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Mr. Gwil Mason
Financial Conduct Authority
12 Endeavour Square
London E20 1JN
United Kingdom

Submitted via email to: dp21-04@fca.org.uk

Re: Discussion Paper ("DP21-04") on Sustainability Disclosure Requirements and investment labels

Dear Mr. Mason,

State Street Global Advisors ("SSGA")[1] appreciates the opportunity to provide feedback on the consultation paper issued by the Financial Conduct Authority ("FCA") regarding 'Sustainability Disclosure Requirements ("SDR") and investment labels'.[2]

We agree that financial services and markets have an important role to play in the transition to a more sustainable future.[3] SSGA has a long-standing and prominent commitment to addressing the impact of climate change on investors. For example, we joined the Net Zero Asset Managers' Initiative and support its goal of achieving net zero greenhouse gas ("GHG") emissions by 2050 or sooner.

At the Corporation level, State Street has been highly supportive of the UK government's net zero ambition, attending the UN Climate Change COP26 in Glasgow,[4] and leading the *Asset Manager and Asset Owner Task Force* under the Sustainable Markets Initiative.[5]

[1] SSGA is the investment arm of State Street Corporation. With $3.9 trillion in assets under management,* SSGA is one of the largest asset managers in the world. For more information, please visit SSGA's website at www.ssga.com. In the UK, SSGA has been operating in London since 1990 and ranks as a major investment manager in the UK. SSGA has a diverse client base including pension funds, insurance companies, official institutions, foundations, charities, local authorities, family offices and intermediaries. Our London office manages a broad range of products and acts as the European trading desk for SSGA's offices around the world.
* as of September 30, 2021 and includes approximately $60 billion of assets with respect to SPDR® products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.
[2] https://www.fca.org.uk/publication/discussion/dp21-4.pdf
[3] FCA DP 21-4, pg. 4
[4] COP26 Takeaways | State Street Corporation
[5] G7 Press Release 11062021 | Sustainable Markets Initiative (sustainable-markets.org) // https://www.sustainable-markets.org/taskforces/asset-manager-and-asset-owner-taskforce

Overall, SSGA supports the FCA's ambition and work to introduce transparency across the investment chain.

With respect to investment fund disclosure and labelling/ classification, we have identified several important considerations for the FCA below. More detailed comments to the specific questions in the discussion paper immediately follow.

Considerations for FCA rules on the UK SDR and investment labels

- **International coordination essential to avoid regulatory fragmentation**

With the rapid development of both mandatory and 'voluntary' sustainability-related frameworks worldwide, there is growing need to ensure harmonisation and consistency in investment product regulation. Global investment managers, such as SSGA, which operate and market products/funds into multiple jurisdictions face particular challenges where governments and supervisors adopt inconsistent approaches.

We appreciate the focus throughout the discussion paper on aligning the FCA's approach with existing regulatory regimes, such as the EU Sustainable Finance Disclosure Regime ("SFDR"), in addition to recommendations by the Task Force on Climate-related Disclosures ("TCFD"). Firms and products subject to the future UK SDR and labelling will have expended significant cost and resource to implement these frameworks, and this includes classification and product disclosure. Inconsistent regulatory requirements (*e.g.*, different terminology, metrics, measurement methodologies) could result in investment managers and products being subject to inconsistent disclosures and/or classifications. We believe that this would exacerbate the risk of "misleading ESG-related claims by products and providers".[6]

The FCA should continue to promote harmonisation and consistency at the international level, and we applaud its work in fora such as the International Sustainable Finance Network within the International Organization of Securities Commissions ("IOSCO").

- **A practical approach to sequencing mandatory requirements**

Although we recognise and support investor need for sustainability disclosures by investment funds and acknowledge the FCA's important objective to mitigate the potential risk of 'green-washing', integrating sustainability considerations into the investment process depends upon access to clear, consistent, comparable and

[6] DP 21-4, introductory remarks.

decision-useful sustainability data from and on the companies in which we invest. This is essential to allow for better sustainability assessments at the portfolio level.

