Depositary Insights

December 2021

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NatWest Trustee and Depositary Services

Foreword

Welcome to the Winter 2021 edition of Depository Insights.

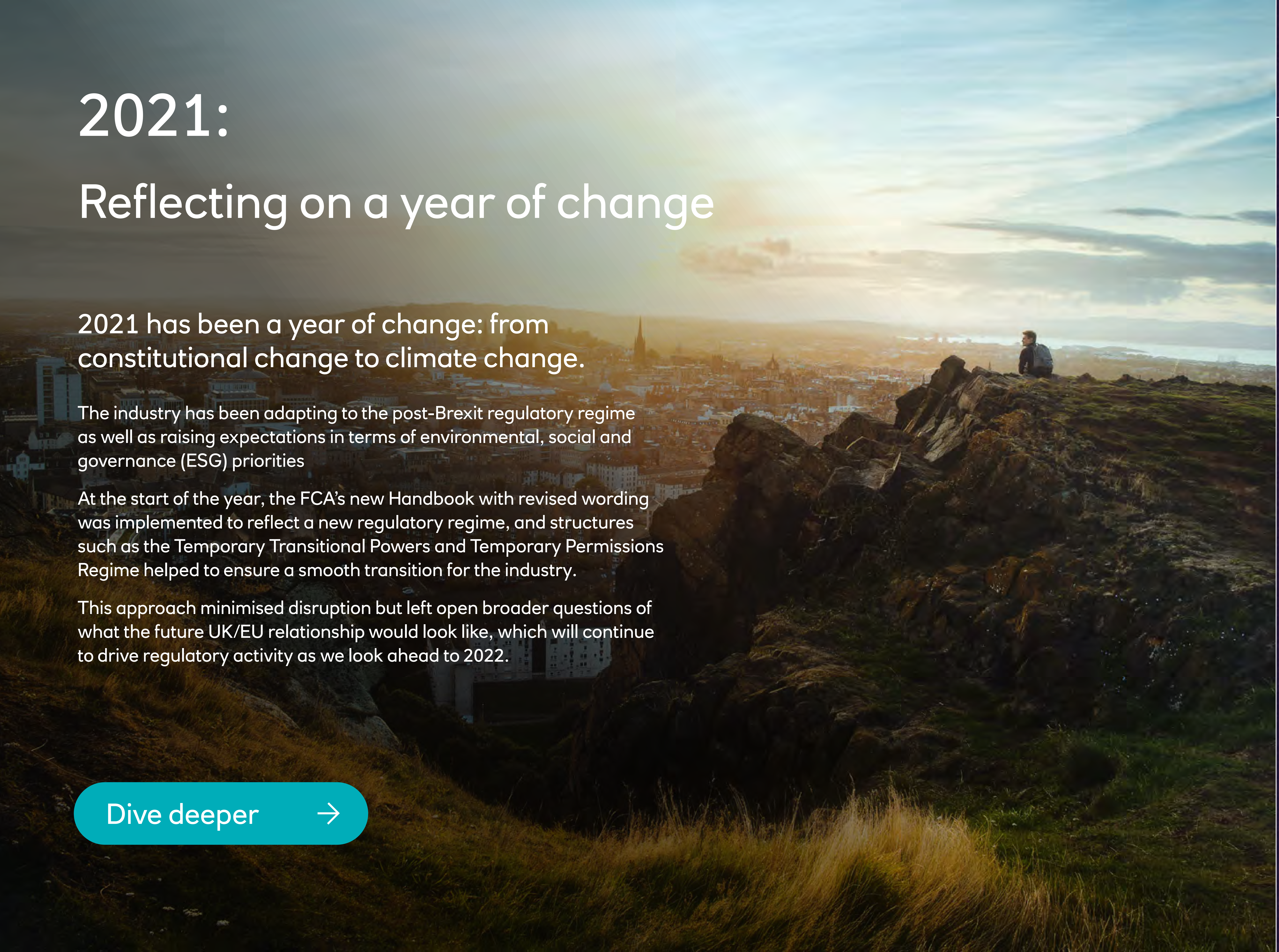
NatWest Trustee and Depository Services team

It has proven to be a particularly busy year in the world of fund regulation, and it is remarkable to consider the volume – and pace – of change that we have seen over the past year. Major themes such as Brexit, Covid-19 recovery and climate change have understandably driven much of the agenda, but we have also seen the year-long development of key initiatives such as the Long Term Asset Fund, the Investment Firms Prudential Regime, and Operational Resilience, to name just three. We have seen regulators take a more assertive, innovative and adaptive approach, which has included robust feedback in terms of the Host AFM review and the review of Assessment of Value reporting. Meanwhile the debate as to the future of the UK regulatory framework has continued, as regulators, government and the industry consider how the UK can grow its position as a leading funds domicile whilst enhancing its reputation in the core areas we see as market integrity and strong governance.

In this edition of Depository Insights we take time to reflect on what has been an extraordinary year in regulation, before looking ahead to 2022: we expect next year to be just as eventful, as focus grows on investor protection, competitiveness, and strengthening the funds market.

We also look in more detail at recent developments regarding the Long Term Asset Fund, and consider the latest position in terms of ESG, green finance and sustainability, which have been given particular relevance following the COP26 climate change conference, and an area in which we are continuing to develop new functionalities for clients. As momentum in this space continues to grow, there is increasing demand for enhanced investor protection in terms of transparency and accountability and third party oversight of data and portfolios.

As ever, we hope you find our analysis helpful and engaging, and we welcome any feedback for future editions.



2021:

Reflecting on a year of change

2021 has been a year of change: from constitutional change to climate change.

The industry has been adapting to the post-Brexit regulatory regime as well as raising expectations in terms of environmental, social and governance (ESG) priorities

At the start of the year, the FCA's new Handbook with revised wording was implemented to reflect a new regulatory regime, and structures such as the Temporary Transitional Powers and Temporary Permissions Regime helped to ensure a smooth transition for the industry.

This approach minimised disruption but left open broader questions of what the future UK/EU relationship would look like, which will continue to drive regulatory activity as we look ahead to 2022.

Dive deeper →

2021: reflecting on a year of change

Enhancing competitiveness

Hence the government's call for input, in January, on the future of the UK funds regime. Respondents were asked for their views on how to boost the competitiveness, attractiveness and efficiency of the UK as a funds domicile, whilst upholding consumer protection and market integrity. It is notable that, though the call for input closed in April, the outcome of the review is still to be confirmed.

NatWest Trustee and Depositary Services (NWTDS) responded to this call for input, noting that there was more that the UK could be doing to market itself as the leading funds domicile, not least in terms of its strong global reputation for governance, of which the independent depositary model is a key part. We also argued in favour of enhancing the 'shop window' of UK funds, introducing changes to the branding of the NURS regime for example, and seizing the initiative on ESG to enable the UK to become the leading jurisdiction for responsible investment. Again, independent oversight will be critical to this and we see the depositary playing an increasingly important role in this respect.

2021: reflecting on a year of change

Part of the competitiveness drive led to the 'at pace' development of the Long Term Asset Fund, which NWTDS supports. The Chancellor announced this new fund type in November 2020, with a desire for the first funds to be issued by the end of 2021, which has ensured that the LTAF received an accelerated focus throughout the year – the consultation closed in June and the policy statement came out on 25 October, just three weeks before the new rules were implemented on 15 November – a rapid deployment indicating a more agile approach to regulatory implementation when it is in pursuit of building out a more globally competitive funds industry.

The FCA also addressed the challenges of purpose and strategy – its mid–year Business Plan came out in July – a few months later than usual, but worth waiting for as it set out a clear steer for the year ahead: more assertive, more innovative and more adaptive, with an enhanced focus on the priorities of consumer protection and duty of care, diversity, and climate change. In our role as depositary we have seen the FCA taking a more probing approach to fund authorisations this year, as well as the issuance of detailed requests for information, indicating a growing regulatory desire for more 'deep dives' to understand the composition of funds at a more granular level and of the firms which issue them. Again, this is core to ensuring investor protection and we believe that independent oversight and governance will play an increasingly vital role in this agenda.

