

FARRER&Co

“In Data We Trust?” – a regulatory viewpoint

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Introduction

A keystone of the evolving ESG regime is data; the collection, analysis and disclosure of data is key to an ESG regime to allow investors to accurately compare products in line with any sustainability objectives they may have. In this briefing we examine the data disclosure obligations on the financial services sector, focussing on current UK obligations. In the UK we have a developing Sustainability Disclosure Regime (SDR) and there are significant gaps in ESG data availability for firms subject to such disclosure obligations. We also draw on the experience so far in the EU and we examine how the financial services sector can try to deal with current data gaps.

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UK perspective

What needs to be disclosed? Where should I be looking for information?

In the UK we have both entity level and product level disclosure requirements under the developing SDR. In order to make these disclosures, firms will need to gather and rely on data. A summary of the current disclosure obligations is set out below:

Scope	Entity level disclosure	Product level disclosure
<p>Entities Asset managers such as portfolio managers, UK UCITS management companies, full-scope UK AIFMs and small authorised UK AIFMs. Asset owners such as certain life insurers and pure reinsurers and non-insurer FCA regulated-pension providers 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. Proposals do not apply to defined benefit pension schemes.</p>	<p>Obligation 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. These disclosures must be made on the firm’s main website.</p>	<p>Obligation Firms will be required to make annual disclosures in respect of the individual products or portfolio management services they offer. Annual disclosures must be published on the firm’s website and put in appropriate client communications or upon client request in specific cases. The FCA does acknowledge that this would not always be appropriate, for example, in the case of discretionary services provided to individuals. Therefore, the FCA is proposing that such product level disclosures should be made to the client upon request, once a year.</p>
<p>Products Asset managers products include: authorised funds, unauthorised AIFs and discretionary portfolio management services. Asset owners products include: insurance-based DC pension schemes, non-insurance based DC pension schemes and SIPPs.</p>	<p>Contents of disclosure 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. Must include a signed compliance statement.</p>	<p>Contents of disclosure These disclosures would comprise a baseline set of core, mandatory carbon emissions and carbon intensity metrics, additional metrics where possible and a scenario analysis. 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 can I find these disclosures?

Generally speaking, disclosures will be available on the firm's website and should be easy to find. In some circumstances, for example if your client has a segregated portfolio mandate that you are advising on, you may need to request disclosure separately.

Why is this relevant to me?

This is relevant to smaller asset managers and wealth managers because when considering investments for clients, it is important to understand the disclosures that asset managers, listed companies and others are obliged to make in order to properly inform any investment decisions you are making and any advice that you are offering clients.

How are product providers expected to deal with missing data when it comes to making product level disclosures?

There are significant issues when it comes to missing data, and this can make it difficult for advisers and investors to understand the disclosures and compare products. The issue of missing and incomplete data availability has been raised by firms with the FCA in responses to 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 do so, it must describe its methodology and provide contextual information in such a disclosure, including setting out the limitations of this approach.

Further, following the feedback to [CP21/17](#), the FCA also 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 even 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, however they 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 also expects data availability to improve in the near to medium term, and therefore it expects 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.



An objective labelling regime

The FCA is proposing that the 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.

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

Acknowledging that some UK firms may also be covered by the EU SFDR, the FCA is seeking 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 later in Q2 2022.

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 has consulted in [CP21/18](#) as to whether the industry thinks these ratings should be regulated. The FCA is also considering IOSCO’s recommendations on ESG ratings and data products providers (published in November 2021). The FCA intends to publish a feedback statement later in 2022. The Government is also considering bringing ESG data and ratings providers into the scope of FCA authorisation and it intends to set out further detail later in the year.



EU perspective

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

The Sustainable Finance Disclosure Regulation (SFDR) sets out the framework for product and entity disclosures. However, the detail of those 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, insurance based investment products, pension schemes and pan-European Personal Pension Products. 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 me?

This is relevant to asset managers and wealth managers because when considering investments for clients, it is important to understand the disclosures that asset managers, listed companies and others are obliged to make in order to properly inform any investment decisions you are making and any advice that you are offering clients. Furthermore, some UK products might mirror EU products, and clients may query why disclosures in one product look different to those in a mirror product.

How are product providers 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.

Authors



Grania Baird
Partner

Email Grania
+44(0)20 3375 7443



Jessica Reed
Partner

Email Jessica
+44 (0)20 3375 7518



Kya Fear
Associate

Email Kya
+44 (0)20 3375 7509



Fiona Lowrie
Consultant

Email Fiona
+44(0)20 3375 7515

Farrer & Co LLP
66 Lincoln's Inn Fields
London WC2A 3LH

+44(0)20 3375 7000
enquiries@farrer.co.uk
www.farrer.co.uk

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