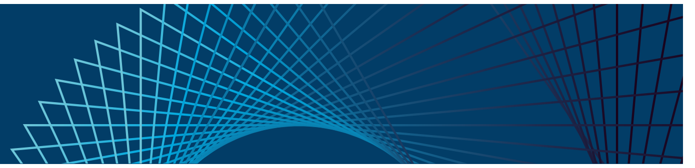
European
Leveraged
Finance
Association



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

1st February 2023

Response by email to: cp22-20@fca.org.uk

Dear Sir/Madam,

Response to FCA Consultation Paper (CP22/20) – Sustainability Disclosure Requirements (SDR) and investment labels

The European Leveraged Finance Association (**ELFA**) welcomes the opportunity to respond to the Financial Conduct Authority (**FCA**) regarding the Consultation Paper (CP22/20) – 'Sustainability Disclosure Requirements (**SDR**) and investment labels' (the "**Consultation Paper**").

ELFA is a professional trade association comprised of European leveraged finance investors from over 60 institutional fixed income managers, including investment advisors, insurance companies, and pension funds. ELFA seeks to support the growth and resilience of the leveraged finance market while acting as the voice of its investor community by promoting transparency and facilitating engagement among European leveraged finance market participants. In the footnotes, we have included some links to our relevant reports and research that we have been involved in regarding sustainability challenges, including our ESG Fact Sheets[1], our Best Practice Guide to Sustainability Linked Leveraged Loans[2] and our Insights Report on the emergence of ESG Provisions in Leveraged Finance transactions.[3]

We are very supportive of the proposed FCA regime set out in the Consultation Paper and the goals which the regime aims to achieve. There are however some key aspects of the proposed FCA regime where further clarification and/or amendments are required and we have set these out in our detailed response to the relevant questions.

We appreciate the FCA's willingness to engage with us on this topic and would be happy to discuss any aspect of this submission in further detail. Please contact either myself (sfox@elfainvestors.com) or Michael Damoah (mdamoah@elfainvestors.com).

Yours sincerely,

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ESG Fact Sheets & Guide for Company Advisers
FIND OUT MORE

[1]ESG Fact Sheet General
[2]Best Practice Guide to Sustainability Linked Leveraged Loans
[3]The Emergence of ESG Provisions in Leveraged Finance Transactions

Annex 1: Responses to Discussion Paper Questions

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?

Whilst we broadly agree with the proposed scope of firms, products and distributors under the new regime, we would however request further clarification and detail on a number of points.

It is not clear whether the FCA has specifically considered how the SDR will affect credit funds. We think that this is an important consideration given the specific challenges faced by the leveraged finance sector. Funds which operate in this market are faced with challenges around sourcing relevant, reliable ESG-related data and the lack of publicly available information for relevant companies. The examples set out in the Consultation Paper are primarily equity-focussed and not credit focussed. It would be helpful therefore to have additional detail which considers and applies the SDR to the leveraged finance sector and include relevant examples. For example, having the flexibility to add perhaps a deadline for companies to come up with relevant set of sustainable KPIs and set at relevant and ambitious enough level would help, otherwise, it will exclude a big chunk of the market and lead to high portfolio concentration.

As such, ELFA welcomes the opportunity to work with the FCA to ensure that the SDR is appropriately tailored to the credit markets, and would point to our ESG Disclosure Initiative as an example of data gathering and harmonising initiative bringing together credit investors, borrowers and their advisers to ensure that ESG data is flowing in the credit market.

Moreover, as stated in the Consultation Paper, funds which are disclosing under Article 8 of SFDR may not meet the FCA's qualifying criteria for a 'sustainable investment label' and may be limited in their use of ESG-related terms. In the absence of flexibility and a degree of tolerance around these issues (particularly in the context of non-UK funds) this is likely to result in confusion, additional queries from investors and the incurrence of additional cost.

In addition, we are concerned that non-UK domiciled funds and non-UK products managed by a UK domiciled fund manager will not be in scope initially and that this delay will create inconsistency in the market. We ask that the FCA:

- confirm the obligations of multinational company funds currently being marketed into the UK, as well as its applicability to overseas funds managing UK products in general;
- clarify whether the rules are intended to apply to closed funds which are no longer open to subscription; and
- clarify the applicability of the regime to distributors who may market funds to high net worth individuals who have opted to be a professional client.

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.

As set out above, we express our concerns regarding the additional cost and resource burden arising from the SDR regime. We believe the differences in management costs, staff capabilities and negotiation power with external advisors across firms of the same type and feature are difficult to measure.

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.