2021: reflecting on a year of change

Strengthening governance

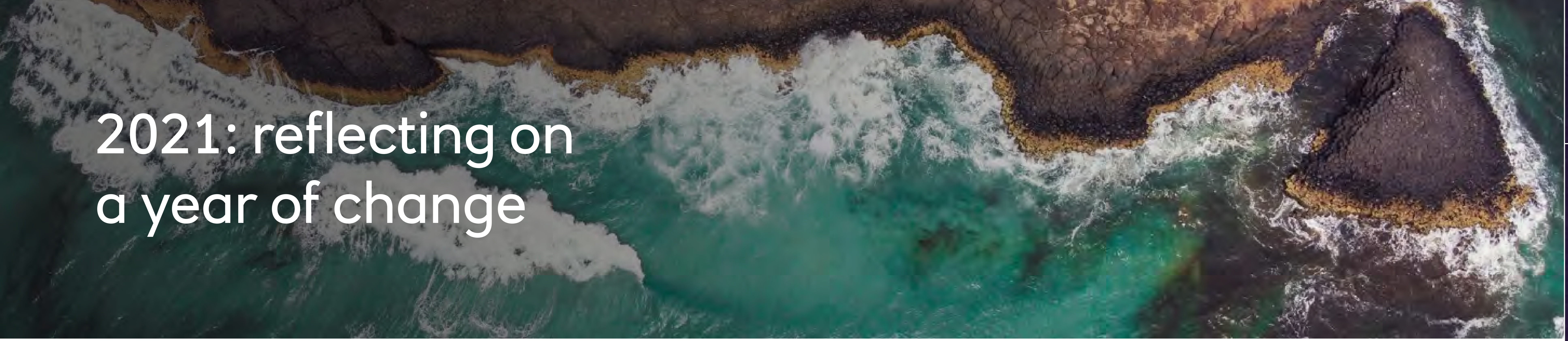
Related to this, fund governance has been a particular area of focus. The FCA's keenly–awaited review into the Host AFM market was published in June, with robust feedback for the host sector in terms of, among other things, conflicts of interest, governance, and skills. The review should be seen as part of a process rather than an event: the FCA has said that it will follow up in 12 to 18 months after the publication of the original report, to assess progress. We believe that the industry as a whole should review the FCA's feedback on a 'best practice' basis: there is read–across which the wider funds market should be aware of and some firms, even outwith the Host sector, may glean valuable insight into how they could enhance their own processes and governance.

Assessment of value (AoV) reporting has also been in the spotlight. A year after the introduction of AoV reporting, the FCA issued its initial feedback on the exercise and again the feedback was robust: too much focus on the fund–level value rather than at underlying unit level, issues in terms of rigour in assumptions, and concerns about the adequacy of challenge provided by independent non–executive directors through governance structures. This feedback should be welcomed by the industry in the interests of its clients. The FCA will expect to see its feedback reflected in the next round of reporting and so a review of the feedback, and mapping to AoV reporting, will be a valuable exercise.

> You can find our analysis of the Host AFM review here, and our overview of the Assessment of Value review here.

Depositaries have been addressing their own processes and procedures, working with the FCA to help shore up their approaches to discharging their duties under COLL 6.5.

As a result of these initiatives, 2021 has been a year in which the architecture of the industry has been strengthened for the future.



2021: reflecting on a year of change

Building resilience

The broader theme of resilience has of course remained prominent, whether that be in terms of firms' ongoing management of the challenges posed by Covid-19, or the focus on operational resilience. For the former, firms have been taking cautious steps towards returning to offices – and the FCA is paying attention to new ways of working, issuing its guidance on hybrid and remote working in October.

Operational resilience is also gaining momentum, with the publication of the policy statement in July, and emphasis now on identifying important business services and setting impact tolerances for the March 2022 deadline.

The Investment Firms Prudential Regime has also been steadily building up throughout the year, with three consultations, three policy statements and finalised rules all being published, ahead of implementation in January 2022, making preparation for implementation an end-of-year priority for firms in scope.

As for LIBOR, regulators have been clear throughout 2021 that the industry is in the 'home straight', with the transition period set for the end of December, and no appetite for stumbles in the final stages.

Emerging technologies

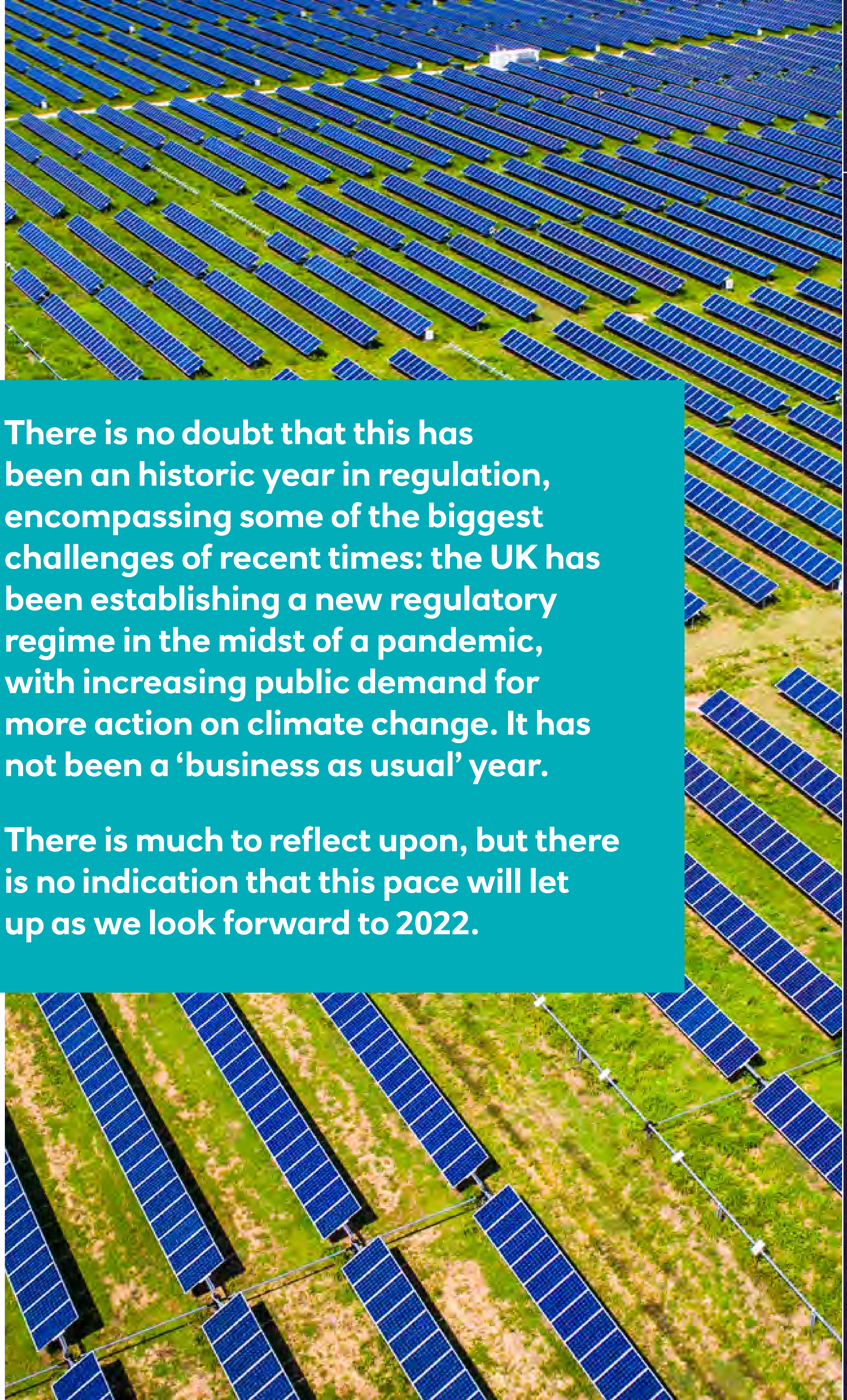
The regulatory focus on cryptoassets has continued to grow. The FCA has been clear about the risks associated with retail investment in this space: a number of speeches have highlighted the potential pitfalls. Firms are watching closely, and considering the opportunities and risks, including in related areas such as tokenisation. The Treasury consulted on stabletokens earlier in the year, but we are yet to hear the outcomes from that process: this is one to watch next year.

