

31 January 2023

SDR and labels policy
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Submitted via email to: cp22-20@fca.org.uk

RE: CP22/20 Sustainability Disclosure Requirements (SDR) and investment labels

BlackRock¹ is pleased to have the opportunity to respond to the Financial Conduct Authority (the 'FCA') consultation paper on Sustainability Disclosure Requirements (SDR) and investment labels.

As an asset manager, BlackRock is a fiduciary that invests and manages capital on behalf of retail and institutional investors across public and private asset classes. The money we manage is not our own – it belongs to our clients, the asset owners, who choose their own investment strategies and products from our broad product offerings.

BlackRock's investment approach is rooted in our fiduciary duty: we start with our client's objectives, we seek the best risk adjusted returns, and we underpin our work with research, data, and analytics. We apply that same approach to sustainability and the way we assess sustainability-related drivers of risk and returns.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of the FCA on this and other topics.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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¹ BlackRock is a leading provider of investment, advisory and risk management solutions, and has been active in the UK for over 50 years. Our purpose is to help more and more people experience financial well-being.

Executive summary

BlackRock is supportive of the FCA's intentions to help build consumer trust in financial markets and tackle greenwashing. We are committed to supporting the FCA in its efforts to define credible standards, criteria and transparency requirements that help investors identify sustainable products that meet their needs and preferences.

The demand for sustainable investment products in the UK:

We observe that a growing number of end-investors want to take sustainability considerations into account when investing. Many are at the beginning of their sustainable investment journey and while they have financial objectives, they also want to help achieve sustainable outcomes in the real economy through their investments. Most commonly, these might include targeting a portfolio level objective or net zero alignment by 2050 or sooner. At the same time, the regulatory focus on delivering value for money and cost transparency has driven the process of portfolio construction, resulting in greater use of lower cost index products, alongside and within active portfolios.

Applying the proposed SDR to investor demand:

Given these drivers, we are concerned that the SDR categories as currently drafted will not meet the needs of many end-investors with sustainability goals. We expect that only a very small number of funds across the industry would be able to qualify under the regime, leaving the majority of funds and the end-investor market they service outside of scope. We do not believe that this is the FCA's intention.

In our experience as a fiduciary, we see investors expressing their sustainability preferences in a variety of ways – including in terms of portfolio-level targets, either over time or in reference to a starting investment universe (such as the FTSE 100, the MSCI World etc). We feel that the SDR regime should reflect the various ways sustainability preferences can be expressed.

However, a significant number of sustainable products (e.g. those targeting a real-world outcome, such as net zero alignment or decarbonisation strategies) will be excluded from the regime. By narrowing the market for sustainable products, the qualifying criteria could only be achieved by concentrated products, with associated risks to investors. Such products would be unlikely to function as core replacements in investor portfolios, reducing investor choice and the ability to effectively transition whole multi-asset portfolios towards sustainable objectives.

From a transparency perspective, the proposed naming and marketing rules could be detrimental to certain parts of the market (such as UK Defined Contribution) where an accurate description of the product (which includes elements of ESG metrics/processes) is required within their tax wrapper. For this reason, an accurate description of an investment process is imperative to allocating capital. While we accept that a fund may not be labelled 'sustainable', the ESG characteristics within the portfolio should be accurately and adequately described and discernible to end-investors.

How the proposed criteria may impact the UK market:

The consequences of this, which we believe are unintended, could be to:

- Hinder access for investors to the full range of products that may best align with their investment objectives, particularly products that net-zero objectives as noted above.
- Prevent the accurate representation of a fund with a name and description based on its investment process.

- This in turn could limit the options for investors seeking to allocate capital to companies that genuinely operate in a manner that provides a positive contribution for the environment and/or society, if that is an investment outcome they choose to pursue.
- Make it more difficult for end-investors to take the first, small steps towards sustainable investing and to grow such investment activity within their portfolios over time.
- Potentially restrict UK investors' ability to access fund ranges domiciled overseas that provide value for money through economies of scale, and promote innovation and competition in the UK market.
- Undermine the Government's objectives of mainstreaming sustainable investment in the UK and making the UK a leading centre for green finance.

Points for further consideration

With this in mind, there are four areas that we would recommend the FCA focus on in order to facilitate the intended end-investor outcomes:

1. Ensuring that products aimed at achieving portfolio level outcomes can be accommodated within the labelling criteria

The focus on asset level requirements within the label criteria is currently too narrow to appropriately reflect the breadth of credible sustainable solutions available to investors in the market today (particularly in index investing), many of which instead commit to sustainable portfolio outcomes ("Portfolio Outcome Products"). Although considered a credible and appropriate standard across the market, funds that have a net zero aligned target or other sustainable strategy may in many cases not qualify for a label as proposed under the consultation.

We therefore support the expansion of the inclusion criteria for the labels to ensure Portfolio Outcome Products, focused on credible and transparent environmental and/or social outcomes, are captured within the regime, broadening investors' sustainable investment options.

Additionally, the proposed threshold for the Sustainable Focus label would fail to account for regional and asset class-specific nuances. Our research shows that the sustainable characteristics of different regional equity and bond markets differ widely; therefore, imposing a flat 70% threshold would narrow the investment universe dramatically for certain strategies.

2. Reconsidering restrictions on marketing rules

The marketing and naming rules proposed under the consultation suggest that unless products carry an SDR label they are unable to meaningfully disclose ESG and/or sustainability characteristics. Whilst labels should act as a guide for the investor to indicate adherence to a common standard, naming and marketing materials should be a clear and factual representation of a product's design. A fund may not be labelled 'sustainable', but we believe strongly that the ESG characteristics within the portfolio should be accurately and adequately described and easily available to investors trying to navigate the market.

Firms have a clear duty to provide investors with communications that are 'fair, clear and not misleading'. This duty includes ensuring that information about an investment product offers sufficient detail about its core features, including but not limited to information about the product's investment objective, how its portfolio manager(s) will pursue this objective and important detail about how investors should consider the product's performance.

While we agree with and support the FCA's move to prevent greenwashing and the need to ensure that investment products and investment services are marketed and sold in a manner that is consistent with their legal and regulatory documentation, we believe that prohibiting reference to certain details beyond reference in pre-contractual disclosures could result in investors receiving incomplete communications that lack the necessary clarity in certain areas.

3. The positioning of investment stewardship as the primary channel for sustainability outcomes in the Sustainable Improvers category

Stewardship is an important aspect of the investment process and plays a role in how sustainability-related risks are disclosed and acted upon. Stewardship is, however, just one factor in investee company decision-making. Many investee companies are widely held through different funds that potentially have very different investment objectives. While investors often agree on the challenges, there is seldom alignment on the best solution. Hence management teams receive feedback and then must determine what they think is in the best interest of the company. It is imperative that we are clear with end-investors on this point.

Mandating divestment decisions on a fund level based on stewardship insights would also pose several implementation challenges for the industry and greatly limit adoption of the regime across both active and index products. Notably, this would have a dramatic impact on the resource requirement – and therefore end-investor costs – of managing funds in this category. Furthermore, for index investing, where there is a fiduciary duty to allocate assets according to the index selected by the investor, this would pose potential conflicts with existing consumer protection requirements. For the Improvers category to be accessible and reasonably affordable to end-investors across the market, firmwide approaches to stewardship, as well as index products targeting portfolio level outcomes, designed to track appropriate indexes, should be includable in the regime.

