

FARRER&Co

“In Data We Trust?” – a regulatory viewpoint

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Introduction

The cornerstone of ESG is data; collection, analysis and disclosure of ESG data is key to the regime. In the UK there is a developing Sustainability Disclosure Regime (SDR) which build on the Task Force on Climate-Related Financial Disclosures (TCFD). This briefing examines the current disclosure requirements and the incoming labelling regime. It also draws on the experience so far in the EU and sets out current data availability issues.

Who is this briefing for?

This briefing is relevant to both asset managers and wealth managers with more than £5bn AUM, who will be subject to the disclosure requirements and firms and advisers who need to understand such disclosures to advise and manage investments for their firms and clients. This briefing does not cover the obligations on asset owners.

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UK disclosure obligations

The UK has both entity level and product level disclosure requirements under its' developing SDR. A summary of the current disclosure obligations for asset managers is set out below. Depending on the amount of assets under management (AUM) these obligations apply from 1 January 2022.

Scope and application	Entity level disclosure	Product level disclosure
<p>Entities</p> <p>Asset managers such as portfolio managers, UK UCITS management companies, full-scope UK AIFMs and small authorised UK AIFMs.</p> <p>Asset managers with £50 bn or more AUM – these obligations apply from 1 January 2022, with the first publication by 30 June 2023.</p> <p>Asset managers with £5bn or more AUM – these obligations apply from 1 January 2023 with first publication by 30 June 2024.</p> <p>Subject to: A de minimis threshold, it is not proposed to apply these requirements to firms that have less than £5 billion in AUM or administration on a 3-year rolling average – which will be assessed annually.</p> <p>For smaller firms, the FCA has noted that it will review thresholds at the first review period in 2025, and the FCA is encouraging firms below the current threshold to make disclosures voluntarily where possible, or start building the capabilities to do so.</p>	<p>Obligation</p> <p>Firms will be required to make annual reports on how they take climate-related risks and opportunities into account in managing or administering assets on behalf of their clients and consumers.</p> <p>These disclosures must be made on the firm's main website.</p> <p>Contents of disclosure</p> <p>The contents of the report must be consistent with the TCFD's recommendations – which require that firms consider and disclose climate-related risks in four areas – namely governance, strategy, Risk management and metrics and targets.</p> <p>The entity level disclosure must be accompanied by a signed compliance statement by a member of the firm's senior management.</p>	<p>Obligation</p> <p>Firms will be required to make annual disclosures in respect of the individual products (e.g., funds) or portfolio management services they offer.</p> <p>Annual disclosures must be published on the firm's website and put in appropriate client communications.</p> <p>The FCA does acknowledge that public disclosure may not be appropriate in the case of discretionary services provided to individuals. In such cases product level disclosures should be made to the client upon request, once a year.</p> <p>Contents of disclosure</p> <p>These disclosures would comprise a baseline set of core, mandatory carbon emissions and carbon intensity metrics, additional metrics where possible and a scenario analysis.</p> <p>Firms must include disclosures on governance, strategy and risk management insofar as they are materially different to disclosures made at entity level and where firms consider that more detailed information would be useful to clients and consumers.</p>



Where are these disclosures to be found?

Generally speaking, ESG disclosures should be made available on the firm's website and should be easy to find.

In some circumstances, for example in the case of a segregated portfolio mandate, ESG disclosures may need to be directly requested from an asset manager.

Why are these disclosure obligations relevant to my firm?

These disclosure obligations are relevant to firm with AUM in excess of £5bn as they will need to understand and implement these requirements to meet their disclosure obligations.

The disclosures are also relevant to smaller asset managers and wealth managers as the FCA is encouraging smaller firms to make sure disclosures voluntarily or to develop capabilities to do so.

Individual wealth managers and advisers ought to understand such ESG disclosures in order to properly inform any investment decisions and investment advice for clients and to take account of sustainability preferences.

How to deal with missing data in relation to ESG disclosures

The issue of missing and incomplete data availability has been raised by firms who are striving to meet their disclosure obligations in responses to the FCA's consultation paper on TCFD-aligned disclosure requirements [CP21/17](#). In its policy statement [PS 21/24](#) responding to that consultation paper and in the discussion paper on the SDR and labelling regime [DP21/4](#) the FCA responded by confirming that it does allow firms to use proxies and assumptions, where hard data is not available. However, where a firm chooses to use proxies and assumptions, it must describe its methodology and provide contextual information in such disclosures, including setting out the limitations of this approach.

Also, following the feedback to [CP21/17](#), the FCA amended its final rules to recognise that for certain investments (for example where the investee company disclosures are not yet required) a firm may not be able to use proxies or assumptions to calculate meaningful data to inform the product disclosures. The FCA does not require firms to make disclosures in these instances, but firms will have to disclose why they have not been able to disclose the metrics as well as the steps that the firm are taking to improve the completeness and quality of data. The FCA expects data availability to improve in the near to medium term, and that the completeness of such disclosures to improve over the next few years.



What is next for the developing SDR in the UK?