2021: reflecting on a year of change

The climate crisis

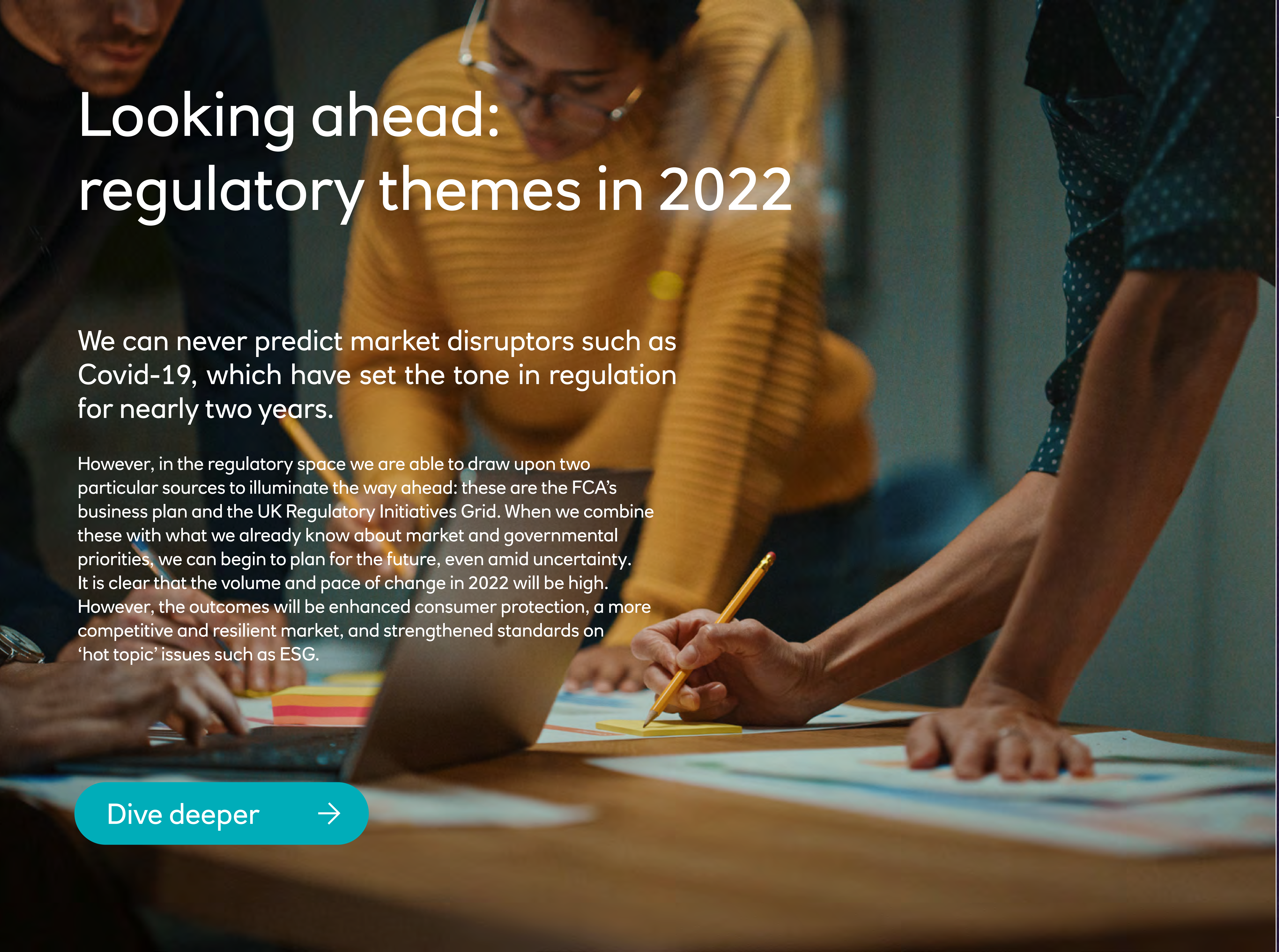
And finally, climate change. The COP26 climate conference in Glasgow has focused minds on the role of financial services in tackling global warming; and the themes of Net Zero, responsible investment, and associated challenges such as transparency, assurance and credibility have continued to gain momentum throughout the year. We saw the publication of the FCA's ESG regulatory principles in July, and its approach to sustainable fund authorisations. The first signatories to the new Stewardship Code have been published, with the focus on outcomes proving a major step up for applicants. Expectations are growing for firms to show, in a credible and transparent way, how on a firm and product level they are addressing the climate challenge.

Attention is increasingly turning to assurance and objectivity: the release of November's discussion paper on the Sustainability Disclosure Requirements (SDR) and the publication of the government's 'Greening Finance' report in October point towards a doubling–down of efforts for the UK to lead the way internationally on climate finance, with the funds industry playing a critical role. To achieve this it will be vital to avoid the risks of greenwashing, or of boilerplate reporting: ESG claims made in prospectuses and marketing materials need to be backed up by verifiable data.



There is no doubt that this has been an historic year in regulation, encompassing some of the biggest challenges of recent times: the UK has been establishing a new regulatory regime in the midst of a pandemic, with increasing public demand for more action on climate change. It has not been a 'business as usual' year.

There is much to reflect upon, but there is no indication that this pace will let up as we look forward to 2022.



Looking ahead: regulatory themes in 2022

We can never predict market disruptors such as Covid-19, which have set the tone in regulation for nearly two years.

However, in the regulatory space we are able to draw upon two particular sources to illuminate the way ahead: these are the FCA's business plan and the UK Regulatory Initiatives Grid. When we combine these with what we already know about market and governmental priorities, we can begin to plan for the future, even amid uncertainty. It is clear that the volume and pace of change in 2022 will be high. However, the outcomes will be enhanced consumer protection, a more competitive and resilient market, and strengthened standards on 'hot topic' issues such as ESG.

Dive deeper →

Looking ahead: regulatory themes in 2022

The business plan

The FCA's business plan, published in July 2021, sets out a clear strategy: alongside the focus on consumer protection and enhancing market integrity, there is a desire to become a more assertive, innovative, and adaptive regulator. There is also a clear steer in terms of consumer protection: the FCA makes numerous references to its ongoing work on the duty of care, with new rules to be published in mid–2022. The consumer investment strategy, published in September, goes hand in hand with this, and we know we can expect further emphasis on growing the market for consumer investments, while making it safer and more attractive to do so.

Climate

The FCA was also clear on climate change. This is now a key part of its remit, and the focus will be on 'deep dives' into portfolios, and driving forward new regulation on, for example, disclosures. Focus will turn to the credibility, assurance and transparency of ESG claims made in prospectuses and marketing material: the UK's Green Taxonomy and the Sustainability Disclosure Requirements are two particular initiatives to watch. Enhancing the governance and oversight of ESG will reduce the risk of consumer harm. A credible, transparent market in green finance will also strengthen the UK's global reputation as a leading jurisdiction for responsible investing.

