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

25 January 2023

SDR and Labels Policy
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

Re: CP 22/20 – Sustainability Disclosure Requirements (SDR) and Investment Labels

Dear Sir/Madam,

T. Rowe Price welcomes the opportunity to submit our firm's individual response to the above consultation paper. Our firm, T. Rowe Price International Ltd (TRPIL) (FRN 194667), is a subsidiary of T. Rowe Price Group Inc. (TRPG).[1] Headquartered in the United States, T. Rowe Price has offices in 17 jurisdictions around the world, including the United Kingdom, with global assets under management of $1.28 trillion (USD).[2] We are a supporter of record for the Task Force on Climate-related Financial Disclosures (TCFD), a member of the IFRS Sustainability Alliance, and a signatory to the UN Global Compact principles. We are also a member of the Global Impact Investing Network (GIIN).

We appreciate the FCA's significant work in producing the Sustainability Disclosure Requirements (SDR) and investment labels proposal. We support the FCA's efforts to improve retail investor understanding of sustainable products, improving their ability to compare between different sustainable propositions, and to protect them from greenwashing. Further, we applaud the FCA's endorsement of using the Sustainability Accounting Standards Board (SASB) and TCFD standards. We are also generally supportive of the new proposed sustainable product labels, although we have concerns that the FCA might limit the use of the Sustainable Impact label to overly narrow circumstances, to the detriment of UK retail investors. Finally, we are not supportive of the creation of a UK Taxonomy. All of these specific comments are explained in greater detail below.

I. EXECUTIVE SUMMARY

Our view regarding the Sustainable Impact label requirements

We generally agree with the comprehensive comments of our trade associations explained in their respective submissions (The Investment Association (IA) and ICI Global), and also with comments submitted by GIIN. We are submitting our own letter to highlight our views related to the Sustainable Impact label requirements:

- We agree that the objective of the Sustainable Impact label should be to achieve a pre-defined, positive and measurable environmental and/or social impact. However, we disagree that each impact fund in this category must show "financial additionality," (i.e., that it provides new capital to projects and activities that offer solutions to environmental or social problems, often in underserved markets or to address observed market failures). Such an outcome – limiting the Sustainable Impact label to primary markets or where only new capital is deployed – would be a

[1] Founded in 1937 in the United States, T. Rowe Price Group, Inc. (NASDAQ-GS: TROW) provides a broad array of pooled funds and actively managed exchange traded funds, sub-advisory services, and separate account management for individual and institutional investors, retirement plans, and financial intermediaries.
[2] As of December 31, 2022.

disservice to retail investors who would lose access to a broader range of impact investment propositions.

- If the FCA does not allow comingling of primary and secondary market impact investments in the Sustainable Impact label, we recommend that the FCA create a separate impact label for listed investment products, which would allow retail investors for appropriate peer group comparisons and differentiation.

- We welcome the simplicity the proposed labels can bring to retail investors; however, we disagree that an investor contribution should be a differentiating factor between the labels, and that only one type of investor contribution is allowed per label as a primary channel by which the product may plausibly achieve a positive outcome. The differentiator should be the sustainable objective of the fund, with additional characteristics specific to that label. For the Sustainable Impact label, this would be the adoption and implementation of theory of change supplemented by the enhanced impact measurements (KPIs), and the portfolio manager should be able to utilize any combination of investor contribution methods (with proper disclosure) in its investment process to deliver on a positive outcome.

- We welcome the principles-based proposed requirements for enhanced KPI impact measurement based on the best industry standards. In the final rule, it would be helpful if the FCA included some examples of well-recognized KPI metrics, such as the IRIS catalogue metrics as agreed by GIIN, and any other metrics it views as reflecting the best industry standards.

II. DETAILED DISCUSSION

(Answers to specific consultation questions are below this Discussion section)

Unintended consequences of an overly narrow Sustainable Impact label to UK's Net Zero ambitions

The overly narrow Sustainable Impact label would restrict the flow of capital to companies that will help the UK and broader global economy achieve its net zero ambitions and become more environmentally and socially sustainable. The government has estimated that a *net* cost of the UK reaching net zero by 2050 is around £321 billion, or just over £10 billion per year – that is just one sustainable goal in one country. While the government should not be directing the flow of private capital, we believe that a broader Sustainable Impact label that includes listed equity and fixed income is more likely to promote the growth and development of impact investing generally. More products will be created, and more clients will be able to express their investing preferences by choosing impact funds. Including unleashing the scale of listed equity and debt markets in the Sustainable Impact label will thus be more likely be critical to enable enough capital to flow into environmentally and socially sustainable economic activities.

