Joint Consultation Paper and Draft RTS of where the floor would be.

For example, the ESAs have clarified that considering sustainability risks (particularly as this is a requirement of SFDR itself) will not bring products into scope:

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Figure 1

Article 8 is more than ESG Integration but stops short of an Article 9 product

Figure 1

Article 8 is more than ESG Integration but stops short of an Article 9 product

3.4 "Provided that the companies in which the investments are made follow good governance practices"

We find this requirement particularly interesting.

It suggests that if the financial product invests in companies which do not follow good governance practices the entire financial product falls out of scope (or perhaps put differently, that a product promoting environmental or social characteristics should by its nature invest only in products with good governance). This is supported by the Joint Consultation Paper[92] and Draft RTS[93].

(We did consider whether products that do not invest in companies at all (e.g. a government bond fund) could be excluded altogether - however we think that this element would actually be construed so that it only applies *to the extent that* the financial product invests in companies.)

This immediately poses some questions:

- How many ineligible companies would de-scope the product (e.g. would a single ineligible company bring the financial product out of scope)?
- Is a company ineligible if the FMP does not know, or not have evidence of, what its governance position is?
- If the product holds a company which follows certain governance standards does it matter if that company owns subsidiaries (or there are other companies in its wider group) that do not? In addition, can the company only be following good governance "practices" if it requires that its service providers/delegates follow the same/similar standards as a pre-condition of their appointment?

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92 See Page 11 – "Furthermore, the ESAs believe that such a precondition [(good governance practices)] is mandatory for any products under Article 8 SFDR with environmental or social characteristics"

93 Recital 26

- Does the phrase 'in which investments are made' include indirect investments through derivatives and other funds? We assume it does include corporate bonds.
- What are good governance practices? We perhaps have a clue from the definition of 'sustainable investment' where the phrase 'good governance practices' is followed by "in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance" but the ESAs have specifically sought to consult on whether this should be read across[94] so we would suspect that it should not be read that way otherwise. In any case, what constitutes 'good' may vary on the basis of company size, maturity and the market – is this intended to be an objective or subjective test?

The Draft RTS further incorporates a requirement (at Article 17(c)) that Article 8 products should include information on the FMP's policy to assess good governance. Does this suggest that this is going to be left to FMPs to self-police (and based on what data)?

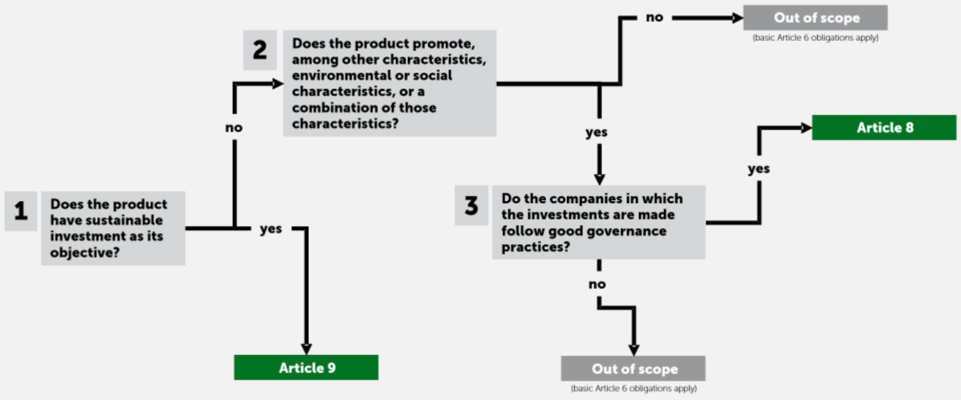
Another point here is that, perhaps unintentionally, this part of Article 8 ("p*rovided that the companies in which the investments are made follow good governance practices*") is not referred to consistently. For example, in the following excerpts Article 8 is referenced without any mention of the requirement for good governance:

- Recital 21 of SFDR notes "*it is necessary to distinguish between the requirements for financial products which promote environmental or social characteristics, and those for financial products which have as an objective a positive impact on the environment and society.*"; and
- in the Executive Summary of the Joint Consultation Paper there is a reference, in relation to pre-contractual information, to "*how a product with environmental or social characteristics meet those characteristics…"*.

