Gwil Mason
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

By email: dp21-04@fca.org.uk

7 January 2022

Dear Mr Mason

Re: DP21/4: Sustainability Disclosure Requirements (SDR) and investment labels

We are writing on behalf of the British Private Equity and Venture Capital Association, the industry body and public policy advocate for the UK private equity and venture capital (PE/VC) industry. With a membership of over 700 firms, we represent the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers and investors. Between 2016 and 2020, BVCA members invested over £47bn into around 3,500 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ 1.1m people in the UK and the majority of the businesses our members invest in are small and medium-sized businesses.

Introduction

We welcome the development of a UK Sustainability Disclosure Requirements regime. Many BVCA member firms have already established formal governance processes associated with their ESG frameworks and policies. Many also already disclose publicly around ESG matters in their annual reviews, specific ESG or responsible investing reports and statutory accounts for their portfolio companies. In practice, the proliferation of different approaches to sustainability reporting can leave PE/VC firms burdened with multiple and diverse information requests from investors on a variety of similar ESG topics and metrics. Firms can be faced with a bewildering array of options when developing and enhancing their investment and reporting processes to incorporate the consideration of ESG risks and impacts. This is especially challenging for new/emerging and smaller PE/VC fund managers. A common UK regulatory framework for sustainability disclosures, will, if implemented effectively, foster comparability for investors *and* be helpful to PE/VC firms when integrating sustainability considerations into their investment processes. A common framework should also support effective communication with investors (and portfolio companies).

Summary and key comments

In addition to our detailed responses to the FCA's specific questions, we would like to make the following overarching comments:

Characteristics of illiquid, closed-ended, institutional investment funds

Whilst they share certain characteristics with other types of asset management business, PE/VC fund management firms also have other characteristics that materially distinguish them from their peers in other sectors. We agree that a common sustainability disclosure framework covering the different

parts of the broader asset management industry is highly desirable, not least from an investor perpsective. Equally, it is critical that the FCA's rules reflect the specificities of different sectors and retain sufficient flexibility to facilitate effective sustainability risk and impact disclosure across the asset managment industry.

With this in mind, we would like to highlight the following areas of the SDR framework where we believe its ultimate effectiveness in a private markets context depends on the FCA taking into account certain features of PE/VC funds when designing the rules:

- Product labels should remain optional for closed-ended institutional funds: The relationships between PE/VC firms and the relatively limited numbers of investors in their closed-ended funds is inherently close and long-term. Communication between a firm and its investors is primarily direct, discussions on sustainability issues often occur in person, and simplified methods of communication are less relevant as investors base investment decisions on extensive, direct due diligence. Whilst a degree of standardisation in what sustainability information is reported would be welcome, our members' experience with SFDR suggests there is a serious risk that reductive product labels may be seen as substitutes for investors conducting detailed ESG due diligence and gaining a clear understanding of how a product's investment strategy and objectives relate to sustainability outcomes. This would undermine SDR's policy objectives and we strongly encourage the FCA to consider how to avoid the UK labelling regime leading to this outcome in the PE/VC context. Our recommendation, as explained further in our answer to Q2 below, is that the labelling regime should be voluntary (i.e. opt-in) for closed-ended products that are only marketed to professional investors.

- Funds that are closed to new investors should be outside the labelling regime: The FCA should carefully consider the position of closed-ended funds that are fully closed to new investors. The terms and features of these products are contractually fixed and investors will already have invested on the strength of the investment policy and strategy promoted to them during the fundraising process. Moreover, it is potentially difficult and expensive for an investor to dispose of its investment in such a fund if the investment strategy or allocation changes in response to new rules (including those that accompany a "label" that is determined by reference to the way that the product was originally marketed). We discuss this issue further in our answer to Q2 below, and believe that such fully closed funds should be out of scope of the labelling regime (unless they "opt in").