4. Ensuring SDR is designed in a way that will not in future hamper UK consumer access to products domiciled overseas

We acknowledge the FCA's goal to ensure the SDR regime is appropriate for the UK market, but in doing so urge the FCA to be mindful of the importance of maintaining cross-border access for the benefit of UK end-investors. Given the consumer detriment that will be incurred by UK end-investors not having this access and/or, in future, needing to repatriate investments, these concerns should be addressed at the outset. Failure to do so would risk disproportionate fragmentation between UK and EU standards, leading to poor outcomes for UK end-investors, including reduced choice and sub-scale fund ranges resulting in increased transition costs (if conversions are necessary). We believe SDR should be rolled out in a way that will allow for the inward marketing of similarly constructed products overseas.

Further detail of our suggested changes, as well as feedback on other issues raised by the FCA, is provided below. We look forward to continuing our dialogue on this consultation and will continue to contribute to the thinking of the FCA on any issues that may assist in the outcome.

BlackRock, January 2023

Q1: Do you agree with the proposed scope of firms, products and distributors under our regime? If not, what alternative scope would you prefer, and why?

From a practical perspective, we recognise why the FCA is taking the approach of first applying the proposed regime to UK funds and giving the industry an opportunity to respond to a consultation on how SDR will apply to overseas funds in due course. At the same time, it is important to note the importance of sustainable products domiciled overseas for UK end-investors' portfolios, and the value UK consumers derive via economies of scale from access to those fund ranges. UK investors have invested ~£9bn in our overseas active funds. We would therefore welcome urgent clarity on when the FCA intends to consult on the Overseas Funds Regime.

Given the consumer detriment that will be incurred by UK end-investors not having this access and/or, in future, needing to repatriate investments, these concerns should be addressed at the outset. If they are not resolved by the time the regime is extended, we risk disproportionate fragmentation between UK and EU standards, leading to poor outcomes for UK end-investors, including reduced choice, sub-scale fund ranges and increased transition costs (if conversions are necessary).

We acknowledge the FCA's goal to ensure the SDR regime is appropriate for the UK market, but in doing so urge the FCA to be mindful of the importance of maintaining cross-border access for the benefit of UK end-investors. We believe a regime which provides for recognition of analogous standards applicable in third countries as far as possible is the most beneficial. This is particularly the case for sustainability related disclosures where there is evidently a large amount of convergence with international standards and other jurisdictions. We also note that ESMA is consulting on fund naming rules and would urge the FCA to work toward international coherence.

Further to this, we ask for clarification on the methodology for the application of SDR to segregated accounts when investments are outside the fund wrapper. While the consultation is clear on the FCA's expectations around investments in segregated accounts when they are held within a fund wrapper, we ask for clarification on how the FCA expects rules to be applied if the investments in the segregated accounts are not held in a wrapper.

Q2: Do you agree with the proposed implementation timeline? If not, what alternative timeline would you prefer, and why?

12 months is a short timeframe in which to meet the requirements. The timeline should be determined by when the clarifications being sought in this consultation are delivered, what the consequent requirements are and the ability to source the underlying data relating to investee companies and assets.

We urge the FCA to be flexible on deadlines should delays in determining the final regime occur. Fixed deadlines with no regard to issues that may arise along the way are not appropriate in supporting an effective regime.

We recommend the FCA ensure that requirements are phased-in where there are dependencies on the outcomes of other regulatory requirements. For example, even with the work of the International Sustainability Standards Board (ISSB) to support a baseline in global sustainable disclosures due by the end of 2022, significant data gaps will remain.

As with SFDR, the FCA should not underestimate the time and effort needed to develop credible methodologies where, in the case of indexing, there are significant dependencies on third party index and data providers (who are not subject to the regulations themselves) to develop the datasets and methodologies for us to be able to embed binding, rules-based and scalable sustainable product attributes.

We would welcome a forward-looking roadmap setting out next steps and timeline, including those pertaining to the rest of the SDR, to understand better the implications across the investment chain. We would also ask that holistic guidance is provided all at once with adequate time to implement, avoiding implementing requirements in a piecemeal manner that could lead to repeated product re-design, potentially requiring investors to reallocate capital between products as and when product definitions are evolved.

Q3: 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.

In line with the answer above, it is difficult to quantify the costs associated with implementation without further clarifications and confirmation of the final rules. However, we note that added operational complexity leads to increased overall fund management costs, which we do not believe is a good outcome for UK end-investors.

With this in mind, we recommend that, where possible, firms should be able to leverage existing architecture put in place for SFDR, in order to minimise costs related to sustainable investing which may need to be passed on to end investors.

Q4. Do you agree with our characterisation of what constitutes a sustainable investment, and our description of the channels by which positive sustainability outcomes may be pursued? If not, what alternatives do you suggest and why?

We are supportive of the introduction of the SDR labels to help bolster trust in sustainable investing, however, the focus on asset level requirements within the criteria is too narrow and fails to reflect the breadth of credible sustainable solutions in the market today, many of which instead commit to sustainable portfolio outcomes.

Under the current SDR proposals, we anticipate that no sustainable products that provide exposure to any broad market investment will qualify for a label (e.g. strategies tilting to issuers with Science Based Targets initiative (SBTi) targets or Net-Zero alignment and decarbonization strategies). Furthermore, the proposed naming and marketing rules would prevent these products from disclosing details on their investment strategy.

This seems misaligned with the FCA's policy objectives and could lead to undesirable consumer outcomes – potentially denying investors the opportunity to access products that best align with their investment objectives by preventing such products from explaining their ESG/sustainable characteristics or objectives.

We therefore support the expansion of the inclusion criteria for the labels to ensure Portfolio Outcome Products, focused on credible and transparent environmental and/or social outcomes, are captured within the regime, broadening investors' sustainable investment options.

It is important to note that as part of this assessment, BlackRock has adopted what we believe to be a credible standard with robust governance and processes for what is considered a "sustainable investment", consistent with those adopted across our cross-border vehicles and to align with SFDR and Markets in Financial Instruments Directive (MiFID) regulations.

We note the definition of Sustainable Focus and Sustainable Improvers labels do not detail "sustainable investment" credibility standards. Any subsequent inconsistency that results may create significant confusion for investors, and arguably encourage adoption of a looser interpretation of "sustainable definitions" in the market, undermining the credibility of the labelling regime.

We would be happy to share with the FCA our extensive research carried out on metrics which can be used to measure the achievement of credible sustainability objectives.

Q5. Do you agree with the proposed approach to the labelling and classification of sustainable investment products, in particular the emphasis on intentionality? If not, what alternatives do you suggest and why?

We support transparent sustainability objectives and clear evidence as to how they are to be achieved.

However, product-level sustainability objectives can be achieved through a combination of different integration, investment, or product design approaches, ranging from screening to optimisation. For example, an increased allocation to companies with a credible sustainability profile may be achieved: (i) by screening out most of the non-sustainable names and re-weighting; or (ii) by tilting towards companies identified as having a positive sustainable profile.

Our view is that intentionality could be proven beyond the channels and asset-level focus proposed by the FCA. The overall sustainability profile of a product, even if under the thresholds for the three labels and not targeting a specific sustainability outcome, could be viewed as intentional. A more open definition of intentionality would then conceptually support the inclusion of Portfolio Outcome Products.

We would appreciate clarification from the FCA on the following:

- How to substantiate the link between the sustainability profile of an asset and the requirement for ‘positive outcomes for the environment and/or society’? For example, could a company be deemed to have a sustainable profile where it carries out its economic activities in a sustainable manner (e.g. a company that stands out for its social focus, for instance through its HR management or the representation of women)?
- Furthermore, we note that the consultation has omitted the concept of double materiality (e.g. ‘do no significant harm’). As such, could a sustainable investment under the SDR formulation have a positive outcome in one area of society and a negative outcome in another? Further clarity is sought from the FCA on this point.

