TISA

Response by TISA to Consultation Paper 24/8

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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 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 240-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.

TISA Response to Consultation Paper 24/8
Extending the Sustainability Disclosure Requirements (SDR) regime to Portfolio Management

TISA welcomes this Consultation.

As we wrote in our response to CP22/20

"TISA's objectives are to enable customers to see where their money is invested, in a clear and comparable way, both before they invest and while they are invested.

Customers should be able to easily assess, before they purchase a product, its sustainability and other objectives, including its intentionality, and how it has performed, whether it is a traditional collective fund, open or closed-ended, **managed or discretionary portfolio**, whether within or without a pension." Emphasis added.

Therefore, this response focusses on the practicalities, including timing, of implementing, or amending the proposals, particularly in respect of discretionary/bespoke portfolios, where we believe further consultation is needed.

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

Yes, we agree with the proposed scope for the application of SDR to portfolio management services. By not including clients that are outside the UK, funds, AIFMs and Manco's it will alleviate some of the issues encountered under SFDR in relation to segregated mandates with professional clients particularly those that are also subject to SFDR (e.g. sub-advisory agreements). Specifically, there will be the removal of the disconnect between the labels applied via the IMA and that from the client (e.g. fund manager) to their underlying client. This explicit carve out also removes the potential duplication of disclosure requirements.

Since SDR is primarily focused at retail clients, we think that it is correct that portfolio management services offered to professional clients are deemed to be an opt-in regime. However, we note that there is likely to be some demand from professional clients, such as trustees of pensions funds and of funds managed for charities, such as churches or similar.

But, we also note that the inclusion of discretionary bespoke portfolios raises a number of difficult issues for those firms offering these services to clients, such as charities and pensions schemes, which may be attracted to having a label.

Delivering reporting at an individual portfolio level against sustainability etc. key performance indicators (KPIs) will be a significant requirement. One option might be for the FCA to consider reporting at the strategy level rather than at the individual portfolio level. The inclusion of bespoke discretionary portfolios within the SDRs may well result in fewer discretionary managers offering portfolios which fall under the naming and marketing rules, let alone the labels, given the onerous requirements to report at a portfolio level. This would not meet the secondary outcomes of increased provision of sustainable investment products and increased capital flows into sustainable activities.

Wealth managers are broadly in favour of the inclusion of model portfolios within the scope but not necessarily customised portfolios and/or bespoke portfolio management services. This is because for customised/bespoke portfolios, a standard disclosure regime does not fit in with a bespoke service tailored for individual requirements. The disclosures required for bespoke discretionary should follow the existing client journey which has been carefully designed to protect clients. For example, the SDR's consumer facing disclosures and the pre-contractual disclosures are not appropriate where the details of the clients' requirements may not be ascertained until the opening Suitability Report is issued following the account opening.

It would be preferable for:

- the relevant SDR disclosures to be adapted into the existing Suitability Report which can then set out the interaction of the sustainability objectives of the portfolio with suitability criteria;
- the annual Sustainability Product Report disclosures could then be included in the annual Suitability Report.

We consider that the exact operation of the SDR disclosure regime for bespoke services could be achieved by adapting the relevant existing suitability rules (e.g. in COBS 4 and COBS 9A). This would provide the option of bespoke portfolio management services to opt-in and apply a label should they meet the criteria

Evidence from the market is that some discretionary customers – trustees of charities, pension schemes, etc - are interested in labels, so we expect firms to wish to meet their requirements, but many members in this part of the market are concerned that any regulations to enable them to meet customers' needs will be unduly onerous.

We are concerned that bespoke portfolio services, with no explicit positive sustainability objective, are captured under the marketing rules and requirements for non-labelled services.

Therefore, we recommend that the FCA consult further with discretionary and institutional portfolio managers on these proposals.

In the meantime, we urge the FCA to finalise the rules applicable to MPS and CIPs as quickly as possible, i.e. those services with the explicit intention of pursuing positive sustainability objectives. We think this is possible, provided it is clarified in the final rules that these services provide suitable portfolio solutions targeted at specific risk thresholds. We also recommend that Advisory Managed services and those provided to Professional clients also be included in the extended rules

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

Members were concerned that there would be insufficient time from the publication of the final Policy Statement to 2nd December, 2024 and requested that implementation be deferred to a year after the final Policy Statement following this consultation.

This will enable firms to properly prepare having seen the final Policy Statement. The proposals contained within the current CP, have changed significantly from the proposals included in CP22/20. Whilst wealth managers could have already prepared in advance in anticipation of the extension of SDR to portfolio management services, any preparations they would have made would still require material changes due to the significant changes from the previous proposal.

Similarly for the ongoing product-level disclosures and entity-level disclosures, we would request these dates be pushed back, in line with response above.

Any extension of the regime to bespoke discretionary management should incorporate the required sustainability related disclosures into the existing client journey. A separate consultation with the industry is required to address the complexities involved, including the suitability process, potential significant additional disclosure and costs and needs of retail clients. There is a need to clearly distinguish between services which pursue explicit positive sustainability objectives and those which apply a responsible investment approach using sustainability characteristics as part of their standard discretionary portfolio service. Similarly, we recommend a minimum 12 month implementation period from the time of publication of final rules.

Question 3: Do you agree with our approach to labelling portfolios, including the threshold and assessment requirements?
If not, what alternatives do you suggest and why?