- Labels must accommodate the fact that PE/VC fund portfolios vary over time: The vast majority of funds raised by PE/VC firms are "blind pool" closed-ended funds i.e. the firm does not know what the underlying investments will be when it raises the fund, and, as investments are sold, the proceeds are returned to investors rather than re-invested. This means that the makeup of the portfolio will vary significantly through the life of the fund, and so the alignment with a taxonomy (or the proportion of otherwise "sustainable" investments) will also vary considerably. The consequences of this for any labelling regime are explained further in our answers to Q2 and Q4 below. Our key recommendation is that any labelling regime must accommodate illiquid, blind pool, closed-ended strategies such as these.

- Labels should not be directly linked to taxonomy alignment: A taxonomy alignment disclosure, and, in some cases, a label, may both provide helpful information to investors, but the information is different and should be separately reported. PE/VC funds take significant

minority or majority ownership stakes in the companies they invest in, which are mostly (although not exclusively) unlisted SMEs. On the one hand, this puts PE/VC firms in a strong position to drive improved sustainability risk and impact management and reporting in parts of the real economy that would otherwise remain outside the scope of sustainability reporting regulation. On the other, it means that reliable taxonomy assessments may be difficult or impossible for PE/VC firms to obtain from all their portfolio companies. As per our answer to Q4, hard rules on portfolio composition based on linking labels to taxonomies in this context, especially while the UK taxonomy only responds to a narrow range of (environmental) issues, would be detrimental to the optimum allocation of capital.

- Consumer-facing disclosures should remain optional for institutional products: Consumer-facing disclosures may be confusing in the context of complex institutional products and producing them for products that cannot be marketed to retail investors would impose considerable burdens and bring little, if any, benefit to the target investor audience. Our recommendation, explained further in our answer to Q1 and Q14, is that funds which are not required to produce a PRIIPs KID (i.e. funds not marketed to retail investors) should not be subject to the requirement to produce a consumer-facing disclosure.

The Disclosures and Labels Advisory Group (DLAG) lacks private markets respresentation

We believe that the breadth of PE/VC-specific considerations touched on above, and in our responses to the questions below, further strengthens the case for PE/VC, and private markets more generally, to be more closely involved in the relevant areas of ongoing policy development in this space. We would like to work with the FCA and the DLAG to help achieve that, and continue to believe that private markets representation on the DLAG itself would be extremely useful in this regard.

In any event, we think it is important that private markets firms are offered the chance to discuss and feed back on the DLAG's output before it is finalised so that, in the BVCA's case, we can identify whether the proposals work in the PE/VC context (typically closed-ended, blind pool, illiquid investment products).

We would also like to highlight that many PE/VC firms have been leaders in the impact investing space for many years, and a number of BVCA members are significant impact investors[1]. We feel this collective expertise and practical experience would make a unique and valuable contribution to the DLAG and we would be delighted to facilitate its integration into the group's work.

Timing of implementation

In our view, it is critical that the UK rules on sustainability disclosures and product labelling are clear from the outset, and do not become fully effective until all the linked regulations and standards (including the UK's Green Taxonomy as it relates to climate change, and ISSB standards) are finalised. To the extent that rules are effective before linked regulations (e.g. aspects of the UK's Green Taxonomy and any future social taxonomy) are fully developed (and the market has had an opportunity to absorb them), transitional provisions should be included to reflect that.

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[1] Further information is available here: https://www.bvca.co.uk/Our-Industry/Impact-Investment

In this regard we note that, in common with many other parts of the financial sector, many of our members either have an EU-regulated fund manager as part of their group, or are marketing funds to EU investors. They are, therefore, subject to the EU's Sustainable Finance Disclosure Regulation (SFDR) and, in some cases, also have reporting obligations under the EU Taxonomy Regulation. Much of the detail of these regulations, including the taxonomy technical screening criteria, principal adverse impact (PAI) indicators and reporting templates, will be covered by delegated legislation under these Regulations, which has been delayed and, in some cases, is still only in draft form.