Such data is essential to enable investment managers, for example, to execute stewardship duties by identifying and engaging with companies' boards on emerging risks—an approach that is particularly relevant for index strategies—in addition to meeting growing investor/asset owner demand to understand sustainability risks posed to their investments, amongst other things. For large index investment managers, such as SSGA, the availability of data sufficient to meet stewardship duties is particularly important. As a near-permanent holder of capital (on behalf of funds and clients for which we act) in many companies, divestment is not an option. Stewardship, including both engagement with portfolio company management and proxy voting, is a critical tool governing the ongoing dialogue between investors and investee companies.

However, companies/issuers are not currently providing sufficient information on sustainability-related risks and opportunities. We appreciate that HM Treasury and the UK FCA have sought to address this more recently with the TCFD-aligned mandatory climate-related disclosures across the investment chain. However, meaningful investment product/fund classification, and the associated transparency, will be challenging in the absence of a completed UK Taxonomy, given the discussion paper makes several references to using the underlying screening criteria, as means of measuring the degree of a product's alignment to the proposed sustainable categories. At present, investment managers are, increasingly, reliant on obtaining data through third party data providers. We therefore support the FCA's consideration as regards the role of other market participants—such as index providers, intermediaries and sustainability-related data providers—and how they can facilitate the flow of sustainability-related information along the investment chain.

- **Balancing consumer protection and broader 'net zero' objectives**

There is a possible tension in advancing the UK government's net zero commitments by encouraging investment in a new 'greener' economy whilst at the same time seeking to protect consumers from so-called greenwashing or "misleading ESG-related claims".[7] These are equally laudable objectives, but an initial focus on investment product classifications/labels and retail investor protection could, inadvertently, direct capital flows in such a way that discourages the longer-term aim of investing in the net zero transition.

In particular, the proposed labelling system could be interpreted as a hierarchicisation of investment products/funds, ranking those that would fall under the 'sustainable' banner above all others. Restrictive labelling and disclosure requirements could incentivise portfolio allocation away from high carbon-emitting

[7] FCA DP 21-4, introductory remarks.

companies and sectors (*e.g.*, cement production and fertilisers), to those companies and sectors with lower carbon emissions (*e.g.*, computer software) – without due consideration of economic relevance and transition financing needs.

- **A risk management approach to sustainable products**

From a risk management perspective, there are important considerations, especially with respect to sustainability-related portfolio level composition criteria and impact on investment product risks.

It is essential that any sustainable investment categories and criteria underpinning the future UK taxonomy be well-defined and sufficiently holistic to ensure investors clearly understand these in the context of the overall risk / reward objectives of the investment product. This is especially relevant where sustainable products are more concentrated, less liquid, display materially higher absolute returns volatility, or relative tracking error against broad-based indices that are widely considered as standard benchmarks for investment product returns and risk exposures.

In particular, the imposition of quantifiable and measurables thresholds would not be appropriate should that interfere with investment managers' fiduciary obligation to their clients – that is, maximising returns in accordance with the relevant investment guidelines whilst mitigating risk.

<u>Discussion paper questions</u>

Q1: What are your views on the tiered approach set out in Figure 2? We welcome views on any concerns and/or practical challenges.

The FCA's aim to "reflect a consistent approach throughout the design, delivery and disclosure of sustainable investment products" is welcome but should not be developed in isolation from regulatory requirements evolving in and outside of the UK. Sustainability-related investment product disclosures have been introduced in the EU and parts of the Asia Pacific region, while the U.S. Securities and Exchange Commission is currently exploring whether to enhance existing product disclosures.[8] Harmonisation and consistency will be essential for firms, such as SSGA, which operate and market investment products/funds across borders. The FCA must also consider the appropriate sequencing of investment managers' obligations alongside other relevant initiatives, including the FCA's climate-related policy statement for issuers/corporates, as mentioned, as well as the to-be developed UK Taxonomy by HM Treasury. We believe that these measures would need to be largely embedded into the UK regulatory framework prior to introducing

[8] https://www.sec.gov/news/speech/gensler-pri-2021-07-28

the UK SDR and investment labels for asset management because, given the need for access to clear, consistent, comparable and reliable sustainability data.