If the good governance requirement is overlooked in this way this could lead to the inconsistent identification of Article 8 products. We suspect that regulators view good governance as a prerequisite for investment but it is important to continue to refer to it.

94 Question 21 (also see page 11 of the Joint Consultation Paper "…the ESAs concluded that possibilities for defining terms [("promotion of environmental or social characteristics" / "follow good governance practices")] are limited.")

Figure 2



1
Does the product have sustainable investment as its objective?
yes
Article 9
no
2
Does the product promote, among other characteristics, environmental or social characteristics, or a combination of those characteristics?
no
Out of scope
(basic Article 6 obligations apply)
yes
3
Do the companies in which the investments are made follow good governance practices?
yes
Article 8
no
Out of scope
(basic Article 6 obligations apply)

Appendix 3 TISA Glossary

THIS GLOSSARY AIMS TO PROVIDE A NON-EXHAUSTIVE LIST OF ESG AND SUSTAINABLE AND RESPONSIBLE INVESTMENT RELATED COMMON TERMINOLOGY AND DEFINITIONS AS A STARTING POINT FOR DISCUSSION. IT IS AN ANTHOLOGY OF DEFINITIONS FROM OTHER ORGANISATIONS THAT ARE CONSIDERED TO BE USEFUL/APPROPRIATE TO THE WORK OF TISA MEMBERS. IT IS NOT INTENDED TO BE DEFINITIVE AND IT IS EXPECTED TO BE UPDATED FROM TIME TO TIME.

TERMINOLOGY	DEFINITION	SOURCE
Active Ownership	Investors addressing concerns on policies and practices, including on ESG issues by voting on such topics or engaging corporate managers and board of directors on them. Active ownership is utilised to address business strategy and decisions made by the corporation in an effort to reduce risk and enhance sustainable long-term shareholder value.	Swiss Sustainable Finance
Best in Class	An investment approach that includes investments based on certain sustainability criteria to focus exposure on sector-leading companies. Best in Class approaches can vary from selecting from amongst the best performing companies (e.g. the lowest carbon / most energy efficient energy producers) to excluding the worst performing companies relative to peers. ***Explanatory Note:*** *Adopting a Best in Class approach can mean having exposure to companies from sectors that may not typically be considered "sustainable". A Positive Tilt approach may also mean this. A Positive Tilt is typified by having less exposure to these kinds of companies than a traditional benchmark (e.g. FTSE 100, S&P 500).*	Glossary to the Investment Association's Responsible Investment Framework
Carbon Footprint (Fund)	An aggregation of the carbon footprint of individual positions within an investment portfolio, relative to the share of the companies held by this portfolio. As a measure to assess the climate risk of an investment portfolio, this key performance indicator for example, may be used by institutional investors aiming to offer transparency and reduce the carbon intensity of their portfolios. *TISA Note: These are not precise measures*	Swiss Sustainable Finance (amended)
Carbon Neutral	This occurs when an organisation's net carbon emissions are equal to zero. The process requires measuring total CO2 emissions, taking active steps to reduce emissions where the company can, and then purchasing CO2 -certificates to offset CO2 emissions that cannot be eliminated from the totality of the company's operations, purchased (SHEC) and supply chains. The CO2 -certificates were generated by a third party who contributed to projects reducing CO2 -emissions (i.e. by replacing fossil power generation with renewable energy projects). The IPCC (Intergovernmental Panel on Climate Change) has recommended	Based on the work of Swiss Sustainable Finance

TERMINOLOGY	DEFINITION	SOURCE
	that global net zero should be by 2050 to attempt to keep warming below 2°C.	
Circular Economy	An economic system whereby the value of products, materials and other resources in the economy is maintained for as long as possible, enhancing their efficient use in production and consumption, thereby reducing the environmental impact of their use, minimising waste and the release of hazardous substances at all stages of their life cycle, including through the application of the waste hierarchy ***Waste hierarchy:*** (a) prevention; (b) preparing for re-use; (c) recycling; (d) other recovery, e.g. energy recovery; and (e) disposal. *TISA Note:* Ellen MacArthur foundation definition of a circular economy brings in further elements: - A **circular economy** is a systemic approach to **economic** development designed to benefit businesses, society, and the environment. In contrast to the 'take-make-waste' linear model, a **circular economy** is regenerative by design and aims to gradually decouple growth from the consumption of finite resources. - It recognises that resource use has major implications on many other ESG factors such as Environmentally: climate change; deforestation; pollution; land use etc - It brings in the concept that the earth is a closed system (environmental economics and externalities and poor recognition or no prices for resources- e.g. when you chop down a tree in the amazon there is no price, just the value of the wood sold and creation of an asset that someone owns which was previously indigenous population) -	Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment. Published 18 June 2020 - Article 2: definitions Ellen MacArthur Foundation