This, together with a lack of clarity in the Level 1 legislation, has led to considerable legal uncertainty, confusion among investors and significant additional costs. Firms subject to these regulations have had to make strategic decisions with incomplete information, and in some instances, have been forced to change their positions as more clarity has gradually emerged.

While we agree that there is a need for urgent action to deal with the climate crisis and to ensure that the UK remains at the forefront of sustainability regulation, we believe that it is important that the UK takes note of the EU experience and seeks to avoid further unnecessary uncertainty and disruption for regulated firms. The UK has acted quickly to mandate TCFD disclosures (which were already established internationally) across much of the economy, which we welcome, and **we believe that it is important that the UK now takes the time required to develop robust and clear standards in relation to other sustainability disclosures**. This is especially important if, as seems to be envisaged, the proposed SDR requirements adapt the UK's TCFD disclosure rules that are coming into force in stages in the coming years.

In addition, many disclosures required to be made by asset managers will be dependent on the data collected and disclosed by their portfolio companies. Phased implementation in relation to different market participants in the investment chain would be helpful for disclosures to flow through to the ultimate investor.

Furthermore, requirements for advisers to integrate sustainability preferences should be clarified before asset managers are required to categorise products in order to allow asset managers to make fully informed decisions.

BVCA responses to specific discussion questions

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

It appears that the same three-tiered approach will apply both to products being targeted at institutional investors only and to those targeting a wider investor base, including consumers. Our view is that the requirement for standardised disclosures should be limited to those products that target consumers, as such disclosures may not be useful to institutional investors.

Standardised disclosures in the context of complex financial, environmental and social issues should not be so simplified as themselves to become unclear or misleading. To take an example, the level of prescription in the PRIIPs KID template and its incompatibility with different asset classes has made it less meaningful to many investors. Therefore, we believe that there should be some flexibility in the reporting that is required.

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

The scope of the disclosure requirements

We believe it is important that the scope of disclosure requirements be consistent with the UK TCFD-aligned requirements, and we support the £5bn AUM threshold that is (initially) being applied in that context. Our view is that, consistently with the TCFD-aligned reporting requirements, firms that are not UK-regulated should not be subject to the UK requirements (in order to avoid duplication with other national rules) even if they market products to UK investors, and we also believe that similar rules should apply that require disclosures "on-demand" only for certain institutional products.

We also consider that, as per PS21/24 on the TCFD rules for UK asset managers, closed-ended funds which operate under Regulation 74 of the UK AIFMD Regulation (closed-ended AIFs that make no additional investments) should be out of scope of SDR (and the labelling regime).

The scope of the labelling requirements

For products aimed solely at institutional / professional investors, a label may amount to a reductive descriptor which is not particularly meaningful. In addition to reviewing the more detailed disclosures, institutional investors will carry out their own due diligence before investing in a product. We believe that it is important that any labelling regime does not encourage or facilitate an approach by well-resourced institutional investors that treats a particular label as determinative (or strongly suggestive) of their investment decision. A label will not be a substitute for detailed due diligence and a clear understanding of a product's investment strategy and objectives and we encourage the FCA to consider how they can prevent that being the effect of a UK labelling regime.

Our view is that the SFDR has had this effect for some EU-based institutional investors, who are ruling out (or scaling down) investment in certain products even though the products allocate capital to societally-desirable projects. In addition, it might in future be difficult for firms to comply with the rules relating to two different labels (for example, the EU SFDR categorisation and the UK label) and firms that are marketing to non-UK investors (especially products with negligible UK investment) may prefer to adopt the non-UK categorisation exclusively, and in such a case this may indeed be less confusing for international and UK professional investors. **The BVCA therefore believes that the labelling regime should be voluntary (i.e. opt-in) for products that are only aimed at professional investors.**