Diversity

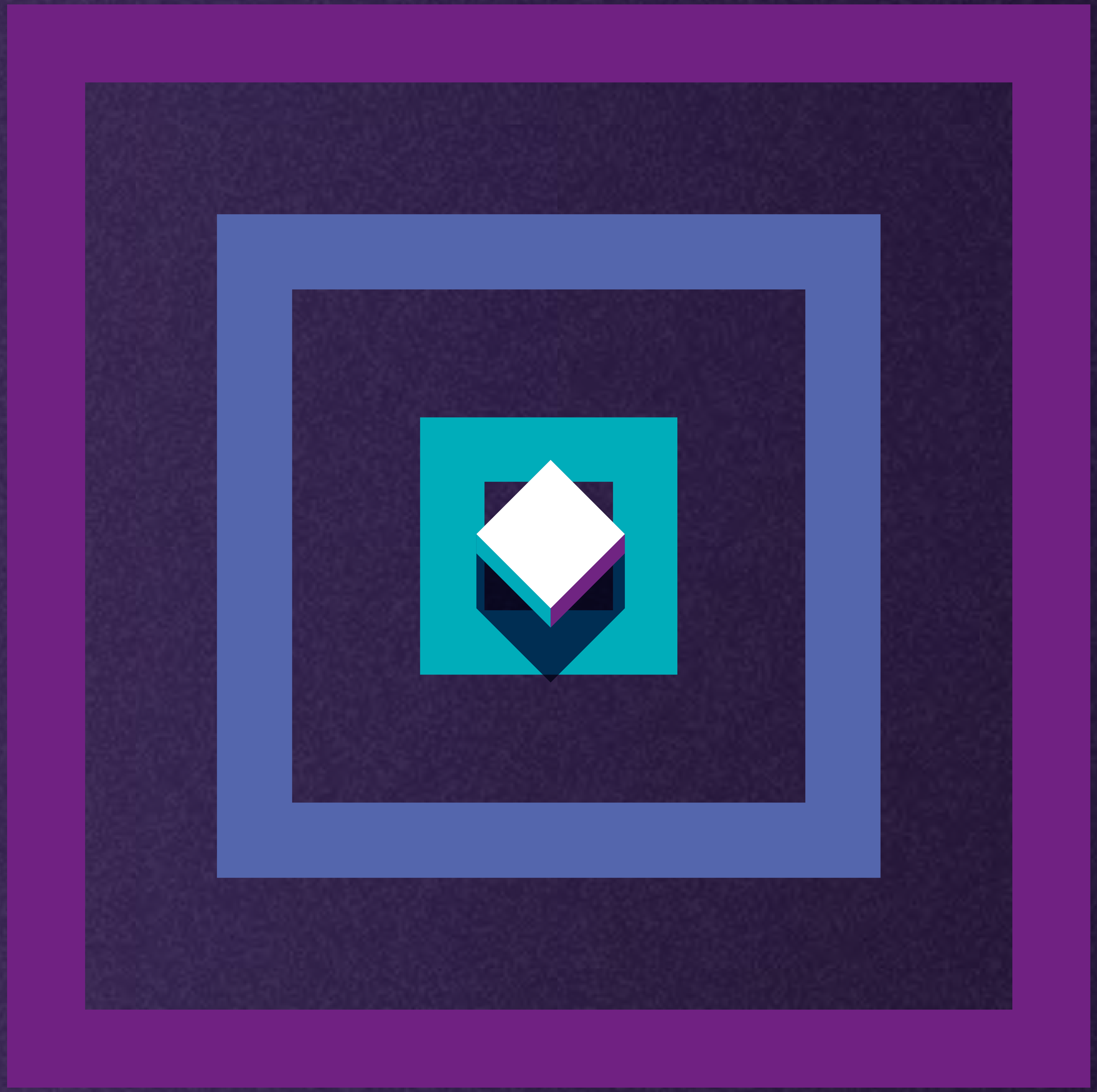
Diversity and inclusion is a growing regulatory priority, and we have seen the publication of a discussion paper on enhancing diversity outcomes at, for example, board level. Given the FCA's enhanced attention on diversity in the business plan, we can expect the regulator to be reviewing responses to the discussion paper particularly closely, with further announcements expected soon. There may also be more requests for information on diversity-related matters and more bilateral, thematic engagement on this topic.

Looking ahead: regulatory themes in 2022

The Regulatory Initiatives Grid

An even clearer picture appears when the business plan is coupled with the regulatory initiatives grid. This is a relatively new document, which emerged from the regulatory framework review. Firms had fed back to UK regulators that there would be benefit in having a timeline of all the key upcoming regulatory developments, such as policy statements, consultations, and discussion papers, in one place, to help with planning ahead, and its introduction has been hugely beneficial.

From this, we get a sense of the volume of activity on the horizon: the grid maps 134 developments. However, while the volume may create an 'operational burden' in the short term, this will ultimately support the development of a more streamlined and efficient regulatory regime.



Looking ahead: regulatory themes in 2022

Continuity and conclusions

A number of the developments represent a continuation of initiatives developed in 2021, with momentum continuing to grow. Next steps are set out in terms of developments such as operational resilience, and the Investment Firms Prudential Regime, for example.

Work on the Long Term Asset Fund will continue into 2022, and we know from the grid that we can expect further consultations in terms of widening the scope and ironing out additional areas such as registration of assets, valuation and assessment without qualification: this is just the beginning for LTAFs.

There is a high volume of ESG initiatives as the UK gears up to operationalise next steps in areas such as sustainability disclosures, TCFD reporting and the green taxonomy. COP26 was a highlight in the regulatory calendar in 2021, with the hard work of implementing a number of the proposed changes being a priority throughout 2022.

The grid does not provide all the answers however. The FCA has been vocal in terms of the risks associated with cryptoassets, for example, and the government, earlier in 2021, had issued a call for views on stabletokens. However, it has not always been possible to provide specific dates for these, besides acknowledgment that outputs will be published 'in due course'. We are, in other words, still in the early stages of a comprehensive policy response to this emerging area of opportunity and risk.

Competitiveness

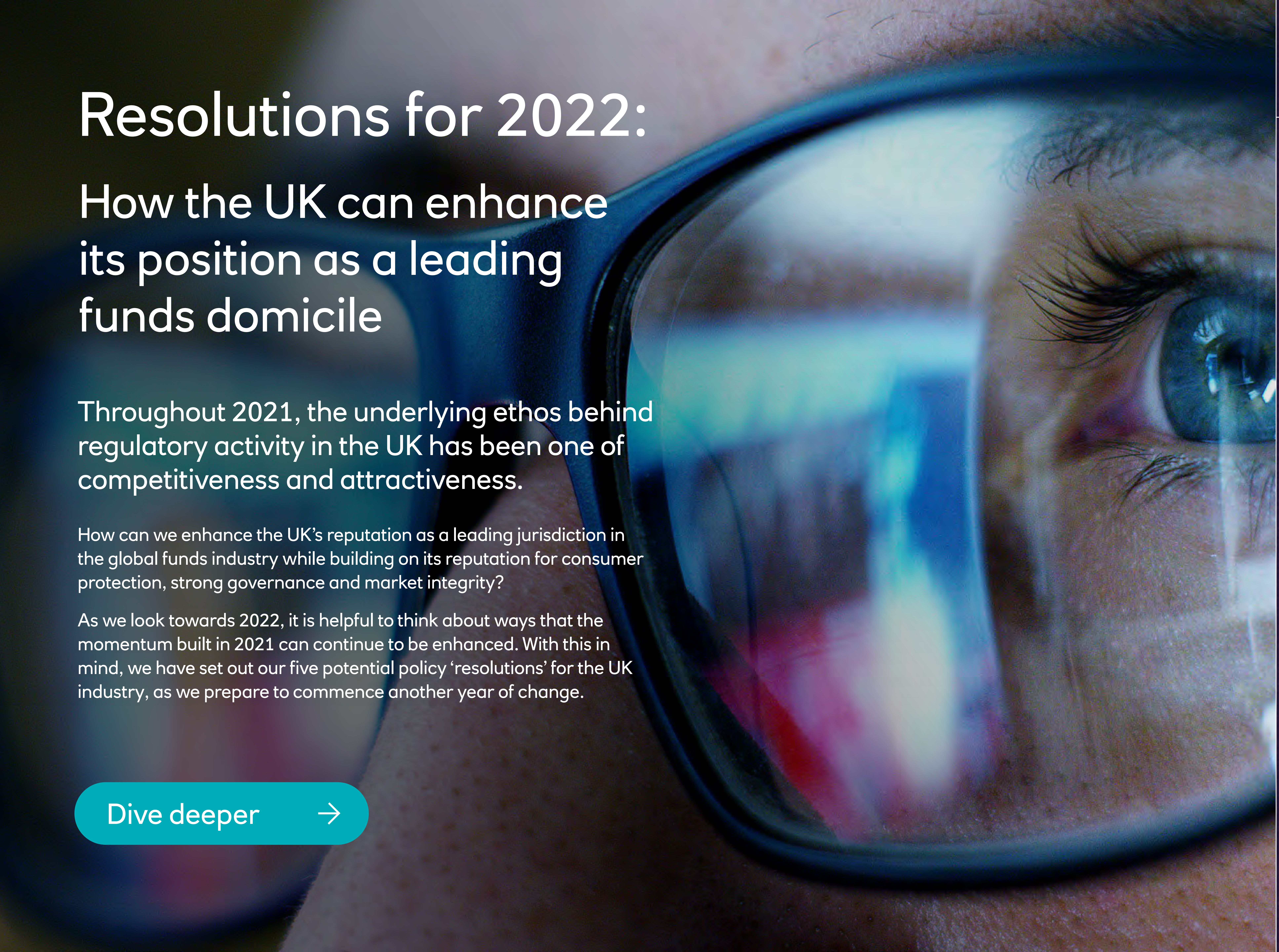
We also know that the government is considering how to enhance the competitiveness of the UK as a funds domicile. The call for input on the future of the UK funds regime was issued in early 2021 and the conclusions of this exercise are still to be released. Ultimately, this exercise is also likely to generate downstream regulatory activity, but for now we are still waiting to see what the outcome of 2021's review will be.