Unintended consequences of an extremely narrow Sustainable Impact label to retail investors; an alternative recommendation

If new and existing listed equity and fixed income funds in the impact space are not allowed to use the Sustainable Impact label, the funds with those investments will likely choose to use the Sustainable Focus label instead. In practice, this would mean that a lower regulatory threshold will apply to such funds: instead of the proposed requirement of 100% of investments, excluding efficient portfolio management, to be aimed to deliver impact; a new requirement of 70% of investments meeting a credible standard of sustainability will apply. This would create a rather broad category, making it potentially difficult for investors to differentiate impact vs. non-impact-oriented investments within the Sustainable Focus label. Firstly, it would be more difficult for consumers to identify which investment products intend to deliver on a sustainable objective through **every** underlying holding and which can invest some of their holdings in securities that are not sustainable. Secondly, it would be more difficult for retail investors to identify whether the intentionality of investments was simply to align to sustainable economic activities *or* if it was to seek investments in securities that deliver sustainable outcomes (i.e., impact). In our experience, our clients who want to invest in our listed equity and fixed income impact funds care a great deal about this important difference.

An alternative recommendation. If the FCA is not comfortable co-mingling private impact and listed impact investment products within the same label, we suggest creating a fourth label that is intended for listed equity and fixed income impact investments (or creating a sub-category within the Sustainable Impact label). Allowing listed impact investment products in the Sustainable Impact label (whether within the existing proposed Impact label or within a new fourth Impact label) would allow effective comparable peer groups to be created. In our experience, the investable universe for a listed equity or fixed income impact fund is dramatically narrower than the investable universes that would be available to a Sustainable Improver or Sustainable Focus fund. For example, our Global Impact Equity fund uses the MSCI ACWI benchmark, which contains approximately 3,000 securities. Once we have applied the fund's exclusion list and filtered to identify companies with the potential to deliver positive environmental or social impact, the investable universe is cut to approximately 500 to 600 securities. It is then from that remaining 20% of the benchmark, where the portfolio manager will look for securities that meet both the impact and financial criteria required for purchase in the portfolio. We believe the reduction of the investable universe would be substantially less for both the Sustainable Focus and Sustainable Improver labels. This is largely because both proposed categories have a much broader investment universe than a Sustainable Impact fund investing in listed securities.

The overly narrow interpretation of the Sustainable Impact label would detrimentally narrow the investable impact universe

Since the consultation paper was released, we have participated in some forums with FCA staff where they have articulated that the Sustainable Impact label is meant only for new capital deployment, which should not be conflated with all private market investments (i.e., "a private investment made in an existing wind farm would not be considered impact"). We believe that limiting the Sustainable Impact label to such a narrow scope would create enormous impracticalities and would make it very difficult to find investments meeting this hurdle, especially in the equity space. We note that most investors would say that the companies best suited to building new wind farms are those that have experience – these companies tend to have existing assets. Additionally, by excluding companies with existing assets from the mix, this could ultimately raise the overall cost of capital for new wind farms, for example, which we believe would represent an unintended consequence and be a sub-optimal outcome for the United Kingdom.

Focusing on primarily measuring financial additionality in Sustainable Impact products oversimplifies impact measurement and overlooks significant progress and innovation in impact investing

We recognize the FCA's concerns around impact measurement and the ability to achieve "pure" impact measurement in the typically larger and more complex companies and other issuers that you find in listed equity and fixed income markets. We note that while impact investing has existed for a long time, it has only started to receive more significant inflows in recent years. In this sense, the space is in its infancy, particularly as it relates to listed equity and fixed income securities. We believe there is a significant opportunity for improved disclosure from issuers that would aid better measurement of positive impact.

While we oppose the financial additionality as a key requirement for the Sustainable Impact label, we support the proposed principles-based requirements for enhanced KPI impact measurement based on the best industry standards. In the final rule, we believe it would be helpful for the FCA to include some examples of well-recognized KPI metrics, such as the IRIS catalogue metrics as agreed by GIIN, and any other metrics it views as reflecting the best industry standards.

Limiting the use of investor contribution in the primary channel by a type of label would undermine the portfolio manager's ability to use a mix of investor contribution tools to deliver on the product's objective

One aspect of the consultation paper that we found difficult to understand is using the investor contribution as a distinguishing feature between the three labels and assigning one type of investor contribution to each label as a primary channel to achieve a product's objective. The differentiator should be the sustainable objective of the fund, with additional characteristics specific to that label. For the Sustainable Impact label, this would be the adoption and implementation of theory of change supplemented by the enhanced impact measurements, as we explain in detail below, in response to specific questions. To achieve best outcomes, the portfolio manager in the Sustainable Impact label should be able to leverage any combination of the investor contribution tools as further explained below.

Conclusion

Impact investing has a significant potential, both for the UK retail investors and the UK economy. We strongly hope that the FCA adopts our recommended adjustments to make the impact investing label available to retail investors in the UK, while protecting them from greenwashing.