More specifically, we do not agree with the FCA proposal to introduce a tiered approach that promotes five broad product labels, supplemented by dual detailed underlying disclosures that are geared at consumers and institutional investor/other stakeholders, respectively. First, the five broad labels reduce sustainable investing into 'niche' categories/classifications and do not accurately reflect the nuanced world of sustainable investing, in our view. Such niche categories could impede investment managers' and other market participants' ability to steer necessary capital flows in line with net zero commitment. For example, as mentioned the proposed categorisations could result in reduced investment in transitioning companies, which would, in turn, impact the UK government's own climate transition plans. We recommend that the FCA instead only focuses on introducing detailed product-related disclosures, which should align with the principles laid down in the EU SFDR.

Second, with respect to dual, or bifurcated, detailed underlying disclosures aimed at retail (or end-consumers) and institutional investors, respectively, we recognise that there are varying levels of understanding and information needs amongst different investor groups. However, we do not believe that it is appropriate to bifurcate consumer and institutional investor product-related information. In our view, all investors should be on a 'level-playing field' and so the FCA should ensure uniform access to a products' sustainability-related information.

That said, it may be necessary and beneficial to increase investor literacy with respect to sustainable investing. As such, the FCA may deem it useful to establish a public glossary of sustainable investing terminology, for which investment managers could signpost as part of these proposals. It would also be helpful to liaise with other regulators to ensure global applicability of any such glossary.

Q2: Which firms and products should be in scope of requirements for labels and disclosures? We particularly welcome views on whether labels would be more appropriate for certain types of product than for others, please provide examples.

Subject to our above comments on potential unintended consequences of the five proposed overarching product labels, we welcome the FCA's consideration as to which firms and/or products should be in scope of UK requirements for product-specific sustainability-related disclosure requirements, and agree that there are certain types of products where this may not be feasible to do so. These include:

- **Segregated mandates**

  The FCA is right to question the applicability to segregated mandates given investment restrictions and guidelines are negotiated and tailored in collaboration with the client based on their specified investment preferences. We believe that segregated mandates should be excluded from the perspective of proactive disclosure on behalf of the investment manager.

However, if a client decides to include the segregated mandate in a relevant product wrapper, then it would be the client's responsibility to determine the appropriate classification. In such instances, we would not be opposed to providing standardised reporting to that client in order to support their regulatory reporting obligations. Standardisation in this respect is important in view of the practical challenges that investment managers experience in implementing the EU SFDR when applying the regime to a large number of tailored products with nuanced differences in their investment strategy, characters, and features.

- **Overseas funds and delegated portfolio management**

As the discussion paper acknowledges, many investment managers will already be subject to the EU SFDR and have undertaken significant implementation work to categorise existing funds and comply with product disclosure requirements. For global investment managers, consistency in regulatory and supervisory approaches to sustainable investing is crucial. We are concerned that inconsistent approaches could result in the same investment product/fund being allocated inconsistent classifications and/or labels. The FCA could consider some form of 'passporting' or equivalency where a fund is already subject to a comparable regime, e.g., the EU SFDR, to avoid such inconsistency.

In addition, we do not believe that it is necessary to apply the regime to delegated portfolio management where a product is not domiciled in the UK or marketed and/or targeted at investors in the UK. Furthermore, intragroup delegation of portfolio management should be excluded from the regime, as this would impose unnecessary compliance and operational costs for seemingly no clear transparency-related benefit.

- **Index-based investment strategies**

For index investment products, we believe the FCA should adopt flexibility given investment managers have limited input with respect to the methodology or standards applied by index providers. The FCA should encourage increased transparency in this regard, which we discuss further in response to Q18.

Furthermore, as mentioned, we believe the FCA should consider the appropriate sequencing of the SDR and investment labelling requirements against its broader work with the UK government to introduce climate-related disclosures across the investment chain. The ability for investment managers to meet the expectations of these proposals depends, largely, upon access to improved sustainability-related information from and on the companies in which we invest on behalf of our clients.

Q3: Which aspects of these initiatives, or any others, would be particularly useful to consider (for example in defining terms such as responsible, sustainable and impact) and how best should we engage with them?

SSGA has been a strong proponent of better international regulatory coordination in the area of sustainable investing for some time. We had supported IOSCO's recommendations on sustainability practices, policies, procedures and disclosures in asset management[9], which strive for consistency with well-established international frameworks, including the TCFD framework. The FCA should seek alignment with those existing international frameworks.

It will be important to consider how the FCA can achieve consistency across a range of regulatory frameworks, not only international initiatives but also, for example, the EU SFDR. Above all else, the FCA should avoid 'cherry-picking' elements from existing frameworks in such a way that would create an entirely new framework. This would be the least optimal outcome given the urgent need to harmonise the myriad diverse regimes that are already in existence.