Looking ahead: regulatory themes in 2022

A roadmap for change

There is acknowledgment that the regulatory agenda will continue to be a heavy one in 2022, but this will allow regulators to chart a course towards a more efficient, resilient and competitive regime.

The Grid and the Strategy provide much-needed transparency in terms of what is on that agenda, and therefore what to expect. And this, in turn, will help firms to prepare, plan ahead, and engage as we enter another busy year.



Resolutions for 2022:

How the UK can enhance its position as a leading funds domicile

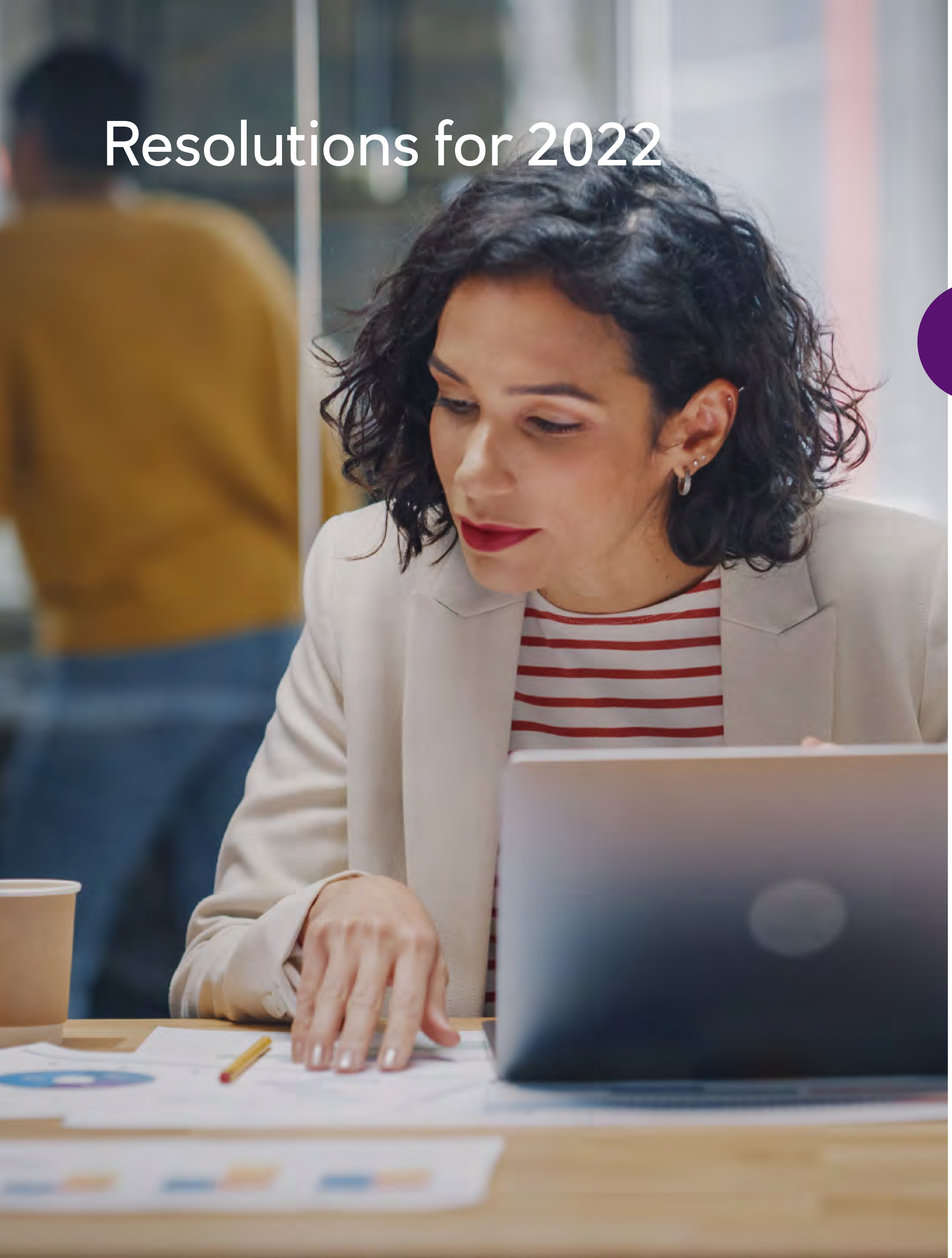
Throughout 2021, the underlying ethos behind regulatory activity in the UK has been one of competitiveness and attractiveness.

How can we enhance the UK's reputation as a leading jurisdiction in the global funds industry while building on its reputation for consumer protection, strong governance and market integrity?

As we look towards 2022, it is helpful to think about ways that the momentum built in 2021 can continue to be enhanced. With this in mind, we have set out our five potential policy 'resolutions' for the UK industry, as we prepare to commence another year of change.

Dive deeper →

Resolutions for 2022



1

By better promoting the UK's strengths in fund governance, we can enhance our attractiveness as a domicile.

Whilst the UK is a global centre for investment management it ranks behind a number of other leading funds domiciles. EFAMA's March 2021 Quarterly Statistical Release showed the UK as the fifth largest domicile for UCITS and AIF funds.

This position could be enhanced, in our opinion, by more proactively promoting and marketing the UK as an attractive location to domicile funds, with a more prominent focus on its high international standards of governance and investor protection. Strong, transparent, and independent governance is a key differentiator for the UK as a jurisdiction.

Resolutions for 2022

2

Renewed fund structures can boost the competitiveness of the industry.

To meet the needs of domestic and international investors the UK must enhance its existing fund range, introduce new structures, and adapt existing ones to ensure the UK industry's range of available product types can compete with other jurisdictions.

LTAFs

The expansion of the scheme to other types of investors, beyond high net worth and defined contribution, with the appropriate safeguards, potentially as an advised product, can help to widen access to investment opportunities in areas such as private equity and infrastructure.

OPFs

The introduction of OPFs will further enhance competitiveness and should be targeted to allow professional and sophisticated investors to gain access to unconstrained investment strategies covering all asset classes.

NURs regime

we support rebranding the NURS regime as 'UK UCITS +'. Branding is important, and with the right branding NURS funds could appeal to investors wanting the investor protection offered by UK UCITS but with greater investment flexibility and some exposure to alternative asset classes, including property.

Resolutions for 2022

3

The funds industry can support post-Covid recovery by accelerating its own growth and investment.