Q6. Do you agree with the proposed distinguishing features, and likely product profiles and strategies, for each category? If not, what alternatives do you suggest and why?

We are generally supportive of the distinguishing features of the proposed labels. However, as outlined more specifically below, further clarity is sought from the FCA in certain areas.

Firstly, we would like to highlight that the proposed narrow qualifying criteria could only be achieved by concentrated products, with associated risks to investors. Such products would be unlikely to function as core replacements in investor portfolios, narrowing investor choice and the ability to effectively transition whole multi-asset portfolios towards sustainable objectives. In our experience as a fiduciary, we see investors expressing their sustainability preferences in a variety of ways – including in terms of portfolio-level targets, either over time or in reference to a starting investment universe (such as the FTSE 100, the MSCI World etc). We feel that the SDR regime should reflect the various ways sustainability preferences can be expressed.

Considering sustainable index products in particular, we feel that the current SDR proposals fail to recognise key indexing ecosystem considerations, such as the rules-based construction of sustainable indices being carried out by third party index providers. Whilst we agree that stewardship is an important aspect of the investment process, stewardship should not constitute the main channel for driving sustainability outcomes under any sustainable label.

In light of this, we would be supportive of:

- a) Expanding the **Sustainable Improvers** label definition to account for commitments to improve, on average, sustainability characteristics of the portfolio over time (Portfolio Outcome Products, such as those committing to robust year-on-year decarbonisation pathways); and
- b) Allowing for more flexibility around the proposed threshold in the **Sustainable Focus** label, to adequately consider different regions and asset classes. We also welcome contributing to the FCA as it calibrates what “credible standards” for asset-level sustainability profiles could look like.

In particular, we would propose the following approaches to the Sustainable Improvers and Focus labels:

Sustainable Improvers	Sustainable Focus
<p>Products with an objective to improve their sustainability profile over time by <u>EITHER</u>:</p> <p>(i) investing in assets that, while not currently environmentally or socially sustainable, are selected for their potential to become more environmentally and/or socially sustainable over time</p> <p><u>OR</u></p> <p>(ii) setting concrete portfolio-level commitments to improve, on average, sustainability characteristics of the portfolio over time (such as committing to robust year-on-year decarbonisation pathways)</p>	<p>Products which maintain a high standard in the sustainability profile of the assets they invest in by committing an appropriate minimum allocation to assets with a credible sustainability profile or theme alignment. [‘Appropriate minimum’ should be calibrated by reference to appropriate region and asset class].</p> <p>While the process of assessing “credible standards” for asset-level sustainability can be defined by managers in the context of the sustainability objective of the product, further non-binding guidance from the FCA would be helpful.</p>

Sustainable Improvers

We are supportive of the creation of the **Sustainable Improvers** label and believe that it would serve a useful purpose for investors. We see this label as broadening the scope of eligible investments and laying the foundations for the investment industry to support a credible green transition.

However, the requirements in their current form would exclude a significant number of existing transition-type products designed to deliver portfolio-level outcomes, as the label proposals require each underlying security to be selected based on some sustainable improvement criteria. References to active ownership may limit the number of products in scope for this label, especially for products with rules-based methodologies (like index funds).

As such, we would support **two key adjustments** to the current label definition:

- (1) In addition to asset-level sustainability improvement, allow for commitments to sustainability improvements over time at portfolio level; and
- (2) Clarify that, while product-level active ownership could be one way to satisfy label requirements, we recommend the reallocation of capital/cost of capital transmission remain a primary channel, including when implemented by firm-level stewardship and engagement.

Mandating active divestment decisions based primarily on stewardship insights would pose several implementation challenges for the industry. For example, reflecting these insights in portfolio construction, at scale, and managers’ ability to ensure that these are reflected on an

ongoing basis to qualify for the label. Having investor stewardship as the primary channel for sustainability outcomes for the Improver category would greatly limit widespread adoption across both index and active products.

For index products in particular, there could be a conflict between active divestment based on engagement insights and the fund's fiduciary obligation to track the reference benchmark index, which is calculated by third-party index providers (which are not subject to the requirements themselves) – given that a decision by the asset manager to divest of a constituent security that remains in the benchmark index would impact performance (e.g. tracking error).

Moreover, for active products, we would like to draw the FCA's attention to the significant operational burden that would need to be undertaken to support the requirements as currently drafted, and the consequent impact on affordability for investors seeking to engage in this type of investment.

Overall, engagement and voting should be seen as one of the many ways that investment managers interact with investee companies, rather than a primary transition mechanism or a measure of success in and of itself. We would urge the FCA to avoid prescriptive targets or measures and instead focus holistically on the quality of stewardship and the ways in which the industry is evolving to meet investor demand.

Portfolio-level Outcomes

By introducing the portfolio-outcome lens to the Improvers label, it would bring credible sustainable strategies with clear year-on-year decarbonisation requirements in scope of this label. Indices adhering to EU Paris Aligned Benchmark (PAB) or EU Climate Transition Benchmark (CTB) decarbonisation standards, which have proven increasingly popular among the UK investor base.

Sustainable Focus

Overall, we are supportive of the **Sustainable Focus** label and the different ways of qualifying in-scope sustainable assets, either via their “sustainability profile” or via “theme alignment”. However, we highlight issues faced when combining prescriptive ‘substance’ thresholds with concepts or definitions that remain open to interpretation.

There are **two key feedback items** for this category:

1. We welcome working with the FCA to provide guidance around the asset-level ‘**credible standards**’ of sustainability in this category.
2. The proposed **minimum threshold** does not account for regional or asset class-specific considerations.

1. Asset-level “credible standard” for sustainability

We welcome the FCA's intention to allow managers to self-define the processes and principles here, but would further welcome more guidance around what constitutes a ‘credible standard’ for the purposes of defining whether or not assets can be deemed sustainable (e.g. what constitutes a credible link between an asset's profile and positive outcomes for the environment/society?).

For SFDR and MiFID, the asset management industry worked extensively, in the absence of prescriptive guidance, to find ways of defining what constitutes a “sustainable investment”, which, whilst reflecting a credible standard of sustainability, is constrained by the prescriptiveness around qualifying environmental and social objectives. Positive investor outcomes could be undermined if the industry needs to invest significant resources in developing new, different, standards and datasets in order to meet the UK label criteria.

As such, we do not seek an FCA mandated or prescribed definition, which we believe would hinder the pace of adoption.

2. Proposed minimum thresholds

Based on what we and other asset managers learned from our experience implementing SFDR, the proposed minimum threshold for this category (at 70%) is both high and also fails to account for differences across regional investment universes and asset classes. This could frustrate the overall policy intention of diverting capital to more sustainable products and outcomes, given only more concentrated, thematic-type products would currently qualify.

Security selection can be based on several factors. This includes one of the most widely demanded sustainable index strategies in the UK and Europe: ESG ‘best-in-class’ index methodologies, such as the flagship MSCI Socially Responsible Investment (SRI) index family. Security selection here is based on ESG ratings (taking only the top performers in each industry), with the resulting portfolio organically exhibiting substantially reduced carbon footprints at the portfolio-level and superior sustainability credentials. End-investors naturally consider such strategies to demonstrate credible sustainability standards, given the substantial focus of the strategy to invest in top ESG performers within relevant sectors.