We also believe that prescriptive rules on portfolio makeup (for example, a requirement for products with a particular label to have a certain proportion of investments in UK taxonomy-aligned activities) would be problematic for a number of reasons. As we describe below, our view is that this could lead to misallocation of capital, but in the context of scope we note that any rules must cater appropriately for a wide variety of strategies. For example, the vast majority of the funds raised by our members are "blind pool" closed-ended funds – meaning that they do not know what the underlying investments will be when they raise the fund and, as investments are sold, the proceeds are returned to investors rather than re-invested. Because the investments are made at different times, often in different geographies and/or sectors, the makeup of the portfolio will vary significantly through the life of the fund, and so the fund's alignment with a taxonomy (or the proportion of otherwise "sustainable" investments) will also vary considerably. Moreover, because the investments are typically illiquid, it is

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not possible to re-balance a portfolio if it fails to meet any particular allocation at any given time. In addition, as the investment opportunities are not known from the outset, the precise allocation to certain sectors or assets will not be knowable at the outset, making it hard to commit to a hard threshold. **We think it is vital that any labelling regime accommodates illiquid, blind pool, closed-ended strategies such as these, and we would like to work with the FCA and the DLAG to help achieve that.**

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

No further comment.

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

We agree with the FCA's ambition to require firms to provide information on sustainability credentials clearly in order to build trust in the market. However, environmental, social and governance challenges are multi-faceted and inter-related, and we believe it is important that a labelling system is sufficiently expansive to ensure that all appropriate sustainability-related strategies are covered.

In part for that reason, we believe that any requirements to report under the UK-taxonomy and/or to report on the level of other "sustainable investments" in a portfolio, should be separate from the label that is adopted. A label should be reflective of an investment strategy and approach, and (at least until a more internationally agreed and all-encompassing taxonomy exists) should not dictate any particular underlying portfolio makeup. Even if, as envisaged by SDR, certain asset managers are required to report under the UK (or other) taxonomy, we do not believe that use of a particular label should be contingent on achieving a given proportion of aligned investments. The label and the alignment disclosure both provide helpful information to investors, but the information is different and should be separately reported.

Our members are particularly concerned about this issue, in part for the reasons referred to above in our answer to Q2, but also because their investment strategies usually involve investment into SMEs, both in the UK and internationally, and reliable taxonomy assessments may not be available for such portfolio companies. In addition, the approach to "sustainability" may be dictated by local conditions; for example, an investment in natural gas infrastructure in the UK may not be regarded as "environmentally sustainable" (now, or perhaps at some point in the near future), while in certain emerging markets such investments remain crucial (until an alternative becomes available) to deliver energy to under-served rural communities whose economic development, and therefore health and well-being, relies upon it. A sustainable investment strategy should be able to respond to such challenges and hard rules on portfolio composition, especially while the UK taxonomy only responds to a narrow range of (environmental) issues, would be detrimental to the optimum allocation of capital.

Our view is that there should not be a hierarchy of sustainable products with some implicitly less desirable than others. All three of the labels that have been identified by the FCA as "sustainable" have an important role to play in the transition to a just and sustainable economy, and, in particular, the

"transitioning" category enables capital to be allocated to assets that are moving from being not sustainable to sustainable, which is hugely important. Each label represents a different strategy, but not one that is necessarily less helpful in delivering desired policy outcomes than another, and investors should be encouraged to invest in all three. This message should be made clear and could perhaps also be woven into the design of any graphical representations of the labelling system.

As regards the "transitioning" label, we note that the FCA's assumption is that these products will move towards a higher allocation to sustainable investments over time. We note that that is not necessarily the case, or even desirable. If a given investment strategy is to transition companies and then to sell/list them, as might be the case for a PE/VC strategy, the allocation to sustainable investments may not increase over time – indeed, at various points in the fund's life, it may reduce.

We appreciate the FCA's intention to create a regime that is consistent and compatible with other global regimes, specifically with EU SFDR, but note this should not constrain the FCA from creating a system of rules and guidance that builds on the lessons from SFDR to be clearer from the outset and encourages the aims of sustainable finance. Where it is possible to align with the SFDR, for example, in its approach to reporting against product-specific sustainability indicators and using a standardised list of PAIs (although the ISSB's output will also need to be considered here), we would support that and believe that this streamlining will make it less burdensome for our members to comply with both regimes. However, we think this will be more difficult to achieve with the labelling regime as set out below.