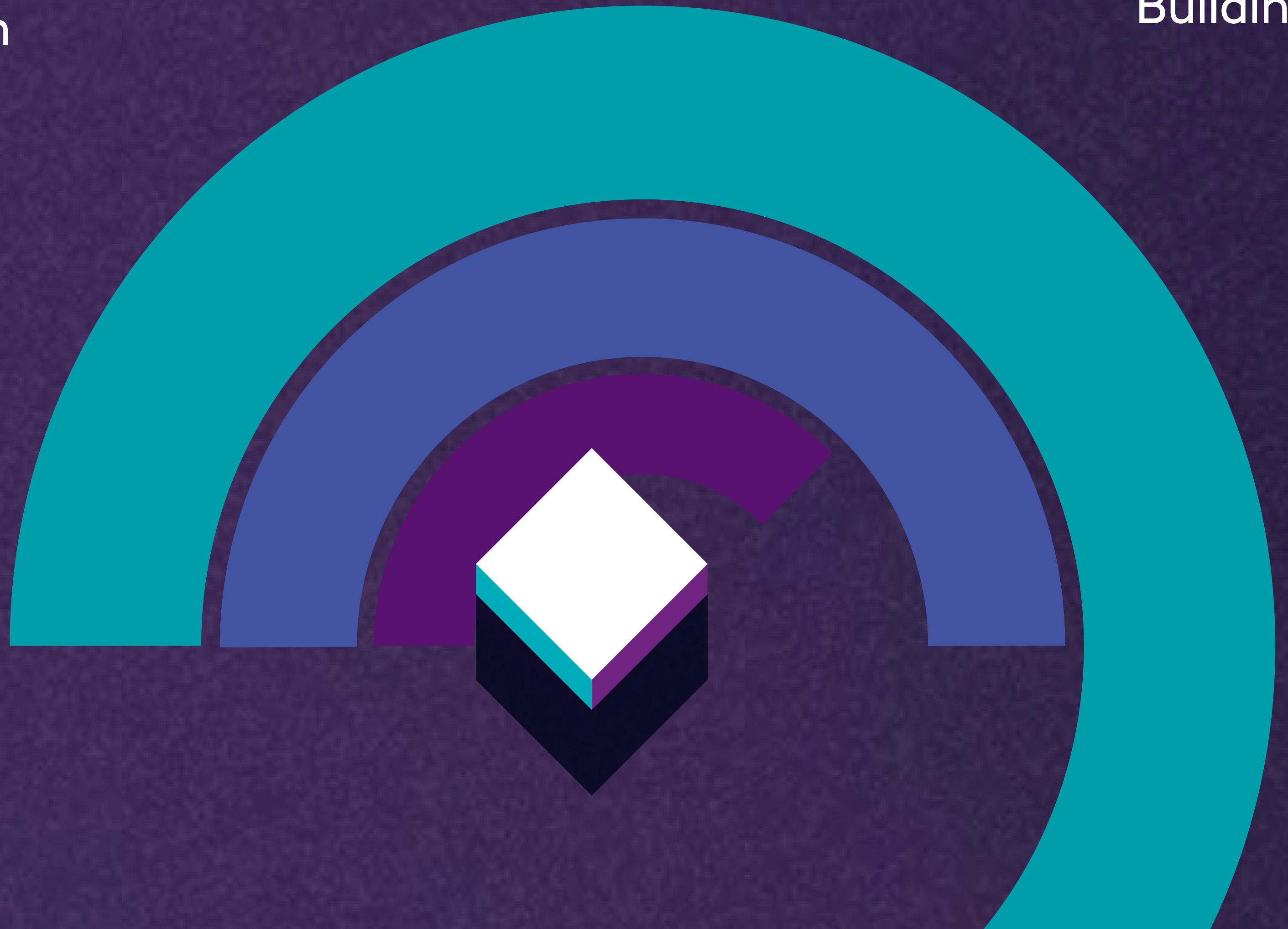
4

The UK can be the leading global jurisdiction for responsible investment.

The funds industry can support post-Covid recovery by accelerating its own growth and investment.

Investment in long-term assets can support economic recovery, particularly through proposals to increase investment in infrastructure through the outputs of the Productive Finance Working Group.

Operationally, the industry's own growth can contribute to this agenda. As it looks to deliver greater value for end investors, we will likely see growth in locations beyond London and the South East. On this point, we speak from direct experience as a growing firm with offices in London and Edinburgh, serving clients and protecting investors across the UK.



Especially given COP26, the UK has an opportunity to build on its strengths in responsible investment to become the pre-eminent global centre for ESG, meeting increasing demand for products with a focus on sustainability, long-term value, and patient capital.

Building on this will require the Government, regulators and the industry to work more closely together to address key priorities in terms of enhancing disclosures, achieving consistency in how ESG outcomes are measured, and providing assurance of the quality of the underlying ESG data, in order to enhance investor protection.

Resolutions for 2022

5

There is a window of opportunity for the UK to emerge as the leading jurisdiction for technological innovation.

Innovation in areas such as distributed ledger technology and blockchain represent another key area of opportunity for the UK to take the lead internationally in terms of smart contracts and fund tokenisation which can deliver efficiency and security for investors.

The Kalifa Review emphasised that "the time to act is now" if the UK is to take the lead, and for the UK to become the centre of new funds business incorporating novel asset classes and technology coupled with robust investor protection, to enable the industry to embrace these opportunities.

An inflection point

The UK's regulatory regime continues to evolve, and we are at an inflection point at which there are now a number of opportunities to enhance the system. The UK's reputation for governance and consumer protection can be developed in tandem with measures which also promote the competitiveness and attractiveness of the jurisdiction.

The Long-term Asset Fund:

From theory to practice

Since the Chancellor announced the proposed introduction of the Long Term Asset Fund (LTAF) in November 2020, work has been underway, at pace, to ensure that the framework is up and running to enable firms to introduce these new fund types by the end of 2021.

The Treasury's intention from the outset has been that, by the end of this year, any firm wishing to introduce an LTAF should be able to do so.

NWTDS supports the introduction of this new fund type and has been following the development of the LTAF closely with clients through our regulatory engagement sessions: our previous two editions of Depository Insights have tracked the key themes. Now we are able to provide a more detailed overview, following the publication of the policy statement on 25 October.

Dive deeper →

The Long Term Asset Fund

Background

As a reminder, the purpose of the LTAF is to enable wider access to investment opportunities in assets such as infrastructure and private equity. This is aligned with the aims of the Productive Finance Working Group which has endorsed the LTAF as a means of enhancing the attractiveness and competitiveness of the UK as a funds domicile.

Regulatory developments such as the establishment of a wholly new fund type can typically be rather lengthy processes, and so the LTAF stands as an example of how government, regulators and industry can work together efficiently to bring a new product to market. In particular, it is notable that the implementation period between publication of the policy statement and introduction of the new rules was just three weeks: a remarkable turnaround time, but one which ensures that the FCA meets the Chancellor's aspiration of LTAFs being available to launch by the end of this year.

Uptake

The level of uptake for LTAFs does remain to be seen at this stage, and the authorisation process will create a lag period between adoption of the new rules and 'go–to–market' of new fund launches. However, some firms will be keen to take the lead and achieve a 'first mover advantage'.

The publication of the policy statement has provided firms with all they need to consider going through the authorisation process; albeit there are still areas which the FCA intends to consult on in H1 2022.

The Long Term Asset Fund

Composition and redemptions

Initially, LTAFs will be aimed at Direct Contribution (DC) pension scheme investors as well as sophisticated and high net worth investors. The policy statement confirms the position in terms of composition of LTAFs: 50% of the portfolio is to be comprised of assets defined as 'long–term' (e.g. infrastructure investments). This figure is not, however, one which will need to be monitored on a daily basis: the FCA has acknowledged concerns raised as part of the consultation process as to how composition will be monitored and clarified that the figure relates to the model portfolio.

In terms of redemptions, LTAFs will permit redemptions with a 90 day notice period, on a frequency of no more than once per month. This has wider implications than the LTAF: the policy statement indicates that the 90 day notice period is likely to be introduced for open–ended property funds as well, with confirmation of this expected in due course.

Borrowing powers will be set at 30% of the net asset value (NAV). Here the LTAF differs from similar fund types such as qualified investor schemes, where borrowing powers sit at 100% of NAV. It should also be noted that the LTAF is not itself a QIS but is its own fund type, with its own section of the Handbook.

Registration of assets and assessment without qualification

The FCA has said that it plans to consult on amending the requirement for the depositary to be the legal owner of an LTAF's non–custodial assets. In the meantime, where a firm wishes to establish an LTAF, the FCA will consider applications to modify or waive this requirement.

In terms of assessment 'without qualification', the FCA has altered the requirement for the depositary to make a determination without qualification that the AFM has the knowledge, skills and experience required to value the assets independently. Instead the FCA will require the depositary to determine that the AFM has the resources and procedures for carrying out a valuation of the assets.