Furthermore, imprecise and vague terminology is generally unhelpful and can lead to misleading claims. We encourage the FCA to consider the adoption of clear and consistent definitions in relation to terms such as 'sustainable' and 'responsible'. Inconsistent terminology has been an ongoing challenge in sustainable investing and is exacerbated when regulatory requirements refer to sustainability-related terminology without clear definition. For example, terminology such as "sustainable investment" or "good governance", which were introduced in the EU SFDR, are notable examples of this issue, since there is no common regulatory or industry standard by which investment managers can establish a consistent approach.

Moreover, combining the terms 'sustainable' and 'responsible' with 'investment', in an arbitrary way, could be misleading to an investor. We fully share the FCA's ambition to incentivise investment in sustainable products/funds, and we are seeing increased client demand in this regard. At the same time, investors are interested in the economic fundamentals of an investment, so the proposed labelling or classification must not imply more than is intended.

Q4: Do you agree with the labelling and classification system set out in Figure 3, including the design principles we have considered and mapping to SFDR? We welcome views on further considerations and/or challenges.

As mentioned, sustainable investing is highly nuanced, and we believe it would be extremely difficult to categorise investment products/funds into the five proposed product labels. Figure 3 could imply a hierarchy that ranks 'impact' and 'aligned'

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[9] See SSGA response to IOSCO's consultative report, here.

product categories down to 'not promoted as responsible'. We are concerned that incentivising portfolio allocation away from high carbon-emitting companies and sectors, to those associated with lower carbon emissions, would make it more challenging for companies to obtain financing necessary to adapt their businesses in line with the net zero transition. Given the potential impact on private capital flows, the proposed labelling regime may risk creating market distortions with 'greener' assets trading on markets at a premium to intrinsic value, and 'browner' assets trading at a discount.

Nevertheless, we understand the FCA also has a policy objective to help retail investors navigate sustainable investment products. Therefore, should the FCA proceed with introducing product labels, we believe it would be important to make clear that they are not weighted in any particular order. In fact, we believe that it will be more important, at least initially, for investments to be made in 'transitioning' products/funds, in order to accelerate the net zero transition.

The initial mapping of the proposals to SFDR is helpful as alignment between the EU and future UK frameworks will be essential, to avoid disruption and confusion amongst investors where investment firms and products are already subject to the EU regime. We appreciate the FCA intends to provide further specificity in due course, but a threshold question is whether the UK SDR and investment labelling criteria will focus on climate change versus the full spectrum of sustainability issues. Although there is reference to broader sustainability issues, and the UK SDR intends to build upon recent climate-related TCFD-aligned disclosures, much of the discussion paper appears to be focused on climate change.

The mapping of the FCA's proposed 'sustainable-transitioning' and 'responsible' categories to Article 8 of the EU SFDR, in addition to the proposed 'aligned' and 'impact' categories to Article 9 of the EU SFDR, is inaccurate. This splits existing EU classifications into several sub-categories, which we do not believe would be a desirable outcome in view of the need for consistency. Moreover, Article 6 of the SFDR requires financial market participants to disclose how sustainability factors are taken into account in investment decisions; investment managers must either explain how this is done, or why it is not appropriate – this is not intended as a product category or classification in its own right. Under an ESG-integration strategy, for example, a portfolio manager may take sustainability factors into account when selecting an investment, but that does not, necessarily, mean the fund has an explicit sustainability goal or outcome. Yet, it would be misleading to automatically assign that investment product/fund a "not promoted as sustainable" label.

We also note that alignment to a future UK Taxonomy would focus the emphasis on the characteristics of single securities / investee companies in the portfolio, and that the proposed regime would look less favourably on strategies that look to improve environmental, social or governance characteristics across a broader investment universe at portfolio level. This includes index strategies where sustainability factors are considered in the construction of the index (also see comments in Q11). Companies are engaged in multiple business activities; some of which may be considered eligible under the future UK Taxonomy, while some will not be. By requiring investment managers to use the (to be developed) UK Taxonomy when allocating a sustainable investment label classification, we believe that it would be necessary for the FCA to specify some threshold for which investment managers can consider investee companies eligible for an 'aligned' portfolio – given we invest in the company, not in the specific aligned activity.