TERMINOLOGY	DEFINITION	SOURCE
Climate change adaptation	The process of adjustment to actual and expected climate change and its impacts.	Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment. Published 18 June 2020 - Article 2(6) definitions
Climate change mitigation	The process of holding the increase in the global average temperature to well below 2°C and pursuing efforts to limit it to 1.5°C above pre-industrial levels, as laid down in the Paris Agreement.	Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment. Published 18 June 2020. - Article 2(5) definitions
Community Investing	Directing investment capital to communities that are underserved by traditional financial services institutions. Generally provides access to credit, equity, capital, housing, and basic banking products that these communities would otherwise lack. The term usually refers to investments in developed countries.	Swiss Sustainable Finance
Environmental Issues	Issues relating to the quality and functioning of the natural environment and natural systems. These include: biodiversity loss; greenhouse gas (GHG) emissions, climate change, renewable energy, energy efficiency, air, water or resource depletion or pollution, waste management, stratospheric ozone depletion, changes in land use, ocean acidification and changes to the nitrogen and phosphorus cycles.	UN PRI
Environmental Objectives	(a) climate change mitigation; (b) climate change adaptation; (c) the sustainable use and protection of water and marine resources; (d) the transition to a circular economy;	Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment. Published 18 June 2020 - Article 9 environmental

TERMINOLOGY	DEFINITION	SOURCE
	(e) pollution prevention and control; (f) the protection and restoration of biodiversity and ecosystems.	objectives
ESG	Environmental, Social and Governance issues.	
ESG Considerations	Any factor associated with environmentally sustainable investments, social investments or good governance investments, or a combination of those factors.	Draft Commission proposal (subsequently deleted) amending MiFID2 as amended by the updated draft Commission proposal amending MiFID2 Article 1 – amendments to Delegated Regulation (EU) 2017/565 (previous version)
ESG Engagement	Engagement refers to interactions between the investor and current or potential investees (which may be companies, governments, municipalities, etc.) on ESG issues. Engagements are undertaken to influence (or identify the need to influence) ESG practices and/or improve ESG disclosure. TISA Note: We note that engagement specifically aims to achieve positive outcomes	UN PRI
ESG Integration	The explicit and systematic inclusion of ESG issues in investment analysis and investment decisions. ***Explanatory Note:*** *ESG Integration alone does not prohibit any investments. In theory, such strategies could invest in any business, sector or geography as long as the ESG risks of such investments are identified and taken into account.* *Firm Level* *ESG integration can be adopted as a firm-wide policy and, in such instances, reflects a firm's commitment to integrate ESG considerations, which will include both risk and opportunities.*	Glossary to the Investment Association's Responsible Investment Framework where the IA has adopted the UN PRI definition. See also: GSIA 2018 Global Sustainable Investment Review

TERMINOLOGY	DEFINITION	SOURCE
	Fund Level *The precise ways in which ESG considerations will be taken into account in investment analysis and in the investment decision-making process will differ in practice between different investment funds, mandates and strategies. Therefore, the framework reflects ESG integration undertaken at a firm level (typically articulated by a firm-level policy) as well as the practical application of ESG integration to specific funds, mandates or strategies.* ▪ UNPRI ▪ It means that leading practitioners are: - analysing financial information and ESG information; - identifying material financial factors and ESG factors; - assessing the potential impact of material financial factors and ESG factors on economic, country, sector, and company performance; and - making investment decisions that include considerations of all material factors, including ESG factors. It does *not* mean that: - certain sectors, countries, and companies are prohibited from investing; - traditional financial factors are ignored (e.g., interest risk is still a significant part of credit analysis); - every ESG issue for every company/issuer must be assessed and valued; - every investment decision is affected by ESG issues; - major changes to your investment process are necessary; and, finally and most importantly, - portfolio returns are sacrificed to perform ESG integration techniques.	