Long Term Assets Funds

50%

of portfolio is long–term assets

90-day

redemption period

Borrowing powers set as

30% of NAV

The Long Term Asset Fund

Next steps

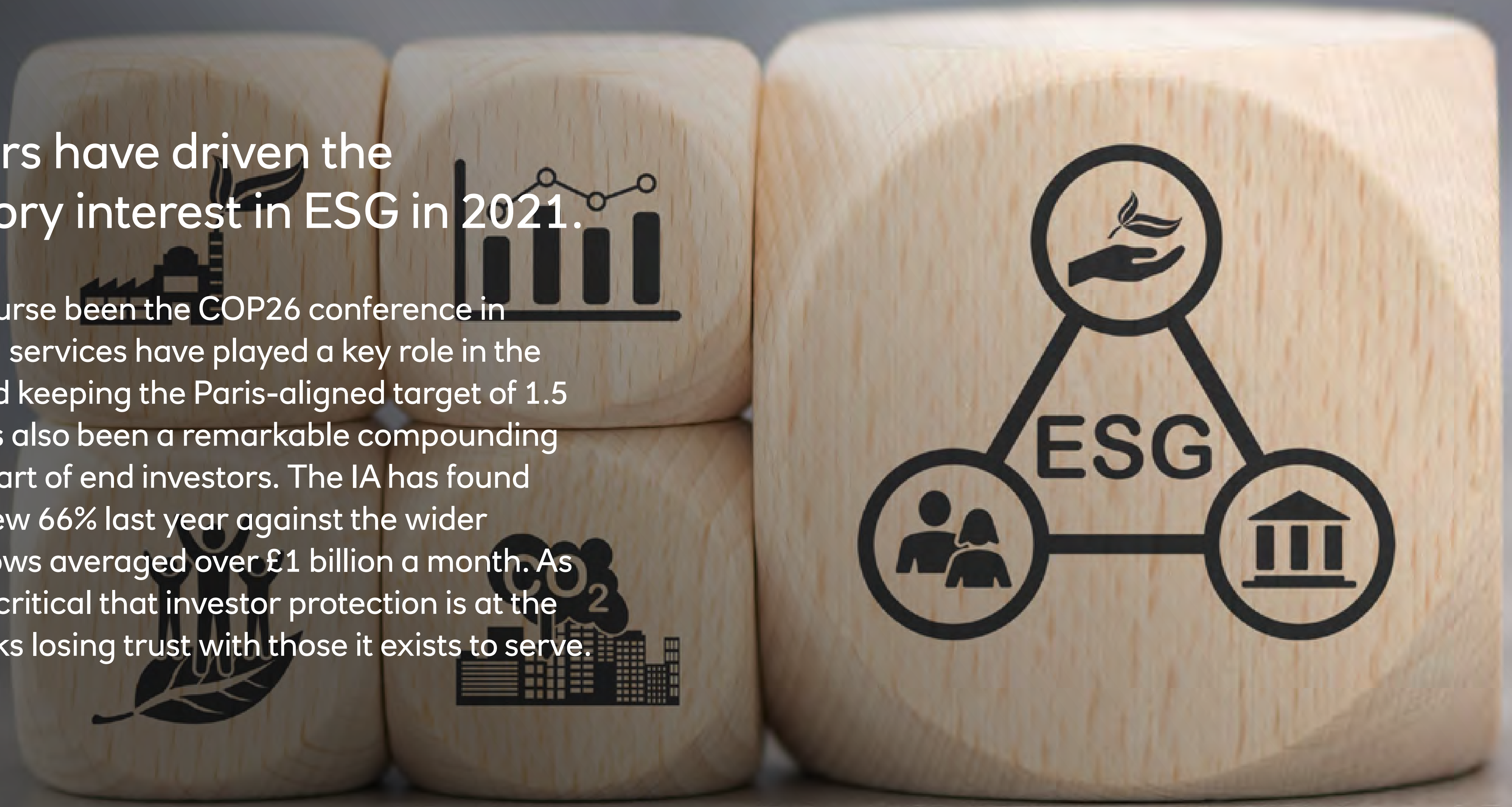
The FCA will consult in 2022 on proposals to amend the rules further to enable a broader range of consumers to invest in LTAFs in a controlled way.

Consultation on registration of assets and assessment without qualification is also expected in the first half of 2022.

We support the LTAF in principle and will assist firms looking to launch. We have engaged throughout the process and have monitored developments since the Chancellor's speech in November 2020; we responded to the consultation paper earlier this year, and see LTAFs as a key aspect of the plans to enhance the attractiveness of the UK as a funds domicile. We speak to clients on this subject regularly and have a good understanding of the spectrum of opinion across the industry. We look forward to continuing to engage as LTAFs evolve, both in terms of launches and the subsequent consultations.

ESG trends in 2021:

Momentum, principles, and assurance



A number of factors have driven the increased regulatory interest in ESG in 2021.

Front-and-centre has of course been the COP26 conference in Glasgow, at which financial services have played a key role in the drive towards 'Net Zero' and keeping the Paris-aligned target of 1.5 degrees alive. But there has also been a remarkable compounding of support for ESG on the part of end investors. The IA has found that "responsible funds" grew 66% last year against the wider industry's 7%, and ESG inflows averaged over £1 billion a month. As ESG continues to grow it is critical that investor protection is at the forefront or the industry risks losing trust with those it exists to serve.

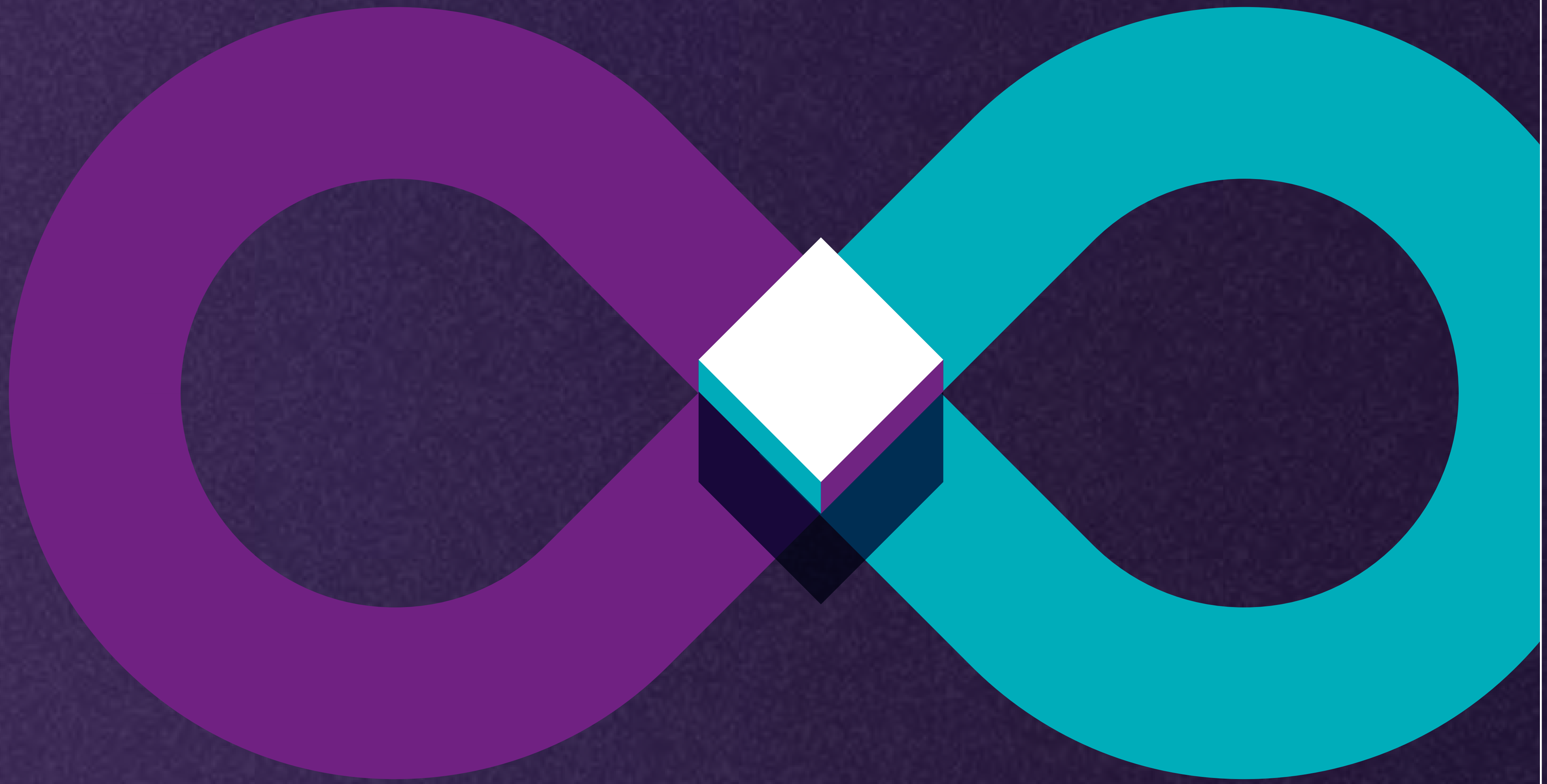
Dive deeper →

ESG trends in 2021

Starting with principles

From a UK government perspective the tone was arguably set at the end of last year when the government set out its ‘ten point plan for a green industrial revolution’, and Richard Monks, the strategy director at the FCA provided initial insight into the seven regulatory principles that the FCA would use to base its regulation of ESG upon. A key aspect of this was that in assessing holdings, a firm should assure ESG data quality including understanding the source and derivation.