Moreover, as the UK government and financial supervisors move to encourage investments that meet certain 'green' criteria, to be defined the future UK taxonomy, there must be clear understanding of the risks associated with sustainable investing. The labelling or classification should not imply more than is intended, and the FCA should avoid terminology that gives the impression that the driver of investment performance is the nature of a business, rather than the financial fundamentals of that business and the price at which it is acquired. It is unclear how investors are to be protected from products labelled as either a 'responsible' or a 'sustainable', based on an incomplete taxonomy, and where the underlying assets may have been acquired at too high a price relative to the financial fundamentals. Investing in new and unproven technologies (although essential to accelerate the transition) is typically considered high risk. While investing in such instruments has a role to play in a portfolio, care should be taken to ensure that the labels (*e.g.*, "responsible") do not potentially misrepresent the level of risk associated with a product. See additional comments in Q6.

Q5: What are your views on 'entry-level' criteria, set at the relevant entity level, before products can be considered 'Responsible' or 'Sustainable'? We welcome views on what the potential criteria could be and whether a higher entity-level standard should be applied for 'Sustainable' products. We also welcome feedback on potential challenges with this approach.

Minimum entry level criteria at the relevant entity level, including matters relating to systems and controls, governance, ESG integration and stewardship, would seem to be a sensible approach, provided that the criteria are indeed "simple and intuitive". However, specifying a higher threshold entity-level standard for 'sustainable' products relative to 'responsible' products may introduce unnecessary complexity.

We agree that the FCA could leverage existing reporting frameworks to satisfy such criteria, though consideration is needed to ensure FCA-approved product classifications remain consistent where those frameworks are subject to substantial revision. With respect to evidencing adherence to such minimum entry level entity-level requirements, this information can be clearly displayed on the investment managers' company website.

With respect to the product-level classification definitions and minimum criteria, we agree with incorporating these into pre-contractual documents, provided that signposting to the company website and common group-wide or global information be permitted.

Finally, the FCA may want to consider how it can ensure the smooth and timely approval/authorisation of product classifications and disclosures given there would likely be a high volume when this discussion paper moves to policy in due course.

Q6: What do you consider to be the appropriate balance between principles and prescription in defining the criteria for sustainable product classification? We welcome examples of quantifiable, measurable thresholds and criteria.

Notwithstanding our recommendation to avoid the adoption of imprecise and vague terminology, a principles-based approach to sustainable investing is preferrable, as this would better support our collective ambition to accelerate sustainable investment.

Quantifiable, measurable thresholds and criteria may have a place in the UK SDR, but the FCA should be mindful of the significant task to obtain underlying data from investee companies, even when using proxies or estimates. The use of proxies or estimates could result in investment managers adopt to varied outcomes in a product's categorisation under the proposed labelling scheme, and while this could be explained as pat be explanation, it would likely Furthermore, such criteria may not have been considered in the design of the product's original investment strategy nor necessarily disclosed to existing investors. The ability of existing products to meet such thresholds is likely to be coincidental, and require significant effort to change this, potentially including shareholder vote. This is especially the case where investee companies are expected to fall outside the UK SDR and future taxonomy, and therefore we will have no option but to rely on imputed or proxy data. See Q8 for specific comments on such thresholds for 'transitioning' products/funds.

More importantly, as mentioned, well-defined and holistic sustainable investment categories and a supporting taxonomy framework is needed, to ensure that investors clearly understand these in the context of the overall risk / reward objectives of the investment product. This is especially relevant where sustainable products are more concentrated, less liquid, display much higher absolute returns volatility or relative tracking error against broad-based indices that are widely considered as standard benchmarks for investment product returns and risk exposures. The imposition of thresholds should not, in any event, interfere with investment managers' obligations to deliver on their fiduciary obligations to their clients – that is, maximising returns in accordance with the relevant investment guidelines whilst mitigating risk.

Finally, we reiterate our concerns regarding the appropriate sequencing of actions. In the absence of the UK Taxonomy and improved issuer disclosure, quantifiable, measurable thresholds and criteria at the portfolio/fund level will continue to be challenging. We urge the UK to prioritise implementation of those frameworks, which are important to enable meaningful investment product/fund categorisation and associated disclosure.