TERMINOLOGY	DEFINITION	SOURCE
	------ **GSIA** "ESG INTEGRATION: the systematic and explicit inclusion by investment managers of environmental, social and governance factors into financial analysis"	
ESG Preferences	A client's or potential client's preferences for environmentally sustainable investments, social investments or good governance investments.	Draft Commission proposal (subsequently deleted) amending MiFID2 as amended by the updated draft Commission proposal amending MiFID2 Article 1 – amendments to Delegated Regulation (EU) 2017/565 (previous version)
Ethical/Values Based Investment	Investments where the main motivation is aligning the ethical values of an organisation or a person with investments. In comparison to sustainable investments which are based on the conviction that an active management of environmental, social and governance risks and opportunities improves the long-term performance of a company, an ethical investment is mainly guided by ethical codes, religious beliefs or personal values and is often carried out using exclusionary screening.	Glossary to the Investment Association's Responsible Investment Framework
Exclusions/ Exclusionary approaches/Negative Screens	Exclusions prohibit certain investments from a firm, fund or portfolio. Exclusions may be applied on a variety of issues, including to align with client expectations. They may be applied at the level of: - Sector - Business activity, products or revenue stream - The company itself; or - Certain jurisdictions/countries. ***Examples:*** - *Investment approach that applies ethical/values-based/religious exclusions: Investment approach that*	Glossary to the Investment Association's Responsible Investment Framework

TERMINOLOGY	DEFINITION	SOURCE
	excludes investments on the basis of ethical, values-based or religious criteria, for example, gambling, alcohol, pork. - *Investment approach that applies norms-based exclusions: Investment approach that excludes investments on the basis of not complying with international standards of conduct, for example, the UN Human Rights Declaration.* - *Investment approach that applies exclusions on the basis of poor sustainability: Investment approach that excludes investments on the basis of sustainability considerations, for example, fossil fuel companies.* - *Investment approach that applies exclusions on the basis of ESG assessment: An investment approach that excludes the worst performing companies relative to peers on the basis of ESG assessment, for example, on the basis of ESG ratings.* *Other terms used to refer to exclusions may include "exclusionary approaches", "negative screens", "screens". Unlike the term "divestment", which involves selling ownership of something, exclusions refer to the strategy having not invested in something from the start.* *Exclusions determine that a fund or mandate does NOT invest in certain things. It does not constitute an approach that is characterised by proactively allocating capital to specific assets.* *It may involve excluding investments from a certain sector or investments that derive a portion of their income from the sale of certain specified products.* *Exclusions may be applied at both a firm and a fund level.* *<u>Firm Level</u>* *Exclusions that apply across the entire firm/group.* *<u>Fund Level</u>* *Exclusions that are specific to a particular investment approach e.g. to a fund or are set by a client in a particular mandate.* *-----* ***GSIA EQUIVALENTS:*** *[1]Negative/exclusionary screening: the exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria* *[2]Norms-based screening: screening of investments against minimum standards of business practice based on international norms*	

TERMINOLOGY	DEFINITION	SOURCE
Governance Issues	Issues relating to the governance of companies and other investee entities. In the listed equity context these include: board structure, size, diversity, skills and independence, executive pay, shareholder rights, stakeholder interaction, disclosure of information, business ethics, bribery and corruption, internal controls and risk management, and, in general, issues dealing with the relationship between a company's management, its board, its shareholders and its other stakeholders. This category may also include matters of business strategy, encompassing both the implications of business strategy for environmental and social issues, and how the strategy is to be implemented. In the unlisted asset classes governance issues also include matters of fund governance, such as the powers of Advisory Committees, valuation issues, fee structures, etc.	UN PRI
Green Bonds	Green bonds are broadly defined as fixed-income securities that raise capital for a project with specific environmental benefits. The majority of green bonds issued to date have raised money for renewable energy projects, energy efficiency measures, mass transit and water technology. Most green bonds have been either plain vanilla treasury-style retail bonds (with a fixed rate of interest and redeemable in full on maturity), or asset-backed securities tied to specific green infrastructure projects. TISA Note: Please refer to ICMA's *Green Bond Principles* for further information.	Swiss Sustainable Finance
Green Investing	Investment in businesses contributing to sustainable solutions in environmental topics including investments in renewable energy, energy efficiency, clean technology, low-carbon transportation infrastructure, water treatment and resource efficiency.	Swiss Sustainable Finance
Greenwashing	…refers to the practice of gaining an unfair competitive advantage by marketing a financial product as environment-friendly, when in fact basic environmental standards have not been met.	Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment. Published 18 June 2020 - Recitals