The table below summarises the percentage of regional MSCI SRI indices invested assets we would categorise as a Sustainable Investment. This indicates there is substantial regional variation in percentage sustainable investments, which a flat threshold would fail to account for.

Table 1: Analysis of ESG Best-in-Class Indices in the context of example SFDR Sustainable Investments definition.

Example ESG Best-in-Class Index*	No. Constituents (Parent Index)	No. Constituents (SRI Index)	Tracking Error vs parent (bps)	% Market Value invested in Sustainable Investments (SFDR)	Emissions intensity** reduction vs Parent Index
World SRI	1508	372	225bps	45%	50%
EM SRI	1377	174	566bps	22%	62%
US SRI	624	150	272bps	42%	38%
Europe SRI	426	119	293bps	54%	66%
Japan SRI	237	52	273bps	56%	13%

Source: BlackRock, as of 30 December 2022. *Based on the MSCI SRI Select Reduced Fossil Fuel index series.

**Calculated as weighted average carbon intensity (Scope 1&2 emissions/EVIC).

Indeed, if we take the World SRI Index above as an example, this already exhibits a substantially more concentrated security profile than its investment universe (i.e. the MSCI World), with 372 constituents as of 30 December 2022 (vs 1508 constituents in MSCI World). The active risk (“Tracking Error” in the table above) is towards the upper end of what our clients express they would be willing to tolerate in a sustainable core allocation.

Using the “Sustainable Investment” definition we have adopted under SFDR as an example shows that even in flagship best-in-class indices the number of assets qualifying as a Sustainable Investment would be lower than 70%. Adjusting such a Best-in-class strategy to make it compatible with a 70% “Sustainable Investment” threshold would lead to poor investor outcomes given: (a) substantial portfolio turnover and costly repositioning; and (b) the risk profile of such a strategy being very concentrated – making it unsuitable for most investors, particularly as used in core allocations.

Furthermore, we would also stress that having very stringent levels set at an asset class level means that funds may not adequately be able to either manage their risk or deliver performance objectives. From our experience with SFDR Article 9 funds, we would highlight those strict limitations at an asset level and expectations that near 100% or all assets meet sustainability criteria fails to appreciate that funds must also adequately manage risk and that whilst these are sustainable products, investors still have an expectation of a level of performance. Being too tight on asset level requirements and constraining portfolios to this extent with specific limitations will impact performance, may lead to challenges in managing risk for these products, meaning that either funds won't apply the label, or that sustainably labelled products don't raise funds due to investors being forced to choose between one or the other.

We also note that the definition of Sustainable Investment under SFDR is due to be reviewed. As such, we welcome contributing to the FCA's thinking on guidance on what would constitute a 'credible' asset-level sustainability profile. Suggested metrics include percentage of revenues from products or services with a positive impact on society and the environment, or companies which have a carbon emissions reduction target approved by the SBTi.

Finally, does the FCA intend to set conditions for the non-covered 30% remainder of the asset bucket? Whilst we note the FCA has stated that investment in assets that a reasonable client would believe conflicts with a product's credible standard, we would welcome further guidance on this point.

Sustainable Impact

We believe that Impact is the correct term for this category. Impact is the widely understood industry term for this category of product, however, 'solutions' has other meanings within the investment management space (investment solutions etc), which could cause investor confusion.

Regarding financial additionality, this is not a fundamental attribute for this type of product. If an investor is seeking an impact product, the primary focus is on change-making, not pure financial outcomes.

Lastly, we note that index-tracking strategies are deemed unlikely to meet the criteria for this category of product. We would like to flag for example Green Bonds Indices, which have been widely adopted as efficient tools to get exposure to this critical asset class.

Q7. Do you agree with our proposal to only introduce labels for sustainable investment products (i.e. to not require a label for 'non-sustainable' investment products)? If not, what alternative do you suggest and why?

We agree with the current approach, however, as mentioned above, we support the inclusion of Portfolio Outcome Products, focused on credible and transparent environmental and/or social outcomes, within the labelling regime.

We also suggest that marketing rules be amended to allow marketing of non-labelled products as 'ESG' or 'sustainable' subject to further minimum requirements being set out to guard against 'greenwashing', for example, a significant portfolio level sustainability outcome/objective and clarity for the investor as to what the product does and does not do.

Q8. Do you agree with our proposed qualifying criteria? If not, what alternatives do you suggest and why? In your response, please consider:

A) whether the criteria strike the right balance between principles and prescription

We are satisfied with the balance struck by the FCA between principles and prescription, subject to points discussed above.

B) the different components to the criteria (including the implementing guidance in Appendix 2)

We agree with the components of the criteria unless otherwise stated:

Principle 3, KPIs:

- Significant ongoing operational requirement to track at fund level (as will be required for sustainability product reports). This will have operational build out and associated challenges to scale.
- Clear definition of KPIs is particularly important in indexing, as ESG data/KPIs used in indices are clearly defined and embedded in a rules-based fashion in index methodologies. The same KPIs can be used in reporting, subject to agreements with respective data providers (noting associated costs).
- Data Challenges:
 - Availability: mismatch between companies where we cannot obtain the same level of information.
 - Reporting: we need to ensure that data provided to investors is consumable and provided at aggregate portfolio level.

Principle 4, Governance and Resourcing:

- Additional clarity is sought on Point 2 regarding due diligence on third party ESG data used.
 - Clarification from the FCA is needed as to whether this applies to every single dataset used in an index, or specifically the subset of data/KPIs that fundamentally drive the strategy and are defined to be aligned with the Sustainability Objective.
 - On due diligence (gaps and shortcomings), we ask for guidance as to whether this refers to the dataset as applied to the product (e.g. coverage), or the data provider methodology. We also ask for guidance as to whether due diligence is a one-off exercise upon launch or an ongoing assessment.
 - We do not think it is appropriate that an asset manager would be held liable for every single ESG data point if one is to be identified as estimated incorrectly by the data provider.

Principle 5: Stewardship

- Whilst we agree that stewardship is an important aspect of the investment process, it is important to stress that stewardship is just one factor in investee company decision making. Many investee companies are widely held through different funds that potentially have very different investment objectives. While investors often agree on the challenges, there is seldom alignment on the best solution. Hence management teams receive feedback and then must determine what they think is in the best interest of the company. It is imperative that we are clear with end-investors on this point.
- We would be unable to deliver a firm level commitment in line with each individual fund strategy and see this requirement as disproportionate. We are committed to investor choice and believe that this requirement would have detrimental unintended consequences by limiting investor choice outside the labelling regime.
- In October 2021, we introduced BlackRock Voting Choice which allows investors in separate accounts and certain pooled vehicles to vote their shares in line with their preferences, or to continue to trust BlackRock as a fiduciary and authorise our stewardship team to vote on their behalf. We are committed to bringing Voting Choice to all pooled funds and have begun trials in the UK.

C) Whether they sufficiently delineate the different label categories, and;

Yes. However, we would also note that it is very possible that a product possesses characteristics that qualify it for more than one label. Whilst we note the FCA's position that only one label is permitted per product, we require further guidance from the FCA on label selection in such situations.

D) Whether terms such as 'assets' are understood in this context?

Yes, however, further clarification is needed on derivative treatment.

Q9. Do you agree with the category-specific criteria for:

A) The 'Sustainable focus' category, including the 70% threshold?

We recommend the Focus label criteria is modified to account for regional and asset-class specific considerations, whilst also providing non-binding guidance on what could constitute a "credible" sustainability profile". Please refer to Q6 for further detail.

B) The 'Sustainable improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?