Q7: Do you agree with these high-level features of impact investing? If not, why not? Please explain, with reference to the following characteristics:

In addition to clarifying criteria underpinning the term 'impact investing' and whether such a label should only be used to categorise an investment that has a positive real world impact, it is not clear whether the proposed labelling scheme focuses on climate change as opposed to the broader spectrum of sustainability-related issues. It is worth highlighting that existing funds that would be expected to fall under the 'impact' category may be focused on areas other than climate change.

Q8: What are your views on our treatment of transitioning assets for:

> **a: the inclusion of a sub-category of 'Transitioning' funds under the 'Sustainable' label?**
>
> **b: possible minimum criteria, including minimum allocation thresholds, for 'Sustainable' funds in either sub-category?**

As mentioned, we fully agree that the UK regime should "avoid discouraging investment in economic activities and projects that are in the process of transitioning to being more sustainable in future", as "investment in [transitioning] products/funds is critical to supporting the broader sustainability goals such as the government's commitment to achieving net zero emissions by 2050".[10] We therefore believe the 'transitioning' category is highly important.

However, we question the appropriateness of requiring so-called transitioning products/funds to meet specified thresholds, or a minimum asset allocation for transitioning, as this could impede the continuing viability of such products/funds. In particular, as mentioned above in Q4, the FCA should refrain from establishing criteria to attain transitioning category status solely on basis of UK taxonomy alignment, even if this is a "low" degree of alignment.[11]

We refer to the response prepared by the UK Investment Association response ("UK IA"),[12] which discusses alternative options that such products/funds could,

[10] FCA DP 21-4, pg. 20 para 3.34
[11] FCA DP 21-4, pg. 20 para 3.33

possibly, use to measure their success at transitioning – though, the emphasis is on measuring success over a specified period of time.

The UK IA also raises an important point about potential negative connotations associated with the proposed naming conventions for the five product labels, as they appear to focus on the climate transition as opposed to broader sustainability matters that investors seek to promote. For this reason, we would reiterate our suggestion to not proceed with the overarching five broad labels, as they would lock UK investment products/funds into a classification regime that is restricted to climate despite other frameworks considering broader sustainability issues.

Q9: What are your views on potential criteria for 'Responsible' investment products?

We reiterate above comments regarding the term 'responsible', especially potential consequences of creating market distortion, with so called 'greener' assets trading on markets at a premium to intrinsic value, and 'browner' assets trading at a discount. That said, the proposed criteria for attaining the 'responsible' label appear relatively reasonable but note that these criteria would impose a higher bar than the proposed 'not promoted as sustainable' category.

Q10: Do you agree that there are types of products for which sustainability factors, objectives and characteristics may not be relevant or considered? If not, why not? How would you describe or label such products?

We agree that there are types of products that do not lend themselves to such labelling and classifications, as outlined in Q3. In addition, we reiterate our concern with the inaccurate mapping of the 'not promoted as sustainable' category to Article 6 of the SFDR. We appreciate that the FCA's intention may be to ensure the continuing viability of products that do not, for legitimate reasons, incorporate any sustainability considerations, however, we question the need for introducing such a category at all. Put simply, we do not believe it is common practice for a label to specify what something is not. The FCA should, instead, seek to build-in transparency provisions similar to those laid out in Article 6 of the SFDR, as mentioned.

Q11: How do you consider products tracking Climate Transition and Paris-aligned benchmarks should be classified?

Sustainable indices are becoming an increasingly popular choice for index funds. From an index perspective, the Climate Transition and Paris-aligned benchmarks ("low carbon benchmarks") are useful tools in directing capital flows to a more sustainable economy. A low carbon benchmark is defined as an investment benchmark that incorporates specific objectives related to greenhouse gas (GHG) emission reductions and the transition to a low-carbon economy — based on the scientific evidence of the International Panel on Climate Change (IPCC) — through the selection and weighting of underlying constituents.[13]

There may be instances where tracking, alone, would not be sufficient to allow investment managers to apply the proposed categorisations, given different portfolios could be starting from very different positions should index providers employ inconsistent methodologies. Also, different industry sectors have very different carbon footprints. It is important to explore the carbon footprint of companies, but also to consider the nature of the carbon exposure.