III. SPECIFIC QUESTIONS AND RESPONSES

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:

…

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?

We welcome the simplicity the proposed labels can bring to retail investors; however, we are not comfortable with the manner in which investor contribution is deployed. In our view, investor contribution is a tool that the asset manager uses to achieve their sustainable objective, not the distinguishing product feature. The differentiator should be the sustainable objective of the fund, with additional characteristics specific to that label (for the Sustainable Impact label, this would be the adoption and implementation of theory of change supplemented by the enhanced impact measurements), and the asset manager should be able to utilize any combination of investor contribution (with proper disclosure) in its investment process. In this regard, we believe that selecting what type of investor contribution to use is a decision that should be made by the portfolio manager at the security level and not at the fund level.

For example, an impact fund (i.e.*,* a fund that aims to achieve a pre-defined, measurable real-world outcome using theory of change) may be comprised of underlying securities that require various methods of investor contribution to deliver real world outcomes:

(i) An acquisitive company in the industrial sector where the asset manager can deploy investor contribution through engagement to encourage the company to focus on the sustainability profiles of potential acquisitions (the investor contribution in this case is the active investor stewardship and engagement, in addition to its investment);

(ii) A utility developing new renewable capacity in a sound manner with robust reporting including impact metrics where the asset manager may deploy investor contribution by influencing asset prices as the impact outcome will be measurable through clear real world KPIs (the investor contribution is influencing asset prices and the cost of capital); and

(iii) A social bond whose use of proceeds goes to neighborhood improvement in a low-income community by revitalizing housing stock where the investor contribution is allocating capital to underserved markets (the investor contribution is financial additionality).

The term "impact" rather than "solutions" is best suited to convey the fund's objective to retail investors. We support using the term "impact" rather than "solutions" in the label, so it is clear to a retail investor that a product's objective is to seek positive and measurable environmental and/or social *impact*.

We suggest the final Handbook rules reflect the financial risk/return fund's objective along with its impact objective. Lastly, if the FCA intends to make it clear for retail investors when the impact fund provides new capital, we suggest creating a fourth category or creating a sub-category within the Sustainable Impact label (*e.g., Impact - Primary Markets* and *Impact – Public Markets*).

Q9: Do you agree with the category-specific criteria for:
…
The 'Sustainable impact' category, including expectations around the measurement of the product's environmental or social impact?

Overall comment on the "sustainable impact" criteria. We support the criteria for the Sustainable Impact label in that it differentiates the impact label from other labels by requiring firms (1) to develop a theory of change,[3] in line with the sustainability product's sustainability objective, emphasizing how its investment process aims to contribute to addressing environmental and/or social problems; and (2) to use and disclose KPIs that apply enhanced impact measurement and reporting based on industry best practices. In this context, we appreciate the FCA's observation regarding the continued innovation in the impact space, as well as allowing for the use of the best industry practices. An agile and less prescriptive approach to defining impact investing will help drive capital flows to companies that can deliver a positive real-world impact, environmental and/or social.

Real-world impact KPIs. We support principles-based requirements for enhanced KPI impact measurement based on the best industry standards. This area is experiencing innovation, which means we have started seeing gradual improvements in data availability, quality, and overall reporting. In the final rule, it would be helpful if the FCA included some examples of well-recognized KPI metrics, such as the IRIS catalogue metrics as agreed by GIIN, and any other metrics it views as reflecting the best industry standards.

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?

We were pleased to see the FCA's endorsement of the TCFD within the proposal. Through our engagements with investee companies, we are finding that many are confused about the various ESG reporting standards and, as a result, are taking a wait-and-see approach to see where regulators land.

We urge the FCA to continue promoting education for corporate issuers that the SASB and TCFD standards will be aligned with the standards of the International Sustainability Standards Board (ISSB) – adopting SASB/TCFD today will put them on the best path for the future ISSB standards. We feel this is not yet well understood by the overall market.

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.

We are not supportive of developing a UK Taxonomy. We believe the establishment of a UK Taxonomy will effectively put the government in the position of picking "winners" and may potentially lead to asset bubbles. We believe that allowing asset managers to determine what is sustainable is more synergistic with allowing creative solutions to flourish within industry.

For example, following the passage of the Inflation Reduction Act in the United States, we are seeing a dynamic shift from companies based around the world as they look to make green investments there. A rigid taxonomy may be less able to keep up with these types of positive developments.

[3] The proposal defines theory of change as "(in relation to ESG) a comprehensive description and illustration of how and why a desired change is expected to occur in a particular context."

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Thank you for considering our views. If you would like to discuss our responses further, please contact Anna Driggs, Managing Legal Counsel for ESG Public Policy, at anna.driggs@troweprice.com.

Sincerely,

/s/ Louise McDonald
Louise McDonald
Head of EMEA Product Management

/s/ Maria Elena Drew
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