We restate our recommendation that the inclusion criteria for the label be expanded to include Portfolio Outcome Products. Please refer to Q6 for further detail.

C) The 'Sustainable impact' category, including expectations around the measurement of the product's environmental or social impact?

At BlackRock, we have established minimum criteria for impact investing across all asset classes. This requires that products adhere to the IFC Principles for Impact Management, for which we are a signatory at the firm level.

When mapped against these Principles, we would note that the FCA's criteria does not include a process that monitors impact credentials of individual investments throughout the investment period. We recommend the FCA consider whether this is something it wants to add to the criteria to align with international best practice.

Please consider whether there any other important aspects that we should consider adding.

As we have explained above, we think that there are a number of potential tools that asset managers may use to manage sustainable investment products and we do not believe it is the FCA's intention to constrain how such products realise their sustainable and financial investment objectives.

Optimised index products provide investor benefit as they bolster the allocation of capital to issuers with higher ESG ratings and help to deliver portfolio level outcomes such as decarbonisation with low levels of tracking error across a full suite of equity portfolio building blocks. Excluding such products from the SDR regime would be a missed opportunity in terms of encouraging adoption of such strategies.

Products which do not qualify for a sustainable investment label under this regime, but nevertheless have sustainability-related characteristics may still meet the needs of many end-investors. The naming and marketing rules should allow consumers to receive the information they need to understand the sustainability related features of such products, while ensuring that these products cannot be misrepresented to consumers as something they are not.

Q10. Does our approach to firm requirements around categorisation and displaying labels, including not requiring independent verification at this stage, seem appropriate? If not, what alternative do you suggest and why?

BlackRock agrees with the proposal around not requiring independent verification, we believe this would add additional complexity and a cost that would ultimately have to be passed on to investors.

The verification process is already underpinned by existing frameworks including Senior Managers & Certification Regime Principles, Management Company Board responsibilities, the Financial Reporting Council Stewardship Code, and the independent role played by fund trustees.

On label display on prospectuses and websites, we agree this is clear and not misleading for investors.

Regarding FCA notification of label use within one month and FCA approval of label, we would ask for clarity as to whether this a self-certification regime. We would also note that the notification requirement seems redundant as it seems it would be covered by the existing Form FN process in any event.

We have no comments regarding the Annual Review and Record Keeping requirement, however, note that a process would need to be built to facilitate this.

Q11. Do you agree with our proposed approach to disclosures, including the tiered structure and the division of information to be disclosed in the consumer facing and detailed disclosures as set out in Figure 7?

We are comfortable with the overall proposal, particularly around the detailed sustainability product report, and welcome the tiered structure, which addresses the information needs of the various stakeholders.

However, we see the requirements for the consumer-facing document as disproportionate. We address this in more detail below, but these requirements seem to include vast amounts of complex information from the detailed report content and would require the 'translation' of complex and developing metrics into lay terms in order to ensure they fit into the two-page format.

This leaves room for misinterpretation and seems to go against the FCA's intention that the consumer-facing document to be easily digestible.

We also restate our position around segregated accounts and urge the FCA clarify what is expected if assets are not in a fund wrapper.

Q12. Do you agree with our proposal to build from our TCFD aligned disclosure rules in the first instance, evolving the disclosure requirements over time in line with the development of future ISSB standards?

BlackRock agrees with the premise of building up from existing industry frameworks, and that the foundation for sustainability-related disclosures is the Taskforce on Climate-related Financial Disclosures (TCFD). The TCFD framework takes a principles-based approach, developed with input from investors and companies. Because of its relative simplicity and consistency, TCFD has garnered significant support from governments, central banks, and more than 4,000 organizations from over 100 countries, as of 2022. The flexibility provided in the FCA's proposal – no mandated template – allows the industry to make informed decisions on the applicability of all TCFD related features for all products (for example scenario analysis) while still coalescing on

core issues, such as TCFD core metrics, to provide coherence and comparability to all users of sustainability disclosures.

Further, we strongly support the proposal to evolve the SDR disclosure requirements over time, in line with the global baseline of climate and sustainability-related disclosure standards, under development in 2023 by the ISSB. We view the work of the ISSB as an important contribution to a multi-jurisdictional effort towards improving the availability, quality, comparability, timeliness, and interoperability of sustainability-related disclosures. Given the FCA's stated aspiration, "as far as possible, to achieve international coherence with other regimes" we encourage the FCA to continue to build bridges where possible – considering both the content and the depth of required disclosures.

As a subsequent step, we anticipate requirements for transition plan TCFD-aligned disclosure rules based on Government Transition Plan Taskforce and future product-level Taxonomy-related disclosure requirements, once the UK Green Taxonomy has been developed. These should be developed in close consultation with the industry and the users of disclosures, and target coherence and comparability with the transition plans required by international disclosure frameworks.

Overall, taking a principles-based, rather than prescriptive approach, provides the flexibility necessary for continuing development of creative, pragmatic best practices, and supports the alignment of international disclosure frameworks. It allows the industry and individual actors within the industry to achieve scale and drive more consistent impact across their entire footprint. However, we also recognise the importance of templates to improve coherence, scalability and ability for consumers to compare products.

Further, we believe it is critical that sustainability disclosure frameworks include private companies – above an appropriate threshold – as well as public companies, to avoid unintended consequences in the capital markets such as (1) the sale of physical assets to private companies to avoid disclosure, and (2) private companies being potentially disincentivized from going public, decreasing choice for public market investors. We therefore welcome the proportionate inclusion of private companies within the scope of the FCA's proposal.

Q13. Do you agree with our proposals for consumer facing disclosures, including location, scope, content and frequency of disclosure and updates? If not, what alternatives do you suggest and why?

BlackRock recognises the importance of consumer-facing disclosures and we welcome the FCA's focus on ensuring that consumers have the information they need to make informed decisions. However, we see the content proposals for consumer-facing disclosures as disproportionate.

In our view, the proposals seem to go beyond the needs of most consumers and will require the 'translation' of complex information, which does not lend itself to a succinct, two-page document.

For example, advanced pre-contractual content requirements that are forward looking and based on predictive scenarios, like sustainability objectives, would stretch the industry's ability to prepare unambiguous and succinct consumer disclosures.

In this respect, these requirements may hinder the industry's ability to deliver on Consumer Duty. Indeed, the regulatory and reputational risk inherent in 'translation' of characteristically complex sustainability issues may in fact discourage the industry from making labelled consumer products available.

To ensure availability of labelled products in the UK, that are aligned with requirements under the Consumer Duty, we encourage the FCA to carefully examine the day-one need and level of detail for the most technically challenging disclosures. Where market data landscape and outcome

identification methodologies are still developing, it may not be yet possible to provide unambiguous commitments, followed by reporting, that sufficiently separates actual metrics from predictive scenarios.

This issue is most pronounced in relation to the “sustainability goals” and “sustainability metrics” content elements. These nuanced concepts can be prone to misinterpretations, in particular when delivered in summary terms. It is our view that future orientated disclosures requirement should only utilise methodologies that are broadly applied in the industry to provide consumers the ability to compare such disclosures.

The industry does not yet have established and shared conventions for the expression of sustainability related outcome goals. Furthermore, such conventions do not yet exist for assessing the relationship between sustainability objective (including outcomes) and financial return “unambiguously”, as proposed.

‘Best-in-class’ methodologies

We seek clarity on the FCA requirement to base all disclosures “on objective data and use best-in-class measurement methodologies, which would include common industry practice as it evolves”. Where conventions and best-in-class measurement methodologies do not yet exist, we ask the FCA to clarify its position on the “to the extent possible” and expectation to disclose the impact on “the financial return of the product” to fully satisfy the Consumer Duty.