TERMINOLOGY	DEFINITION	SOURCE
Impact Investing	The Investment Association endorses the Global Impact Investing Network's (GIIN) definition of Impact Investments: "Investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return." ***Examples:*** - *Social bond fund: A fund that invests in bonds, whose funding is ring-fenced for projects or initiatives that have the intention to generate positive, measurable social and environmental impact alongside a financial return, for example, one or more of the Sustainable Development Goals (an "SDG fund").* - *Private impact investing: Investing directly in unlisted projects, companies or initiatives that have the intention to generate positive, measurable social and environmental impact alongside a financial return, for example, one or more of the Sustainable Developments Goals (an "SDG fund") .* - *SDG Impact Funds: Funds where impact is measured with respect to the UN Sustainable Development Goals (SDGs). This can be achieved, for example, through listed equities, a social bond fund or private impact investing.* *According to GIIN, "there are four key elements:* - *Intentionality: Impact investments intentionally contribute to social and environmental solutions. This differentiates them from other strategies such as ESG investing, Responsible Investing, and screening strategies.* - *Financial Returns: Impact investments seek a financial return on capital that can range from below market rate to risk-adjusted market rate. This distinguishes them from philanthropy.* - *Range of Asset Classes: Impact investments can be made across asset classes.* - *Impact Measurement: A hallmark of impact investing is the commitment of the investor to measure and report the social and environmental performance of underlying investments."* *The Investment Association reserves the right to review its alignment with the GIIN at any time, as and when its membership deems it appropriate.* *https://thegiin.org/assets/Core%20Characteristics_webfile.pdf*	Glossary to the Investment Association's Responsible Investment Framework GIIN Impact Investing Guide

TERMINOLOGY	DEFINITION	SOURCE
	----- **GSIA EQUIVALENT:** "IMPACT/COMMUNITY INVESTING: targeted investments aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose"	
Materiality	In the sustainability context, information is material if there is a clear link to the financial performance of a company.	Swiss Sustainable Finance
Norms based screening	Screening of investments against minimum standards of business practice based on international norms. Norms-based screening involves either: - defining the investment universe based on investees' performance on international norms related to responsible investment/ESG issues, or - excluding investees from portfolios after investment if they are found following research, and sometimes engagement, to contravene these norms. Such norms include but are not limited to the UN Global Compact Principles, the Universal Declaration of Human Rights, International Labour Organization standards, the United Nations Convention Against Corruption and the OECD Guidelines for Multinational Enterprises.	UN PRI
Positive Tilt	A portfolio that overweights investments that fulfil certain sustainability criteria and/or deliver on a specific and measurable sustainability outcome(s), relative to a benchmark (e.g. FTSE 100, S&P 500), for example, half the carbon intensity of the benchmark.	Glossary to the Investment Association's Responsible Investment Framework
PRI *UN Principles for Responsible Investment*	The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance issues and to support signatories in integrating these issues into investment and ownership decisions. The six Principles were developed by investors and are supported by the UN. They have more than 2,000 signatories from over 60 countries representing over US$80 trillion of assets.	"Principals for Sustainable Investment: An investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact" (https://www.unpri.org/download?ac=10948)