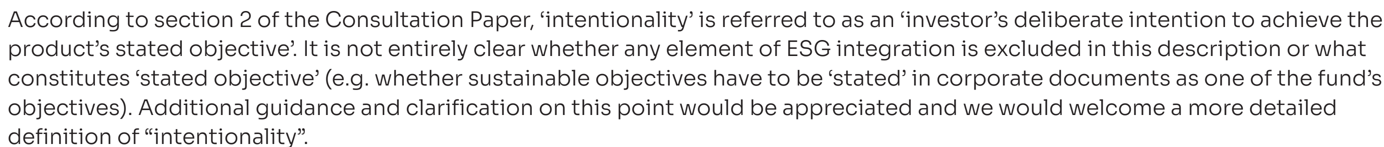
We are supportive of the FCA's characterisation of what constitutes a sustainable investment product as one that has an explicit environmental and/or social objective which is part of the investment objectives (alongside the relevant product's financial return objective) and that such objective is expressed in specific and measurable terms.

We acknowledge the description of the channels of positive sustainability outcomes but wish to highlight the fact that: 1) certain capital markets issuers (such as unlisted companies offering leveraged loans and high yield bonds) do not provide investors with sufficient sustainability data or other relevant information; and 2) the leveraged finance market also faces specific challenges such as those mentioned above. It therefore would be helpful if Box 3 of the Consultation Paper is expanded to demonstrate how the various direct and indirect channels or mechanisms can apply in the context of private credit funds.

In addition, we would raise concerns over active investor stewardship and engagement being one of the main criteria to be applied in respect of the sustainable improver category. The ability of the leveraged finance sector to engage actively at shareholding levels or exercise voting rights is more limited than for other sectors and therefore credit funds are curtailed in their ability to use the main mechanisms available under the regime. A contradiction therefore arises since many the companies within an asset manager's portfolio (particularly in the mid-market) nonetheless will be focussed on transitioning and improving the sustainability profiles..

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 are supportive of the labelling and classification regime to build and retain customer and client trust in sustainable investment products, and to protect and enhance market integrity.



According to section 2 of the Consultation Paper, 'intentionality' is referred to as an 'investor's deliberate intention to achieve the product's stated objective'. It is not entirely clear whether any element of ESG integration is excluded in this description or what constitutes 'stated objective' (e.g. whether sustainable objectives have to be 'stated' in corporate documents as one of the fund's objectives). Additional guidance and clarification on this point would be appreciated and we would welcome a more detailed definition of "intentionality".

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? In particular, we welcome your views on:

(a) Sustainable Focus: whether at least 70% of a 'sustainable focus' product's assets must meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme?

(b) Sustainable Improvers: the extent to which investor stewardship should be a key feature; and whether you consider the distinction between Sustainable Improvers and Sustainable Impact to be sufficiently clear?

(c) Sustainable Impact: whether 'impact' is the right term for this category or whether should we consider others such as 'solutions'; and the extent to which financial additionality should be a key feature?

In general, we are supportive of the distinguishing features as set out in the Consultation Paper, however we would appreciate greater clarity in respect of certain issues.

(a) Sustainable Focus – We are supportive of setting a threshold to ensure that an agreed percentage of a product's assets must meet a relevant credible standard of sustainability or otherwise align with a specified environmental and/or social theme. We would request additional detail as to how the 70% threshold referred to in the Consultation Paper is to be calculated and the extent to which other assets will be included and/or excluded in any such calculations, such as cash or derivatives.

In addition, although the absence of definition of 'credible standard' may allow for a degree of flexibility, it is also not clear to us how the broad spectrum of assets in which credit funds invest would fit under the prescribed 'credible standard'. We request that the FCA provide additional guidance for the purposes of determining whether an investment meets the criteria of 'credible standard' of environmental and/or social sustainability including application of international standards and/or taxonomy regimes.

(b) Sustainable Improvers – We are supportive of having an 'improver' category as we recognise the need to encourage more progressive practices by issues which may represent a larger part of the market.

However, we express our concerns over investor stewardship being a key feature in the improver category. As stated in our response to Q4, stewardship is not always possible for credit funds which by their nature as creditors will have limited control or influence than shareholders. Therefore, we ask that the FCA set out separate criteria for funds such as hedge funds or private credit funds for which investor stewardship is arguably less forceful than it would be from the standpoint of a shareholder.

(c) Sustainable Impact – We acknowledge that many of the most impactful funds are those financing the transition of existing assets to a more sustainable path as opposed to funding the creation of new businesses. We express our concerns on the ambiguity of an 'impact' label, which poses a risk of preference for 'impact-focused funds' investing in new assets over those transitioning existing businesses.

In addition, the reference to "underserved" and "market failure" is likely to narrow the scope and application of this label and in doing so, adversely affect the speed and scaling of this label for consumers and clients alike. We also request that the FCA consider extending contribution to refer to/take into account enterprise contribution.[4]

As a general point, we note that minimum asset allocation requirements have not been included for the Improver and Impact labels. Can the FCA please confirm that this is the case and clarify why this distinction has been made.

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 are supportive of the proposal to only introduce labels for sustainable investment products and exclude a 'non-sustainable' label.

[4] The GIIN, the leading trade body for the impact investing industry, has moved away from narrowly defining it in terms of the 'additionality' concept as has been considered as something more possible to evidence in private, illiquid markets.