We would highlight that the proposed level of detail and content in the Handbook Draft relating to sustainability objectives and metrics exceeds the industry’s current ability to utilise only methodologies that are broadly applied.

For example: “...in determining and disclosing its sustainability objective in specific and measurable terms, a firm should describe:

- a) the mechanism(s) by which the sustainability objective is expected to be attained
- b) the time horizon over which the sustainability objective is expected to be attained
- c) potential barriers or risks to the attainment of the sustainability objective”

While (a) in the list is comparable to SFDR disclosures and common industry practices are evolving, and (c) is similar to disclosure of data and methodology limitation under SFDR, methods to address item (b) do not yet pass a hurdle of being broadly applied in provision of unambiguous consumer disclosures. Further guidance from the FCA on expectations for the most technically demanding disclosures, will help the industry reflect on the regulatory risk in disclosures that involve, for example, predictive scenarios.

Unexpected investments

While we agree the sentiment and information content of the “Unexpected investments” category, we raise a concern on the industry’s ability to deliver the disclosure in the spirit of TCFD Disclosure Principles as the FCA intends.

“Unexpected investments” is a subjective qualifier, and it is unlikely that such a task can be executed consistently, comparably, and verifiably (TCFD Principles 4, 5 and 6) over a vast range of products. Given the ease with which investment in certain strategies could be categorised as ‘unexpected investments’, such subjectivity is undesirable as it would make end-investor information unreliable.

We would suggest instead the disclosure of top holdings. Disclosure of such holdings is an objective measure and brings attention to the most material assets, instead of potentially less material and subjectively categorised holdings. Top holdings disclosure would also align more

closely with SFDR disclosures and allow the end-investor to judge the profile of a product based on material information.

“Unexpected investments” could also be reframed as portfolio level concept ‘other investments not meeting the sustainability approach’ to bring focus to portfolio level to limit single asset level subjectivity.

Scope

We believe current end-investor disclosures provide sufficient decision relevant information for those products that do not seek to fulfil the requirements for sustainable products or do not have sustainability-related matters integral to their investment policy and strategy. We do not suggest bringing nil-sustainability-feature products into the scope of consumer-facing disclosures, even if the proposed disclosures are limited.

Q14. Do you agree with the proposal that we should not mandate use of a template at this stage, but that industry may develop one if useful? If not, what alternative do you suggest and why?

We agree with the FCA proposal to provide some prescription around the content, while allowing flexibility for firms to formulate disclosures. We encourage the FCA to continue consumer research and utilise research findings in the development of consumer-facing templates and disclosures.

While the end-investor-facing disclosures are not expected to be fully descriptive, we recognise the value in helping the industry with guidance or a soft form template to create more uniform data for the consumer interface to improve coherence, scalability, and ability for consumers to compare products.

However, allowing the industry more flexibility in detailed pre-contractual disclosures is desirable.

Q15. Do you agree with our proposals for pre contractual disclosures? If not, what alternatives do you suggest and why. Please comment specifically on the scope, format, location, content and frequency of disclosure and updates.

BlackRock generally agrees with the proposal for content for pre-contractual disclosures. As noted under Q13, the pre-contractual disclosures set the reference for end-investor-facing disclosures. The required depth and complexity of pre-contractual disclosures and periodic reporting in sustainability reports will hence influence industry’s ability to express all pertinent issues in lay language, in required depth, and in the required two-page format.

We would note that the proposed pre-contractual disclosure requirements and how the Draft Handbook and Non-Handbook text set out the requirements in significant detail set a high bar for disclosures - a high bar that surpasses international requirements.

However, the proposed disclosures seem to be broadly in line with the spirit and letter of current UK ESG IOPs and requirements set out in the Dear Chair Letter. If that is not the case, we would expect the FCA to clearly communicate where it sees this proposal to exceed and differ from the spirit and understood expectations of current practice.

If the bar for labelled products post consultation is set to meaningfully exceed current practice, that may lead to proliferation of products with “integral sustainability features” that do not fully come under the direction of most of the proposed regulation. This may not be desirable, nor an expected, outcome of the regulation.

As discussed in relation to Q13, while we agree the sentiment and information content of the “Unexpected investments” category, we raise a concern on the ability of the industry to deliver the disclosure in the spirit of TCFD Disclosure Principles. While investment in certain strategies can be readily categorised as “Unexpected investments” it is unlikely that such task can be executed consistently, comparably, and verifiably over a vast range of products.

Q16. Do you agree with our proposals for ongoing sustainability related performance disclosures in the sustainability product report? If not, what alternative do you suggest and why? In your response, please comment on our proposed scope, location, format, content and frequency of disclosure updates.

BlackRock agrees with FCA proposals on ongoing sustainability performance disclosures. As discussed under Q15, we view the periodic reporting under a lens where we see the proposed disclosures to be broadly in line with the spirit of the requirements set out in the Dear Chair Letter. We would urge the FCA to clearly communicate where the current proposals, in its opinion, differs from the spirit of current practice.

We also recommend that firms are allowed to publish composite sustainability reports covering two or more funds managed by the same firm, in line with the approach allowed for in the assessment of value reports. This will enable investors to compare products managed by the same firm, reduce duplication and overload of information if disclosures are consistent across asset classes and/or similar investment strategies.

We have no specific comments on the proposed scope, location, format and frequency of disclosure updates. In relation to content, we would recommend that the proposed requirement under ESG 4.5.7R(8)(b) for presentation of comparative historical annual calculations is limited to five years as opposed to all historic years which would result in a disproportionate amount of information.

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

We are generally in agreement with the proposal for an ‘on demand’ regime. However, we would recommend that firms are only required to produce an ‘on-demand’ sustainability product report annually at a date determined by the firm in line with the requirements for ‘public’ product sustainability reports, as set out in ESG 4.4.7R.

The additional proposed requirement for firms to also provide each individual client with one other report for each reporting period may lead firms to produce multiple reports at different times each year, which will be challenging from an operational perspective, given the dependency to source relevant data for such reports at different dates. This will also result in investors receiving different sustainability information over a specified reporting period.

Q18. Do you agree with our proposals for sustainability entity report disclosures? If not, what alternatives do you suggest and why? In your response, please comment on our proposed scope, location, format, content, frequency of disclosures and updates.

Paragraph 5.86 of the consultation requires all in-scope managers to produce a sustainability entity report. For the purpose of determining whether an asset manager is in scope, additional guidance is provided in Table 1 in Paragraph 3.7. Table 1 confirms that entity-level disclosures are applicable to firms with assets under management (AUM) of £5 billion or more (on a 3-year rolling average).

However, no clarity is provided as to the methodology that should be adopted for measuring AUM. In particular, the consultation does not confirm whether AUM should be measured using a contractual view (i.e. the value of AUM belonging to clients with which a firm has a contractual relationship) or a managed view (i.e. the value of AUM which the firm manages, irrespective of whether it manages assets by way of delegation from another firm or by virtue of a direct relationship with the client).

Table 1 in the consultation defines the product scope of entity-level disclosures with reference to “overall assets managed in relation to in-scope business” (emphasis added); on this basis, we presume the FCA expect firms to adopt, primarily, a managed view. As an exception to this approach, if a firm delegates management to a firm that is not in scope of the SDR, we presume the contracting firm would be required to include those assets in its assessment. Explicit confirmation on this matter will ensure consistent application of the rules across firms. Additionally, confirmation that AUM should be measured using the Net Asset Value (including an offset for any negative values or liabilities attributable to positions in a portfolio) would be welcomed.