Nevertheless, for index strategies tracking the 'low carbon benchmarks', we agree that this should be an integral element when assessing whether the product/fund qualifies under the UK regime. We believe that the index providers creating such Climate Transition and Paris-aligned benchmarks are in a better position to classify their indices to ensure consistent classification for funds following the same index.

Q12: What do you consider the role of derivatives, short selling and securities lending to be in sustainable investing? Please explain your views.

If the question defines sustainable investing by reference to how particular activities are financed, then derivatives, short selling and securities lending have a limited role in sustainable investing. That said, we firmly believe that these types of strategies are essential in efficient portfolio management, and will, in fact, provide continued benefit in the transition process. In particular, from our perspective:

- Derivatives allow hedging of exposures and provide visibility on forward prices.
- Securities lending helps facilitate short selling.

Investment firms and other financial market participants are, however, seeking innovative ways in which to integrate sustainability considerations into the role of derivatives, as the FCA points out, as well as other areas such as securities lending. We recommend that the FCA monitors industry and standard-setters' progress in these areas, with a view to initiating a discussion on any dedicated requirements at a later stage – though, we would oppose any regulatory intervention that would lead to the preclusion of such tools from investment portfolios. The rationale being the need ensure efficient portfolio management, including with respect to satisfying existing rules in relation to appropriate portfolio diversification.

Q13: What are your views on streamlining disclosure requirements under TCFD and SDR, and are there any jurisdictional or other limitations we should consider?

[13] eu-climate-benchmarks-a-guide.pdf (ssga.com)

The UK approach to implementing climate-related disclosures in line with the TCFD recommendations is pragmatic, particularly, as many global investment managers have already sought to implement TCFD recommendations relating to governance, strategy, risk management, metrics and targets.

Additional clarity around how the FCA intends to harmonise its recently finalised policies on TCFD-aligned disclosure and the incoming SDR would be welcome. There may be an inherent challenge in streamlining the two regimes, as TCFD treats companies as a platform rather than a series of projects (a 'top down' approach) whereas the SDR approach would appear to do the reverse in treating companies as a series of projects (a 'bottom up' approach).

We would be inclined to support the TCFD approach, though material deviation from the EU SFDR would not be helpful for reasons already discussed.

Q14: What are your views on consumer-facing disclosures, including the content and any considerations on location, format (e.g., an 'ESG factsheet') and scope?

As mentioned, although we are supportive of enhanced transparency to retail investors with respect to a product or funds' sustainability-related strategy, characteristics and features, the creation of a tiered labelling and classification framework, as drafted, may be a deterrent for investors' evaluating all of the relevant product documentation. This would be problematic as the sustainable investing world is more nuanced than the proposed labelling scheme would suggest, and so it is highly important that investors review all relevant documentation. To be clear, we are not opposed to an 'ESG factsheet', but we do not believe it should constitute an appropriate supplement.

We also refer to our earlier comments about the need for equal access to product information for investors.

Q15: What are your views on product-level disclosures, including structure, content, alignment with SFDR and degree of prescription?

Alignment with the incoming Principal Adverse Impact (PAI) indicators prescribed under the SFDR could be a sensible starting point. This is particularly relevant for investment managers with both UK and EU products, given they will have already, for example, acquired data licenses necessary to comply with the EU. Importantly, alignment between the UK and EU regimes would also enable a level of comparability for global customers who can invest in both EU and UK products.

In terms of implementation, we see two options: to either mandate PAI indicators across all products, or to apply them to products under certain categories. The EU legislation has mandated a template that allows for explanations, so issues relating to data source, use of proxies, reasons for variation are transparent.

There will obviously be other information from the TCFD regime that will be useful for fund investors at a product level.

Q16: What are your views on building on TCFD entity-level disclosures, including any practical challenges you may face in broadening to sustainability-related disclosures?

We agree with the UK's approach to build upon TCFD entity-level disclosures. Our TCFD-aligned disclosures are currently covered in State Street's annual 2020 ESG report.[14] The proposal to allow for flexibility in referencing disclosures made at the consolidated level is therefore helpful.

Product manufacturers and/or intermediaries are likely to face practical challenges in clearly explaining certain elements of TCFD, such as scenario analysis results, to a consumer/retail investor. Hence, we believe there is a role for regulators to support in promoting greater financial literacy in relation to sustainable investing, as mentioned.