While we agree that an indicative mapping to the SFDR categorisations would be helpful for firms, we do not think that the UK labels will align perfectly and this should be recognised. Moreover, based on our understanding of market practice, our view is the FCA's provisional mapping does not align with current rules and guidance under SFDR, which might lead to investor confusion. For example:

- We do not think that the FCA's proposed "Not promoted as sustainable" category aligns fully with SFDR Article 6 products, whose managers generally will have an obligation to consider "sustainability risks" (as defined in SFDR) even when they promote no "environmental or social characteristics" in accordance with SFDR Article 8. Many such Article 6 products may in fact fall into the proposed "Responsible" category (where sustainability factors are considered in the context of financial risk and return).

- In the FCA's provisional mapping, both the "Aligned" and "Impact" categories are mapped to Article 9 SFDR (albeit that the "Impact" label would only comprise "a small subset of Article 9 funds". Guidance issued by the European Commission notes that Article 9 products have to invest exclusively in "sustainable investments" as defined under Article 2(17) of the SFDR (i.e. those that make a positive contribution to an environmental and/or social objective and do no significant harm to other objectives). This appears to be a higher bar than envisaged by the Aligned category. On the other hand, it is currently unclear under the EU rules whether assets that are currently not sustainable but are transitioning to sustainable investments can be included in the portfolio of Article 9 funds, which might discourage market players from categorising their products as Article 9 products. In this regard, as mentioned above, we believe that the inclusion of a "transitioning" label is helpful (and we agree that this probably would map to Article 8 unless the Commission confirms that "brown to green" investments are eligible for inclusion in an Article 9 portfolio).

Also, as the names of the labels are taken from plain language, they might lead to confusion for consumers and in other contexts, e.g. the name Impact could mean something different in a different geography to the UK. Given the international investor base for UK-regulated asset managers, the labels need careful thought and market testing in an international context, not only in the UK.

As a further practical point, we would also suggest that the rules include a process or mechanism for the labels of particular products to be changed during their life, should circumstances require, for example as a result of changes to underlying definitions, the introduction of new sustainability standards or evolutions in the market.

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

We do not think it is necessary to impose entity level criteria in respect of Sustainable products, and definitely not in the context of Responsible products. To fulfil the criteria set for these categorisations at product-level would automatically mean that some changes are required at entity level. Prescribing additional requirements at entity-level will lead to needless complication, particularly in the context of multi-strategy global asset managers.

We would also like to highlight in this context that, whilst an increasing number of PE/VC firms are signatories to the UN PRI, the UK Stewardship Code is better suited for investments in listed companies and therefore not directly relevant to our member firms. Effective stewardship is an inherent element of the PE/VC investment model, where funds take significantly influential or controlling stakes in unlisted portfolio companies with a view to increasing those companies' value over several years through operational improvements, expansion and other methods. This level of control, as touched on in the above 'Summary and key comments' and discussed in further detail to our response to DP19/1[2], puts PE/VC firms in a strong position to drive improved sustainability risk and impact management and reporting in the real economy. Considering the stewardship practices already in place within our industry, we believe the Stewardship Code is less applicable for PE/VC firms as adopting it would result in duplicative reporting requirements, albeit in a different form, with limited benefit.

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

We welcome the range of criteria mentioned in the Discussion Paper to classify products. We think it would be better for the criteria to be principles-based rather than prescriptive. It would be very difficult to set out appropriate prescribed criteria for the range of strategies pursued by PE/VC funds and indeed other products in the market. In particular, we do not think that the UK taxonomy is an appropriate tool for fund labelling. We welcome the development of the taxonomy and obligations for certain companies and asset managers to use it for reporting, but we believe that it is not appropriate to require any particular allocation to such investments as a requirement for a particular product label. Similarly, we do not think that requiring a given proportion of other investments "verifiably established

[2] BVCA response to DP19/1 Building a regulatory framework for effective stewardship – available here

to be sustainable" would be a desirable way to design labels, even if there may be reporting obligations that relate to such investments.