TERMINOLOGY	DEFINITION	SOURCE
Private Impact Investing	Investing directly in unlisted projects, companies or initiatives that have the intention to generate positive, measurable social and environmental impact alongside a financial return, for example, one or more of the Sustainable Developments Goals.	Glossary to the Investment Association's Responsible Investment Framework
(Proxy) Voting and Shareholder Resolutions	Voting refers to voting on management and/or shareholder resolutions as well as filing shareholder resolutions.	UN PRI
Research Provider/Rating Provider	Organisation providing research and/or ratings on the sustainability performance of companies, issuers, countries or sectors. Most investors and asset managers use such third-party information when preparing sustainable investment products.	Swiss Sustainable Finance
Responsible Investment	Approach to managing assets that sees investors include environmental, social and governance (ESG) factors in: - their decisions about what to invest in; - the role they play as owners and creditors. It aims to combine better risk management with improved portfolio returns, and to reflect investor and beneficiary values in an investment strategy. It complements traditional financial analysis and portfolio construction techniques. Consideration of the impact of material factors, such as ESG considerations, on financial risk and return. *Note: Responsible investment does have similarities with investment approaches such as impact investing, sustainable investment and green investment. While these approaches seek to combine financial return with a moral or ethical return, responsible investment's sole purpose is financial return, arguing that to ignore ESG criteria is to ignore risks and opportunities that have a material effect on the returns delivered to clients and beneficiaries.*	UN PRI British Standards Institute (PAS7340)
Screening	A method to narrow down potential investments based on criteria. Screening can be: a. Negative/exclusionary screening: The exclusion from a fund or portfolio of certain sectors, companies or practices based	TISA introductory text but detail from UN PRI

TERMINOLOGY	DEFINITION	SOURCE
	on specific ESG criteria; b. Positive/best-in-class screening: Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers; c. Norms-based screening: Screening of investments against minimum standards of business practice based on international norms. Norms-based screening involves either: - defining the investment universe based on investees' performance on international norms related to responsible investment/ESG issues, or - excluding investees from portfolios after investment if they are found following research, and sometimes engagement, to contravene these norms. Such norms include but are not limited to the UN Global Compact Principles, the Universal Declaration of Human Rights, International Labour Organization standards, the United Nations Convention Against Corruption and the OECD Guidelines for Multinational Enterprises.	
SDG impact fund	Funds where impact is measured with respect to the UN Sustainable Development Goals (SDGs). This can be achieved, for example, through listed equities, a social bond fund or private impact investing.	Glossary to the Investment Association's Responsible Investment Framework
Sin Stocks	A sin stock refers to a publicly traded company that is either involved in or associated with an activity that is considered to be unethical or immoral. Sin stocks are generally frowned upon because they are perceived as making money from exploiting human weaknesses and frailties. Sin stock sectors usually include alcohol, tobacco, gambling, sex-related industries and weapons manufacturers.	Investopedia
Social Bond Fund	A fund that invests in bonds, whose funding is ring-fenced for projects or initiatives that have the intention to generate positive, measurable social and environmental impact alongside a financial return, for example, one or more of the Sustainable Development Goals. TISA Note: Please also refer to ICMA's *Social Bond Principles*.	Glossary to the Investment Association's Responsible Investment Framework
Social Issues	Issues relating to the rights, well-being and interests of people and communities. These include: human rights, labour standards in the supply chain, child, slave and bonded labour, workplace health and safety, freedom of association and freedom of expression, human capital management and employee relations; diversity; relations	UN PRI

TERMINOLOGY	DEFINITION	SOURCE
	with local communities, activities in conflict zones, health and access to medicine, HIV/AIDS, consumer protection; and controversial weapons.	
Socially Responsible Investing	Socially Responsible Investing (SRI) is the term historically used for sustainable or responsible investing. Originally it referred to investments based on exclusionary screening and was more associated with ethical or value related approaches. Some players still use it as a generic term for sustainable investing but will be phased out over time.	Swiss Sustainable Finance amended
Stewardship	Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society. *Explanatory Note: Stewardship is shown on both a firm level and a fund level to reflect that, whilst firms will adopt their approach to Stewardship at a firm level, stewardship activities will differ across funds, asset classes and geographies.*	FRC 2020 Stewardship Code with explanatory note from the Investment Association's Responsible Investment Framework
Stranded Assets	Carbon Tracker introduced the concept of stranded assets to get people thinking about the implications of not adjusting investment in line with the emissions trajectories required to limit global warming. Stranded assets are now generally accepted to be those assets that at some time prior to the end of their economic life (as assumed at the investment decision point), are no longer able to earn an economic return (i.e. meet the company's internal rate of return), as a result of changes associated with the transition to a low-carbon economy (lower than anticipated demand / prices). Or, in simple terms, assets that turn out to be worth less than expected as a result of changes associated with the energy transition.	Carbon Tracker https://carbontracker.org/resources/terms-list/
Sustainability	Meeting the needs of the present without compromising the ability of future generations to meet theirs.	Our Common Future, Brundtland Report 1987 (chapter 2 paragraph 1)
Sustainability factors	Environmental, social and employee matters, respect for human	Regulation of the European Parliament and of the Council