Q17: How can we best ensure alignment with requirements in the EU and other jurisdictions, as well as with the forthcoming ISSB standard? Please explain any practical or other considerations.

As mentioned, we welcome the FCA's ambition to align with requirements in the EU, as well as forthcoming ISSB standards. We believe that alignment with requirements and other jurisdictions is most achievable at the international level, hence fora such as IOSCO's Sustainable Finance Network and interactions at the ISSB level will be crucial.

We have already specified several areas where the discussion paper could better align with the EU SFDR. The interoperability of emerging sustainable taxonomies is also an important consideration. Significant divergence in technical screening criteria will be disruptive to cross-border sustainable investments, and costly for the asset management industry as investment managers will need to access and maintain multiple sets of data on our global investment universe in order to achieve the same level of transparency. Costs would, in turn, be passed onto investors, and we do not believe this is the right incentive to scale sustainable investments.

With respect to the ISSB, we note that the FCA has proceeded with issuer/corporate climate-related disclosures and intends to further revise its policy once the ISSB standards are published. It would be prudent to ensure the appropriate sequencing of regulatory requirements, given investment managers rely on an improved baseline of corporate/issuer disclosures in order to meet their UK SDR obligations. Misalignment will be inevitable without better global coordination. For example, the EU SFDR and forthcoming standards from the

[14] State Street firmwide ESG report, <https://www.statestreet.com/ideas/articles/2020-esg-report.html>, April 2021.

ISSB may take a different approach, with the former focusing on the full spectrum of sustainability risks and the latter adopting a 'climate first' approach.

Q18: What are your views on the roles of other market participants in communicating sustainability-related information along the investment chain?

As mentioned, comparable disclosures along the investment chain are essential and should be appropriately sequenced, starting with issuers.

More specifically, we believe that there is need to consider the role of index providers. Index providers are increasingly introducing sustainability-related products in the market. However, it is imperative that such providers are encouraged to provide investment managers with necessary transparency and legal certainty regarding the construction of such products, to enable investment managers to consistently report against their benchmarks under the UK SDR regime. The FCA may consider mandating such transparency as part of the UK 'onshored' rules of the EU Benchmarks Regulation, at least in terms of providing the same information on indices that investment managers are required to produce for investment products/funds. Consideration as to ways in which the FCA can support increased transparency around the use and provision of sustainability data across the investment chain would generally be helpful.

Furthermore, we believe that it is important to explicitly discourage intermediaries from basing their investment advice solely on the labelling regime, since it is crucial that the fundamental characteristics of a product/fund are fully evaluated.

Q19: Do you consider that there is a role for third-party verification of the proposed approach to disclosures, product classification and labelling and organisational arrangements of product providers? Do you consider that the role may be clearer for certain types of products than others?

Firms should maintain the option of seeking voluntary assurance on their control environment relating to any area of their operations, including sustainable investing. We believe it would be premature to mandate third party verification and assurance. Such an approach would make sense where there are established standards against which to measure, but there are no such standards in existence today. Furthermore, in the absence of investee companies providing comparable data in their disclosures, in addition to data providers aggregating this information using consistent methodologies, we believe that two very similar portfolios could score very differently.

Q20: What approaches would you consider to be most effective in measuring the impact of our measures, including both regulatory and market-led approaches, and should disclosures be provided in a machine-readable format to better enable data collection and analysis

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The appropriate measures will vary depending upon the intended impact of these measures. For example, if the intention is to protect retail investors then measuring the impact will be difficult, particularly if measured against the potential alternatives. If the intention is to encourage investment in the new 'greener' economy, measurement will be easier, both in absolute terms and versus peers.

The FCA should provide for a post implementation review period resulting in further guidance and observations without the threat of supervisory action, unless egregious non-compliance has been identified. This would enable industry to adjust classifications and disclosures in line with evolving regulatory frameworks and guidelines, whilst preserving consumer trust in sustainable products.

Finally, we agree that disclosures should be provided in a machine-readable format, provided that this does not significantly increase associated reporting costs and resource, nor detract from the meaningfulness of increased product transparency to investors.

Once again, SSGA appreciates the opportunity to comment on this important consultation, and please feel free to contact either of us with any questions.

Sincerely,

Alex Castle

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