Q7: Do you agree with these high-level features of impact investing? If not, why not? Please explain, with reference to the following characteristics:
- **intentionality**
- **return expectations**
- **impact measurement**
- **additionality**
- **other characteristics that an impact product should have**

We agree that intentionality and impact measurement are key features to include in the characteristics of impact investing.

In addition, we consider that a hallmark of impact investing, and a key differentiator between impact investors and those that intend to reduce harms in their investments, is that the investment itself, or the companies into which investments are made, are specifically aimed at solving a defined environmental and/or social problem. Further, the investment should do no significant harm to other environmental or social objectives.

Many PE/VC firms have been leaders in the impact space and a number of BVCA members are significant impact investors. We would welcome the opportunity to engage with the FCA going forward on defining the features of impact investing.

Q8: What are your views on our treatment of transitioning assets for:
a: the inclusion of a sub-category of 'Transitioning' funds under the 'Sustainable' label?
b: possible minimum criteria, including minimum allocation thresholds, for 'Sustainable' funds in either sub-category?

We welcome the approach to include Transitioning products under Sustainable products. It should include products that invest in activities that are not yet sustainable with a view to transitioning them to sustainable activities. As noted above, this would mean that, at any given time, the portfolio may include no "sustainable" investments and it is not necessarily the case that the proportion of "sustainable" investments will increase over time (if the strategy is to invest in assets that are not sustainable, to transform them into "sustainable" investments, and then to sell them – which is certainly a strategy that a PE/VC investor, who will often have control rights, might adopt – see further our comments in Q5 and 'Summary and key comments' about PE/VC firms being well placed to drive change). For that reason, we do not agree that there should be prescriptive asset allocation requirements for such products. Rather the label connotes a particular investment strategy and approach in relation to which a reporting requirement would be more appropriate.

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

As noted in the response to Question 4, the name "Responsible" may not be suitable for the criteria envisaged for this category.

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

As noted in the response to Question 4, we do not think such a category of products, to the extent that it exists at all, requires a label.

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

We think such products should be classified as Transitioning or Aligned depending on the context and the fact pattern.

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

No further comment, as these activities are not core to our members' activities.

Question 13: What are your views on streamlining disclosure requirements under TCFD and SDR, and are there any jurisdictional or other limitations we should consider?

The BVCA welcomes the FCA's aim "to design a regime that avoids duplication and ensures that clients and consumers are provided with consistent and coherent information." The BVCA is supportive of efforts to improve ESG transparency both within the UK and internationally but is mindful that such transparency should not result in multiple layers of partially overlapping regulatory obligations that could simply cause confusion for both firms and investors. Accordingly, the BVCA welcomes, in principle, the proposal to streamline disclosure obligations under TCFD and SDR.

However, we would like to engage further with the FCA on its intentions regarding the idea of adopting the TCFD framework for all sustainability issues. Although TCFD is an excellent framework for climate-related reporting, we think there may be challenges in integrating a wide range of diverse ESG issues into that framework.Any attempt to do so would need to be careful not to result in overly long and expensive disclosure obligations, particularly of the narrative type, that may not deliver clear, decision-useful information to investors. That is particularly problematic at the moment, when market particpants are designing their TCFD reporting in preparation for mandatory TCFD reporting in the UK.

We would suggest that the FCA explores a requirement for products which have sustainability-related objectives to report on bespoke indicators that are appropriate for those objectives (an approach that would align, to some extent, with SFDR) and to consider using a framework that is consistent with international standards such as the ISSB standards and the EU's PAI indicators under SFDR, to require reporting of external impacts for larger portfolios. We would welcome the opportunity to discuss this further.