Yes, we support the approach. There should be a level of consistency applied across SDR in respect of the thresholds used to achieve labelled status. We welcome the change from the previous consultation (CP22/20) which required a much higher 90% or more of the value of all constituent products which they invest qualify for the same label. In our previous response, we highlighted that the proposed threshold of 90% or more of the value of all constituent products qualifying for any label coupled with the requirement that these products align to one label will be very difficult to achieve while also trying to construct a well-diversified portfolio. Setting the threshold this high could lead to unintended consequence of model portfolios being too concentrated on a small subset of products/companies.

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Entity level disclosures

We recommend that the SDR requirements are not extended to portfolio management services in respect of sustainable entity reports.
TCFD entity reports are already required by portfolio managers in scope. We do not think they will be useful for retail investors and should be excluded.

Threshold criteria – fund of funds clarification

The consultation paper provides some clarity around the investment policy and strategy application to portfolio managers (para 3.23, Table 1). In particular, whilst some funds have sustainability labels, the requirement that the portfolio manager is responsible for ensuring the assets are in accordance with the labelling criteria and absolute measures of sustainability are used in relation to the portfolio's sustainability objective. However, this effectively puts the onus on the portfolio manager to perform their assessment of a fund's underlying assets on a look through basis. Portfolio managers, especially those providing bespoke and model portfolio services, select suitable investments from a wide range of both direct securities and significantly from collective fund instruments with sustainability characteristics. We urge the FCA to clarify in their final rules, areas where managers can rely on the due diligence already performed by fund manufacturers and circumstance where they can use these to meet the absolute criteria for relevant assets and funds to include in the portfolio to avoid duplication and unnecessary additional costs. In particular, where funds have explicit sustainability objectives, such as an SDR labelled UK fund or Article 8 or9 EU fund, and equivalent when extended to model portfolio services, these could be used by a portfolio manager and treated as part of the assets making up the 70% threshold minimum criteria when constructing the portfolio.

Furthermore, clarification is needed in circumstances where, for example, unforeseen market movements or other underlying criteria such as a KPI change (e.g. ESG score), mean that the assets fall temporarily below the minimum 70% threshold label criteria. Would there be safe haven or allowance for portfolio allocation to realign with the minimum threshold within say 6 months?

Question 4: Do you agree with our approach to naming and marketing?
If not, what alternative approach would you suggest and why?

Yes, we support the FCA's approach. We agree with the proportionality approach to the disapplication of the naming and marketing rules to professional clients. Professional clients have a higher level of knowledge and sophistication when it comes to making investment decision-making. Therefore, feels appropriate that the scope for this part of SDR is narrower. Any marketing of portfolio management services to professional clients will still be governed by the anti-greenwashing requirements.

Question 5: Do you agree with our proposed approach to disclosures, including the tiered structure?
If not, what alternative do you suggest and why?

Yes, we support this approach for model portfolios, centralised propositions, but where bespoke advisory or discretionary portfolios are concerned, the consumer facing disclosure document is going to be almost unique to each client, as it is not a product, but a service led by their needs and preferences. As such, it might not be obvious to a client that the content of a standalone document is actually contractual.

Moreover, in the case of bespoke services that are unique to each individual client, it is difficult to see how a pre-contractual disclosure can be made, beyond giving examples of what a client may wish to consider and confirming that the exact parameters will be covered in an agreement with them. We consider this a better approach that removing bespoke services from the SDR and Labelling regime altogether, at this point (and subject to separate consultation as noted above in question 1).

Question 6: Do you agree with our proposals for distributors?
If not, what alternatives do you suggest and why?

Yes, we agree with these proposals

Question 7: Do you agree with the proposed cost-benefit analysis set out in Annex 2.
If not, we welcome feedback in relation to the one-off and ongoing costs you expect to incur and the potential benefits you envisage.

We agree with the FCA's comment (Annex 2 Paragraph 28)

"Without the interventions proposed in this CP, firms providing portfolio management services cannot use sustainable investment labels for their portfolios and we assume they do not voluntarily produce the consumer-facing, detailed product and entity- level disclosures that are required under the wider SDR regime. There may be less incentive for firms to voluntarily produce disclosures without being able to benefit from the credibility of using a label."

We commend the FCA for the detail.

We comment that although the FCA uses the Government discount rate for costs and revenues of 3.5%, commercial businesses generally use much higher discount rates. Moreover, the FCA has not attempted to provide any costed benefits from its proposals.

The cost-benefit analysis also **does not include any additional sustainability / responsible investment resource** in the first, second or third lines. The requirements around SDR will increase the resource and expertise requirements, particularly in meeting the independent verification requirements. Additionally, as this matures it is likely that firms will seek external assurance which will increase costs further. Responsible and sustainable investment teams are being morphed into quasi-compliance units as this is where the SMEs sit. Whilst compliance and risk functions are building expertise, as much of the work related to regulations such as SDR rests with the first line, the resource gap is becoming wider. For large institutional firms this may be less of an issue, but for the wealth management industry, as they do not have the same scale of responsible and sustainable investment infrastructure, it will be an issue.

Overall, we consider that firms will wish to take advantage of the benefits to their clients and that firms that do so will benefit from this. It will make the UK more attractive, but we wish the FCA had tried to estimate (what we believe are) the benefits of these proposals.