The second bullet of section 5.98 states that disclosures should be made in respect of both the firm’s operations and how it manages assets on behalf of investors and consumers. This appears to be a deviation in approach from Policy Statement 21/24 which limits its scope to an entity’s in scope TCFD business.

The need to include operational disclosure also feels duplicative to the work of the International Sustainability Standards Board (“ISSB”). We recommend limiting the scope to remove operational disclosures.

Q19: Do you agree with how our proposals reflect the ISSB’s standards, including referencing UK-adopted IFRS S1 in our Handbook Guidance once finalised? If not, please explain why?

We are comfortable with the FCA’s approach on the ISSB, given the role it will play in driving corporate disclosures. As the consultation notes, ISSB standards have not been issued or endorsed by the UK Government, so there could be issues around timing, we therefore welcome the FCA’s flexible approach in only initially mandating core disclosures, with a view to building on this over time.²

However, we seek clarity on one point mentioned in this section. In the consultation, the FCA references the SDR requirements relating to operations and asset management activities. However, the ISSB requirements should cover the operational element and will have a different reporting location (annual accounts). It would be helpful if the FCA could provide guidance on its thinking in this area.

Q20. Do you agree with the FCA’s general anti-greenwashing rule? If not, what alternative do you suggest and why?

Recent years have given rise to a proliferation of investment products focused on ESG/sustainability. Many of these products in reality make widely varied sustainability-related claims. Despite this, set against still-maturing rule sets, evolving sustainability-related metrics and growing investor familiarity, it is sometimes taken for granted that some of these products can under-deliver on their sustainable investment objectives. The perception that ‘greenwashing’ is a problem in the sustainable investment landscape is indeed problematic as it can undermine investor confidence and inhibit the further uptake and growth of sustainable investment.

² For further information see our Policy Spotlight: [BlackRock supports consistent climate related disclosures; urges global coordination](#)

In our mind, it is important that consumers receive communications that assist them in making informed decisions, and we are supportive of regulation that provides transparency and better highlights the specific sustainability claims that various investment products are actually making.

However, we do not believe the proposed general anti-greenwashing rule is necessary given existing requirements that achieve the same outcome. The existing regulatory regime obliges firms to ensure that the information that they communicate to clients is 'clear, fair and not misleading' and that investment products and services are marketed in a way that is true to label (PRIN 2.1., principle 7, COBS 4.2.1) – is sufficient.

The existing regime includes provisions designed to ensure consistency (COBS 4.5.8), and in a product context we understand these oblige firms to ensure that communications created to support the marketing of an investment product are aligned to the product's legal and regulatory documentation. These requirements capture sustainability as they do any other characteristic and/or approach to investing.

We would also reiterate that we think it is disproportionate to ban products outside of the labels from being able to continue to describe the tilts/screens utilised in the investment strategy in the funds' name. Screens/tilts are approaches that can still be a key product objective and it may be misleading not to include in naming.

Q21. Do you agree with our proposed product naming rule and prohibited terms we have identified? If not, what alternative do you suggest and why?

While it is understood that not all products will meet the standards to qualify for a label, it is essential that a product's name does not mislead consumers, and that the name accurately reflects the nature of the product. From a transparency perspective, the naming and marketing regime as currently drafted will be detrimental to certain parts of the market (such as UK DC) where an accurate description of the product (which includes elements of ESG metrics/processes) is required within the tax wrapper and so is imperative to allocate capital.

We agree that an investment product should not be positioned as 'sustainable', or any related term, if it is not sustainable in substance. We also agree that product names are typically one of the first things that a retail investor reads or hears about an investment product and that appropriate naming plays a crucial role in their understanding of the product's features.

However, as noted throughout this response, it is essential that we can accurately represent a product with a name and description based on its investment process. Provided the product name and marketing materials accurately describe a product's investment process, 'greenwashing' can be avoided without the need for prescriptive regulation of specific terminology.

Hence, we believe that the naming and marketing rules in their current form are disproportionate and will frustrate investor demand for entry-level sustainability products.

As a general principle, we do not believe it is in an end-investor's best interests if we cannot accurately represent a product with a name and description based on its investment process. In line with our standard prospectus and marketing disclosure requirements, we need to be able to accurately name and/or describe a product. Hence, we require the flexibility to include ESG terminology if it is an accurate description of the investment process. Some non-exhaustive examples include:

- Thematic, where the name describes the theme but doesn't qualify for a label;
- Portfolio level commitments like Paris Aligned, Net Zero etc, particularly where it is needed to differentiate from 'standard' non-ESG funds.

In order to comply with existing regulatory obligations (including PS 19/4), to provide investors with clear information that is not misleading, it is essential that we can include all relevant information in the prospectus as the primary contractual document. This should include an accurate description of the investment process, which in turn should be able to be referenced in all communications and marketing collateral to ensure the investor has a full understanding of what they are buying.

We would note that the draft rules already require the inclusion of an actual label for in-scope product in the prospectus and other documentation, so a non-labelled product would be clearly demarcated by 1) the fact it does not have a mandated label and 2) potentially through additional disclosure in the IOP such as “The Fund intends to provide investors with [xyz sustainability outcome] through the ESG Policy outlined below but the Fund is not labelled for the purposes of SDR.”

More broadly, labels should act as a guide for the investor to indicate adherence to a common standard and naming should be a fair representation of product design. These are distinct, and we would stress that conflation may cause us to misrepresent non-labelled products.

Q22. Do you agree with the proposed marketing rule? If not, what alternative do you suggest and why?

As set out in our responses to earlier questions, firms have a clear duty to provide investors with communications that are ‘fair, clear and not misleading’. This duty includes ensuring that information about an investment product offers sufficient detail about its core features, including but not limited to information about the product’s investment objective, how its portfolio manager(s) will pursue this objective and important detail about how investors should consider the product’s performance.

While we agree with and support the FCA’s move to prevent greenwashing and the need to ensure that investment products and investment services are marketed and sold in a manner that is consistent with their legal and regulatory documentation, we believe that prohibiting reference to certain details beyond reference in pre-contractual disclosures could result in investors receiving incomplete communications that lack the necessary clarity in certain areas.

For example, under the proposals and in instances where firms are constrained to solely feature certain information, e.g., the investment product’s benchmark, in the pre-contractual disclosure, marketing and post-sale communications such as performance and positioning updates/reporting could lack crucial information and context about how the portfolio manager(s) consider and use a benchmark and about its performance and decisions tied to allocation and steps to mitigate perceived risks.

Instead, we would support necessary references to sustainability and other related terms within marketing and communications in a proportionate way, so long as these are not used in a way that could mislead or confuse investors or misrepresent the investment product.

Q25: What are your views on how labels should be applied to pension products? What would be an appropriate threshold for the overarching product to qualify for a label and why? How should we treat changes in the composition of the product over time?

For the purpose of this question, we have addressed Q25–29, which relate to pension products, in the answer below.

We continue to see widespread growth in sustainability related commitments made by our pensions clients, most commonly targeting a portfolio level objective or net zero alignment by 2050 or sooner. Since the primary objective of retirement solutions, and fiduciary duty of

schemes, is to convert savings into spending – financial returns are critical and so lower cost sustainable index funds have been a crucial component of such new propositions.

The current SDR labels will exclude most default fund solutions that use tax efficient wrappers.