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

- **whether the criteria strike the right balance between principles and prescription;**
- **the different components to the criteria (including the implementing guidance in Appendix 2);**
- **whether they sufficiently delineate the different label categories; and,**
- **whether terms such as 'assets' are understood in this context?**

The qualifying criteria as set out in the Consultation Paper are fairly strict and we believe they could be more accommodating in cases where firms have limited resources or control/influence at a shareholding level. We would also ask that the FCA to consider the alignment of the SDR regime with SFDR. As the FCA acknowledges, the SDR may require a "levelling up" of an Article 8 fund.

In relation to the requirement on KPI disclosures, we raise concerns over its possibility of limiting credit managers' ability to invest into smaller companies which may not have the resources to provide KPI disclosures. We would appreciate greater clarification on the sustainability-related metrics to be disclosed, as well as the possibility of less stringent criteria for smaller companies. We further ask the FCA to take into account fluctuating trends, investors' changing needs and evolving expectations of ESG investing. We therefore propose the consideration of amendments to KPIs over time to better reflect the market as it evolves. We look forward to enhancing our dialogue with the FCA on this and welcome the opportunity to review any such changes to KPIs from time to time.

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?

We express concerns as to the difficulty in implementing a third-party independent verification at this stage. Based on current market practice, we believe that verification may significantly increase firms' costs, particularly for smaller ones as well as create an uneven playing field between funds pursuing different investment strategies. We are therefore supportive of the FCA's approach of not requiring independent verification.

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 appreciate the FCA's recognition of the existing disclosure obligations of UK firms under the EU SFDR and SEC regulations and welcome the mapping of interaction between the regimes as set out in the Consultation Paper.

However, as set out above, we express concerns as to the unaligned standards and disclosure obligations with the EU SFDR which may, for example, result in an Article 8 SFDR fund failing to meet with the FCA's qualifying criteria for a 'sustainable investment label'.

In addition, we request that the FCA take into account the variety of industries, nature of businesses, trading strategies, and disclosure frameworks of firms, as well as allow for some flexibility in certain disclosure requirements, particularly with regard to cost calculation mechanisms, so that the regime can better reflect the distinction and differing capabilities between investment firms. We are also aware of the scope and complexities of pre-contractual and sustainability product disclosure obligations, and we request that the FCA provide additional clarification and guidance to help us navigate the regime.

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 proposal not to mandate the use of a template at this stage to allow for a degree of flexibility. However, we welcome the opportunity to help develop a sample template or guideline with explicit disclosure obligations for the purposes of providing additional guidance and clarification. ELFA would be happy to work with the FCA in creating a template, drawing on our experience through the ESG Fact Sheet Series.

Q20: Do you agree with our proposed general 'anti greenwashing' rule? If not, what alternative do you suggest and why?

We agree with the FCA that firms should already be ensuring that the information they communicate to clients is 'fair, clear and not misleading' as stated under PRIN 2.1, Principle 7, and COBS 4.2.1. Given that the intention is that this new rule clarifies existing rules, we ask that the FCA consider whether the new anti-greenwashing rule is required. The addition of this new additional rule which clarifies existing rules may have the unintended consequence of implying that the current rules do not adequately address the risk of greenwashing. We would also ask that the FCA provide details as to the extent of clarification which will be required and the extent to which these will lead to further additional constraints under the new 'anti-greenwashing' rule.

We would also appreciate greater clarity on how the proposed general 'anti-greenwashing' rule interacts with other proposed measures by the FCA as set out in the Consultation Paper.

Appendix of Member Firms

Aegon Asset Management
AlbaCore Capital
Alcentra
Allianz Global Investors
Allspring Global Investments
Amundi
Angelo, Gordon & Co
Apollo Global Management
AXA Investment Managers
Bain Capital Credit
Barings
BlackRock
Blackstone
BlueBay Asset Management
Bridgepoint
Capital Four
CELF Advisors LLP, The Carlyle Group
Chenavari Investment Managers
Columbia Threadneedle Investments
CPPIB Credit Investment
Credit Suisse Asset Management
CVC Credit Partners EU CLO Management
CVC Income & Growth Ltd
DWS Investment
Evli Fund Management
Federated Hermes
Fidelity International
Five Arrows Managers
GoldenTree Asset Management
Guggenheim Partners
HPS Investment Partners
Insight Investment
Invesco
Janus Henderson
JP Morgan Asset Management
Kartesia
KKR Credit Advisors
LFP Opportunity Loans/ DELFF Management
M&G Investments
Morgan Stanley Investment Management
Muzinich & Co
MV Credit Partners
NIBC Bank
NinetyOne
Nuveen
Oak Hill Advisors
Oaktree Capital Management
Palmer Square Capital Management
Partners Group
Pemberton Asset Management
Permira Capital
PGIM Financial
Pictet Asset Management
Polus Capital Management
Robeco Asset Management
Schroders Capital
Sculptor Capital
Spire Partners
Strategic Value Partners
T. Rowe Price
Tikehau Investment Management
TwentyFour Asset Management
Voya Investment Management