In November 2021, the FCA published a discussion paper on the UK's SDR and investment labels ([DP21/4](#)). In this DP, the FCA sought views on SDR disclosure requirements for asset managers and certain asset owners, as well as its initial proposals for a sustainable investment labelling system. This SDR will require the gathering and analysis of significant volumes of data.

The FCA is proposing a three-tiered disclosure regime with both entity and product level disclosures. Under this approach, the entity-level and product-level disclosure requirements would build on the FCA's TCFD-aligned disclosure requirements as set out in PS21/24, which is summarised below.

1	Product labels High level easy to understand label which involves standardised product classifications to help consumers understand the sustainability characteristics of various products.
2	Consumer-facing disclosures Further baseline disclosures which should be accessible to retail investors although the FCA has noted that there is a need for investor education so that retail consumers fully grasp this information.
3	Detailed disclosures This would be more granular information and could be made at both product and entity level. The FCA believes this level of disclosure would primarily be useful to institutional investors.

The FCA is proposing that the above labelling regime should use objective criteria and descriptive labels such as setting out the proportion of sustainable investments or the nature of the product's objectives. The FCA does not believe that subjective labels such as traffic lights would be appropriate for a regulatory regime, and it would be difficult to supervise effectively.



Mapping the UK regime to the EU SFDR

The FCA is aware that some UK firms may also be covered by the EU SFDR and is aiming to ensure that the UK SDR is consistent with the EU SFDR. As part of this objective, the FCA has also set out a proposed mapping for the UK label system to the EU SFDR, which is set out below.

		Sustainable		
Not promoted as sustainable	Responsible The product may have some sustainable investments.	Transitioning The product has sustainable characteristics, themes or objectives; low allocation to Taxonomy aligned sustainable activities.	Aligned The product has sustainable characteristics, themes or objectives; high allocation to Taxonomy aligned sustainable activities.	Impact The product has objective of delivering positive environmental or social impact.
FCA proposed indicative mapping of UK labels to the EU SFDR				
Article 6 SFDR	Article 8 SFDR	Article 8 SFDR	Article 9 SFDR	Subset of Article 9 SFDR

The FCA also sought views on how the UK regime can remain consistent with the SFDR in DP21/4. The window for submitting feedback to the FCA in relation to the DP closed on the 7 January 2022, and the FCA is currently working on a consultation paper which is due to be published in the Autumn.

The UK regulation of ESG ratings

One of the key tools for monitoring ESG goals is the use of ESG ratings provided by third parties. These ratings are currently unregulated, however the FCA used [CP21/18](#) to generate discussion about the increasingly prominent role of ESG data and ratings providers, noting potential further policy intervention in this space.

Since then, the regulator has published FS22/4. The FCA notes here that to avoid potential harm to markets and consumers it considers that ESG data and reporting services should be transparent, well-governed, independent, objective and based on reliable and systematic methodologies and processes. It is going to continue to work with the Treasury who are considering bringing ESG data and rating providers within the regulatory perimeter.



EU perspective

How are product disclosures to be made? Where should I be looking for information?

For firms subject to EU regulation, the SFDR sets out the framework for product and entity disclosures and the Level 1 entity obligations have been in force since March 2021 on a comply or explain basis. However, the detail disclosures as they relate to Article 8 (so-called “light green” products) and Article 9 products (so-called “dark green” products) are set out in a supplemental delegated regulation which has recently been adopted by the European Commission and is now under review by the European Parliament and Council.

The products that the SFDR applies to include: portfolios managed under MiFID II, alternative investment funds, UCITS. For more information on the EU disclosure regime, please see our disclosure guide [here](#).

Disclosures are made within pre-contractual documents (for example, fund prospectuses), as well as on firm’s websites and in their periodic reports.

Why is this relevant to my firm?

These disclosures are relevant to any UK firms which are subject to SFDR as they need to understand and implement these disclosures in order to comply with their obligations.

The disclosures are also relevant to UK asset managers when considering EU regulated investments for their clients to properly inform any investment decisions and investment advice being offered, especially if clients have sustainability preferences.

How are firms expected to deal with missing data issues?

As in the UK, there are significant data gaps which firms are struggling to deal with. In March 2022, the ESAs issued an updated [Joint Supervisory Statement](#) on the application of the SFDR which considered the data issues. The ESAs confirmed that they expect the prospectus of any in-scope financial product to provide an “explicit quantification” of the extent to which the portfolio is taxonomy-aligned, and that estimates cannot be used to calculate taxonomy-alignment.

Although, the ESAs noted that the use of “equivalent information” is permitted in certain circumstances. Unfortunately, there is no guidance on what constitutes “equivalent information”. This can cause significant issues when an adviser is trying to compare products to help clients make investment decisions. Hopefully the data will develop in the near future to allow more consistent comparisons to be made.

What’s next for the ESG disclosures in the EU?

The EU is continuing to implement the SFDR and Taxonomy Regulation RTS, and is working on expanding the ESG regime to cover more environmental objectives and to include the social and governance elements. Additionally, ESMA is reviewing the current regime particularly in light of potential greenwashing and has said it may develop more specific criteria for Article 8 products which currently only require “promotion” (widely defined) of environmental or social characteristics.

Similarly to the UK, there are ongoing discussions as to the regulation of ESG ratings.

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