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Question 14: What are your views on consumer-facing disclosures, including the content and any considerations on location, format (eg an 'ESG factsheet') and scope?

As noted above, the BVCA welcomes plans to improve transparency and consistency of disclosure in relation to ESG. We also understand the purpose behind consumer-facing disclosures, being to provide an initial layer of disclosures "that are more accessible to retail consumers". However, we are concerned that consumer-facing disclosures may be confusing in the context of complex products that are not intended for marketing to retail investors and that producing such disclosures for products that cannot be marketed to retail investors would serve little purpose (since no retail consumer would be in the position of making an investment decision concerning the product to which the consumer-facing disclosure relates) and add unnecessary and disproportionate compliance burden to firms offering such funds.

Accordingly, the BVCA invites the FCA consider tying the obligation to produce a consumer-facing disclosure under SDR to the existing circumstances in which a PRIIPs KID is required to be produced. **For funds which are not required to produce a PRIIPs KID (funds not marketed to retail investors) there should be no requirement to produce a consumer-facing disclosure.** Equally, we consider that listed investment companies should also be out of the scope of this requirement, because the listing rules already require detailed ESG disclosures and sustainability reports, whilst investment company shares cannot properly be considered as products targeted at retail customers (as opposed to interests being made available to individual shareholders). We also refer to our suggestion above that the labelling regime should be on an "opt-in" basis for products that are only made available to professional investors.

For products for which a consumer-facing ESG factsheet is regarded as suitable, we believe that some flexibility is required to ensure that different investment strategies can report decision-useful information that aligns with their particular strategy. As noted above, we believe that defining product-specific sustainability indicators, which align with the promoted sustainability objectives of the product, would be a good approach (and aligns with one aspect of the SFDR).

Question 15: What are your views on product-level disclosures, including structure, content, alignment with SFDR and degree of prescription?

The BVCA broadly welcomes the creation of product-level disclosures to enhance ESG transparency and consistency for investors at a product level. As is implicit in our response to Q14 above, we consider that for funds where no requirement to produce a PRIIPs KID arises, the only product-level disclosure obligation should be the detailed underlying disclosures discussed in paragraphs 4.14 to 4.17 of the Discussion Paper. The BVCA is supportive of the categories of more detailed information proposed in paragraph 4.16 of the Discussion Paper, namely:

- information on data sources, limitations, data quality etc;
- further supporting narrative, contextual and historical information;
- further information about UK Taxonomy alignment; and
- information about benchmarking and performance.

Inevitably, much will depend on the detail of the obligations to be developed further by the regulator and the BVCA looks forward to engaging in subsequent consultation exercises relating to more detailed proposals.

In terms of alignment with SFDR, the BVCA considers that broad alignment to the principles behind SFDR is to be welcomed, as is the distinction common to both the FCA's proposals and SFDR between entity and product level disclosures. However, the BVCA would not welcome proscriptive alignment to the SFDR regime because:

- the BVCA considers that SDR represents an opportunity for the UK to calibrate a financial sector ESG disclosure regime suited to its needs and which learns positive lessons from the initial experiences of SFDR implementation in the EU; and

- in addition to SFDR, the FCA should also have regard to other relevant international comparators in terms of existing or proposed disclosure regimes, including the proposals of the Securities and Exchange Commission in the USA.

Finally, in relation to the degree of prescription of the new regime, the BVCA considers that there is a balance to be struck between, on the one-hand, ensuring that any disclosure regime adheres to meaningful and consistent standards such that the risk of "greenwashing" is mitigated and investors are provided with useful information, and, on the other, being so prescriptive as to make compliance prohibitively difficult in particular asset classes. Whilst being held to consistent standards, the BVCA therefore considers that firms should have the opportunity to present information in a way that is meaningful in the context of their products and the asset classes in which they invest.

Question 16: What are your views on building on TCFD entity-level disclosures, including any practical challenges you may face in broadening to sustainability-related disclosures?