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	rights, anti-corruption and anti-bribery matters.	of 27 November 2019 on sustainability-related disclosures in the financial services sector (SFDR or the 'disclosure regulation')
Sustainability Focus	Investment approaches that select and include investments on the basis of their fulfilling certain sustainability criteria and/or delivering on specific and measurable sustainability outcome(s). Investments are chosen on the basis of their economic activities (what they produce/what services they deliver) and on their business conduct (how they deliver their products and services). ***Examples:*** - *Sustainability Themed Investing[1]:* - *Best in Class[2]:* - *Positive Tilt:* ***Explanatory Note:*** *Adopting a Best in Class approach can mean having exposure to companies from sectors that may not typically be considered "sustainable". A Positive Tilt approach may also mean this. A Positive Tilt is typified by having less exposure to these kinds of companies than a traditional benchmark (e.g. FTSE 100, S&P 500).* **-----** **GSIA EQUIVALENTS:** [1] Sustainability themed investing: investment in themes or assets specifically related to sustainability (for example clean energy, green technology or sustainable agriculture); [2] Positive/best-in-class screening: investment in sectors, companies or projects selected for positive ESG performance relative to industry peers.	Glossary to the Investment Association's Responsible Investment Framework
Sustainability preferences	A client's or potential client's choice as to whether either of the following financial instruments should be integrated into his or her investment strategy:	Commission Delegated Regulation amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability

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	(a) sustainable investment; (b) a financial instrument that promotes environmental or social characteristics as referred to in Article 8 of Regulation (EU) 2019/2088 ('SFDR' or the 'Disclosure Regulation') and that either: (i) pursues, among others, sustainable investments; or (ii) as of 30 December 2022, considers principal adverse impacts on sustainability factors, as referred to in Article 7(1), point (a), of that Regulation;	factors, risks and preferences into certain organisational requirements and operating conditions for investment firms. - Article 1: definitions
Sustainability Related Exclusion	Investment approach that applies exclusions on the basis of poor sustainability: Investment approach that excludes investments on the basis of sustainability considerations, for example, fossil fuel companies.	Glossary to the Investment Association's Responsible Investment Framework
Sustainability risk	An environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment	Regulation of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (SFDR or the 'Disclosure regulation')
Sustainability Themed Investing	An investment approach that specifies investments on the basis of a sustainability theme/themes, examples might include climate change mitigation, pollution prevention, sustainability solutions and approaches that address one or more of the UN Sustainable Development Goals (SDGs). Investment in themes or assets specifically related to sustainability (for example clean energy, green technology or sustainable agriculture).	Glossary to the Investment Association's Responsible Investment Framework Global Sustainable Investment Alliance
Sustainable Development Goals	**17 Goals for People, for Planet:** The Sustainable Development Goals are a universal call to action to end poverty, protect the planet and improve the lives and prospects of everyone, everywhere. The 17 Goals were adopted by all UN Member States in 2015, as part of the 2030 Agenda for Sustainable Development which set out a 15-year plan to achieve the Goals.	UN SDG https://www.un.org/sustainabledevelopment/development-agenda/

TERMINOLOGY	DEFINITION	SOURCE
Sustainable Finance/ Sustainable & Responsible Investment (SRI)	The process of taking due account of environmental and social considerations in investment decision-making, leading to increased investments in longer-term and sustainable activities. More specifically, environmental considerations refer to climate change mitigation and adaptation, as well as the environment more broadly and related risks (e.g. natural disasters). Social considerations may refer to issues of inequality, inclusiveness, labour relations, investment in human capital and communities. Environmental and social considerations are often intertwined, as especially climate change can exacerbate existing systems of inequality. The governance of public and private institutions, including management structures, employee relations and executive remuneration, plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process.	Action Plan: Financing Sustainable Growth. Published 8 March 2018
Sustainable Investments	An investment in an economic activity that: contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance; *Note separate definition of Environmentally Sustainable Investments in EU Taxonomy Regulation ('an investment in one or several economic activities that qualify as environmentally sustainable under this Regulation').*	Regulation of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (SFDR or the 'Disclosure regulation') - Article 2: definitions Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment. Published 18 June 2020