Although considered a credible and appropriate standard across the market, particularly when also considering risk, return and liquidity profiles required of pension portfolios, products that have a net zero aligned target may in many cases not qualify for a label as proposed under the UK SDR consultation. This can be attributed to requirements imposed on underlying assets rather than delivery of portfolio level outcome for sustainably labelled products.

We believe there needs to be appropriate recognition of portfolios that align with credible sustainable standards as adopted across the pension markets that differentiates such products with those that have no/weaker sustainability related commitments. Otherwise, pension savers may find themselves with an invidious choice between sustainable and unsustainable funds, rather than being able to opt for products with more protean investment objectives.

Should this not happen, we may see:

- Asset Managers that inappropriately compromise on risk/return or liquidity profiles to meet label requirements.
- Compromise to manager criteria determining which assets are considered to be of a credible standard and fit for inclusion (i.e. greenwashing).
- Disincentivising the adoption of sustainable labels because of a lack of pragmatic solutions covering "core" portfolios, which in turn could undermine the overall success of the labelling system. The binary approach to what is considered a sustainable product does not give fair representation to products that do not qualify for a label but are credible sustainably oriented solutions.

In line with this and as stated throughout this response, we do not believe the regime as currently drafted would be suitable for pensions products and we recommend amendment in line with our response.

Q31. Would the proposals set out in Chapters 4-7 of this CP be appropriate for other investment products marketed to retail investors such as IBIPs and ETPs. In your response, please include the type of product, challenges with the proposals, and suggest an alternative approach

Considering the application of the proposals in Chapters 4-7 to ETPs marketed to UK retail investors raises similar concerns to those noted earlier in this response.

Notably, if the proposals were to be enacted in their current form, and extended to EU-domiciled ETPs:

- Only more concentrated, potentially riskier products would classify for the labels. As such, it is unlikely that such products would be able to function as core replacements in investor portfolios.
- The proposed regime does not allow for a gradual or "steppingstone" approach to sustainable investing and does not consider the significant part of the market where investors are still at the beginning of the sustainable journey (i.e. who are looking to invest sustainably but may be unwilling or unable to take on high tracking error or be exposed to the additional risks of investing in a narrow investible universe).

Rather, the narrow range of sustainable exposures which *might* fit into the proposed framework would not provide the range of portfolio building blocks necessary for investors to transition

entire portfolios to an ESG/sustainable profile. Indeed, we are concerned that the lack of a product ladder for sustainable investing may frustrate investor demand.

In addition, the disregard for portfolio level outcomes means that a significant number of sustainable products targeting a real-world outcome (e.g., strategies tilting to issuers with SBTi targets or those with a higher low-carbon transition score, and/or screening strategies with embedded portfolio level carbon emissions intensity reduction targets) could not be marketed as sustainable. This in turn could:

- Lead to a number of undesirable consumer outcomes - not least by potentially denying investors the opportunity to access the full range of products available to meet their investment needs by preventing such products from promoting their sustainable characteristics or objectives.
- Undermine the FCA's policy objectives by limiting the potential for the re-allocation of capital to companies that genuinely operate in a manner that provides a positive contribution for the environment and/or society.

When it comes to marketing EU-domiciled ETPs to UK investors, it is important to note that UK investors represent ~5% of our EMEA sustainable ETF AuM. If in future we were required to materially alter the strategies of existing ETPs in order to meet SDR labelling requirements that are to diverge materially from EU requirements, this could result in significantly increased portfolio turnover (and associated transaction costs) that, in turn, could give rise to conflicts/risk BlackRock has not treated customers fairly.

It would not be feasible to launch UK-domiciled 'sister' ETPs due to the significant costs involved in launching and operating a new UK-domiciled ETP platform and adding new funds to track existing exposures could lead to sub-scale suites resulting in poor outcomes for UK investors (e.g. fragmented liquidity, lower scale/volume potentially leading to increased trading costs etc.).

Divestment as a consequence of Stewardship and Engagement

The likely product profiles referred to in Q.6 (Box 7, Example 1) of the consultation document indicate a fundamental misunderstanding of the rules-based approach to indexing, combining it with active divestment decisions based on stewardship insights. As we explained earlier, the concepts of divestment and influence/engagement are divorced (e.g., cannot influence if not invested) and over-reliance on this in the rules would present particular challenges for index investing.

We suggest an alternative approach to remove the necessity to take active divestment decisions based on stewardship insights as a gating-criteria for label qualification. Also, as outlined throughout this response, we propose the inclusion of portfolio-outcomes focused strategies within the regime.

Portfolio-level Outcomes

As noted above, without further clarification, we do not see how any existing index products (including those tracking an EU Paris-Aligned or Climate-Transition benchmarks) could comply with the requirements of a Sustainable Improvers label. This is not only due to over-reliance on divestment as a consequence of stewardship (see above), but also because the proposals are focused at a security-level, to the detriment of portfolio-level, outcomes.

This further underlines our proposals for the inclusion of portfolio-outcomes focused strategies.

Cross-Border Distribution

BlackRock

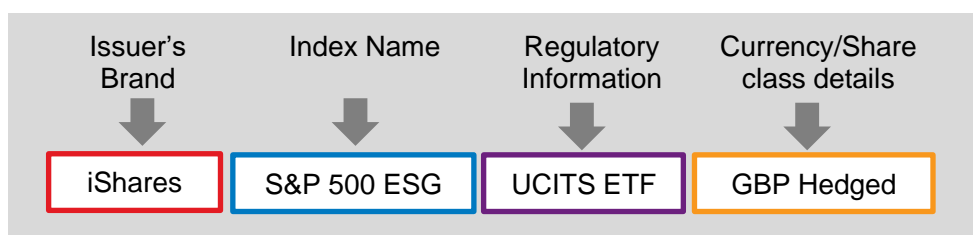
As the SDR labels diverge so significantly from standards applicable to EU-domiciled ETPs that are distributed (via UCITS) across Europe, the marketing rules are particularly difficult to apply.

As mentioned above, we do not believe it would be in investors' best interests to re-name or materially alter the strategies of ETPs in order to meet SDR labelling requirements – BlackRock's sustainable ETF strategies were created in response to investor consultations and, therefore, are meeting the sustainable investment demands/needs of investors

Naming Conventions

The prescribed SDR fund naming requirements, coupled with the fact that they would not apply to index or data providers, would create additional risks and challenges for ETP issuers and lead to sub-optimal consumer outcomes.

This is because ETP names follow accepted conventions, driven by regulation (e.g. ESMA Guidelines) and market practice, that are designed to help investors to compare exchange-traded products and to understand their features. The basic structure of ETF names is intended to tell investors the product's most important features and are typically structured as follows:



Critically, the second component of the fund name is the name of the benchmark index that the ETF tracks. Indices (and their names) are owned by third party index providers which calculate and provide independent verification of the indices, the use of which is then licenced to the ETF provider. It is, therefore, not within the ETF provider's power to change the name of the index that its ETF tracks. Moreover, index names are designed to convey information to investors to help them understand the features and characteristics of the index (e.g. geography, relevant market, ESG or sustainability features).

Terms like 'ESG screened' are not adopted for promotional purposes, they are descriptive and intended to help investors distinguish between products and understand features that are factually accurate (e.g. where terms refer to features of portfolio objectives (e.g. ESG score improvement, decarbonisation commitments, screens/tilts)).

It follows that removing such references from fund names would be unhelpful and, potentially, misleading for investors trying to compare products, particularly when the investor is trying to distinguish between products which may reference the same underlying benchmark index (e.g. the S&P 500), but where one integrates features like exclusionary screens and optimisation based on higher ESG ratings and the other does not.