In principle, the BVCA welcomes the introduction of TCFD entity level disclosures. We also, in principle, welcome the alignment of entity level disclosures to TCFD to create a common framework that investors will be familiar with and for consistency across sectors of economic activity. However, as explained in more detail at Q13 above, we would like to engage further with FCA on its intentions regarding the idea of adopting the TCFD framework for all sustainability issues.

The BVCA also welcomes (subject to seeing the detail of how the rules would operate) the concept of allowing firms flexibility to ensure that disclosures are made at the level of consolidation which they consider would be most decision-useful for clients and consumers. The detail of how that flexibility operates will be important to ensuring that it achieves its stated aims and the BVCA therefore looks forward to engaging with future consultation exercises on more detailed proposals in this area.

Question 17: How can we best ensure alignment with requirements in the EU and other jurisdictions, as well as with the forthcoming ISSB standard? Please explain any practical or other considerations.

As noted in our response to Q16, the BVCA is supportive of alignment to international standards to provide consistency across international markets and avoid unnecessary duplication of efforts by firms with an international presence. The BVCA considers that firms should be permitted to use information compiled for SFDR compliance purposes to comply with corresponding obligations under SDR. However, the BVCA would not welcome proscriptive alignment between SDR and SFDR for the reasons articulated in our response to Q15 above. More generally, the BVCA does agree that the ISSB standard should be used as a benchmark in creating UK ESG disclosure obligations so as to facilitate maximum international consistency in ESG reporting and disclosure obligations.

BVCA

Question 18: What are your views on the roles of other market participants in communicating sustainability-related information along the investment chain?

We consider that some level of obligation on financial advisers to consider sustainability matters in their investment advice would be appropriate. However, we consider that any such obligation should be framed in a principles-based manner and avoid being overly prescriptive, so as to afford financial advisers flexibility to act in their clients' best interests. We note that many of the funds offered by BVCA members are not distributed through financial advisers in any event and are frequently (with some exceptions) unavailable to retail clients. As mentioned above, we also believe that the obligation on advisers should be made clear from the outset, so that products can be designed and labelled by firms in a way that aligns with the likely preferences expressed by advised investors.

Question 19: Do you consider that there is a role for third-party verification of the proposed approach to disclosures, product classification and labelling and organisational arrangements of product providers? Do you consider that the role may be clearer for certain types of products that others?

The BVCA considers that the proposed obligations on firms under SDR to categorise their funds and comply with disclosure, labelling and organisational arrangements should be imposed on firms themselves and subject to the FCA's normal supervision tools. External verification would, in our view, add significantly to the costs of compliance for firms without clear benefit. A third party verification obligation also risks creating an un-level playing field because such verification is likely to be considerably more straightforward and therefore less expensive in the context of larger funds and those investing in listed instruments (about which significant levels of public information are likely to be readily available to firms undertaking external verification exercises) than for smaller funds and those invested in illiquid unlisted instruments whether debt or equity, such as many BVCA member firms. **Accordingly, the BVCA considers that an external verification obligation should not be imposed.**

Question 20: What approaches would you consider to be most effective in measuring the impact of our measures, including both regulatory and market-led approaches, and should disclosures be provided in a machine-readable format to better enable data collection and analysis?

We consider that engagement with market participants is likely to be the most effective way of measuring the impact of the FCA's proposed measures. In particular, canvassing the views of the end-users of the disclosures (consumers for retail disclosures and institutional and other professional investors for the more detailed disclosures) would be an appropriate way of assessing whether the new regime is working in practice. In principle we have no objection to disclosures being provided in a machine-readable format to better enable data collection and analysis, however we would ask that any system facilitating such data collation be made as user-friendly and easy for small firms (who may have limited information technology resources) to adopt as possible.

We would be happy to discuss the contents of this letter with you; please contact Tim Lewis (tim.lewis@traverssmith.com) and Tom Taylor (ttaylor@bvca.co.uk).

Yours sincerely,

Tim Lewis, Chair, BVCA Regulatory Committee