Throughout 2021 the momentum has continued to build. We have seen the FCA adopt climate change as a part of its overall regulatory remit and it gets a great deal of coverage in the FCA’s 2021 business plan, so there is no doubt that, as Richard Monks said, ‘sustainable investing is here to stay’, and that there is a real focus on building trust in this market.



Disclosures and reporting

Partly that trust comes from disclosure – in 2021 we have seen a consultation on introducing mandatory Taskforce on Climate Related Financial Disclosure (TCFD) reporting for asset managers from 2023. This focuses on things like risk management and governance, but also disclosing on metrics and targets – firms will need to disclose the metrics they use to assess climate-related risks and opportunities. This links back to the FCA's principle of assuring ESG data quality. In November the FCA issued a discussion paper on sustainability disclosures and fund labelling, and the government's 'Greening Finance' report sets out next steps in terms of, for example, the introduction of a UK Green Taxonomy.

These developments are similar to some of the developments we are seeing in the EU: for example, the Sustainable Finance Disclosures Regulation (SFDR), which sets out in detail how firms should disclose on things like climate-related risk in portfolios, and the Taxonomy Regulation, also known as the EU Green Taxonomy, which also seeks to provide these commonly-agreed terms. SFDR's Level 1 requirements were implemented in March with a series of requirements on the Taxonomy applying in early 2022.

It is also worth noting that there are now these two different regulatory approaches to ESG between the UK and the EU. The UK has taken a more 'principles' and 'outcomes' based approach, while the EU has taken a more 'prescriptive' approach.

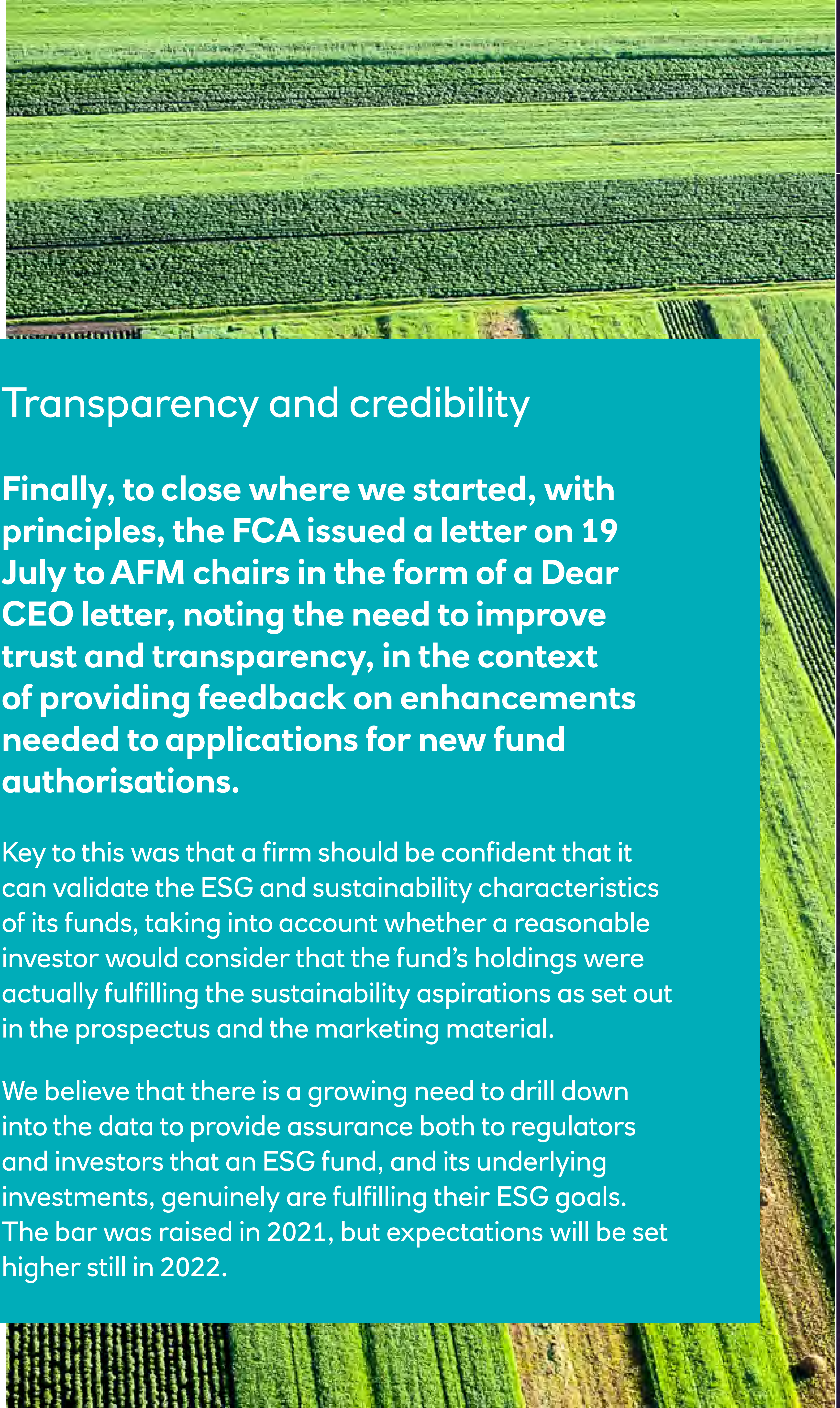
In both instances, however, there is an emphasis on disclosure, on data quality, and on assurance, so that there is transparency and so the end investor can make informed investment decisions and have confidence that the product they have bought does what it says it will do.

ESG trends in 2021

Raising the bar

There are a host of additional ways that funds and firms can seek to demonstrate their ESG credentials. One example is the UK Stewardship Code, which applies to asset managers, asset owners and service providers, and which requires signatories to provide annual reports on policies and outcomes in terms of the economy, the environment and society.

The Financial Reporting Council published its first list of approved signatories of the code on 6 September, and a third of applicants were unsuccessful, which shows that the bar was significantly raised with this iteration of the code, with a focus on achieving outcomes – not just on having a policy.



Transparency and credibility

Finally, to close where we started, with principles, the FCA issued a letter on 19 July to AFM chairs in the form of a Dear CEO letter, noting the need to improve trust and transparency, in the context of providing feedback on enhancements needed to applications for new fund authorisations.

Key to this was that a firm should be confident that it can validate the ESG and sustainability characteristics of its funds, taking into account whether a reasonable investor would consider that the fund's holdings were actually fulfilling the sustainability aspirations as set out in the prospectus and the marketing material.

We believe that there is a growing need to drill down into the data to provide assurance both to regulators and investors that an ESG fund, and its underlying investments, genuinely are fulfilling their ESG goals. The bar was raised in 2021, but expectations will be set higher still in 2022.

‘Greening finance’

The next steps

In October, ahead of COP26, the government published its ‘Greening Finance’ roadmap.

The report sets out the steps it intends to take to help ensure the financial services industry is geared up to support initiatives such as the UK’s 2050 Net Zero strategy and to ensure that growing investor interest in ESG matters is backed up by credible, transparent and verifiable data. This follows the publication of the FCA’s ESG regulatory principles in July, in which the expectation was made clear that a reasonable investor should easily be able to assess the extent to which the underlying portfolio of a fund matches up to the strategy as set out in the prospectus and marketing material. The strategy is a major step in demonstrating how this will work in practice and we believe that it is critical part of efforts to ensure that this fast–growing market embeds high standards of investor protection.

Dive deeper →

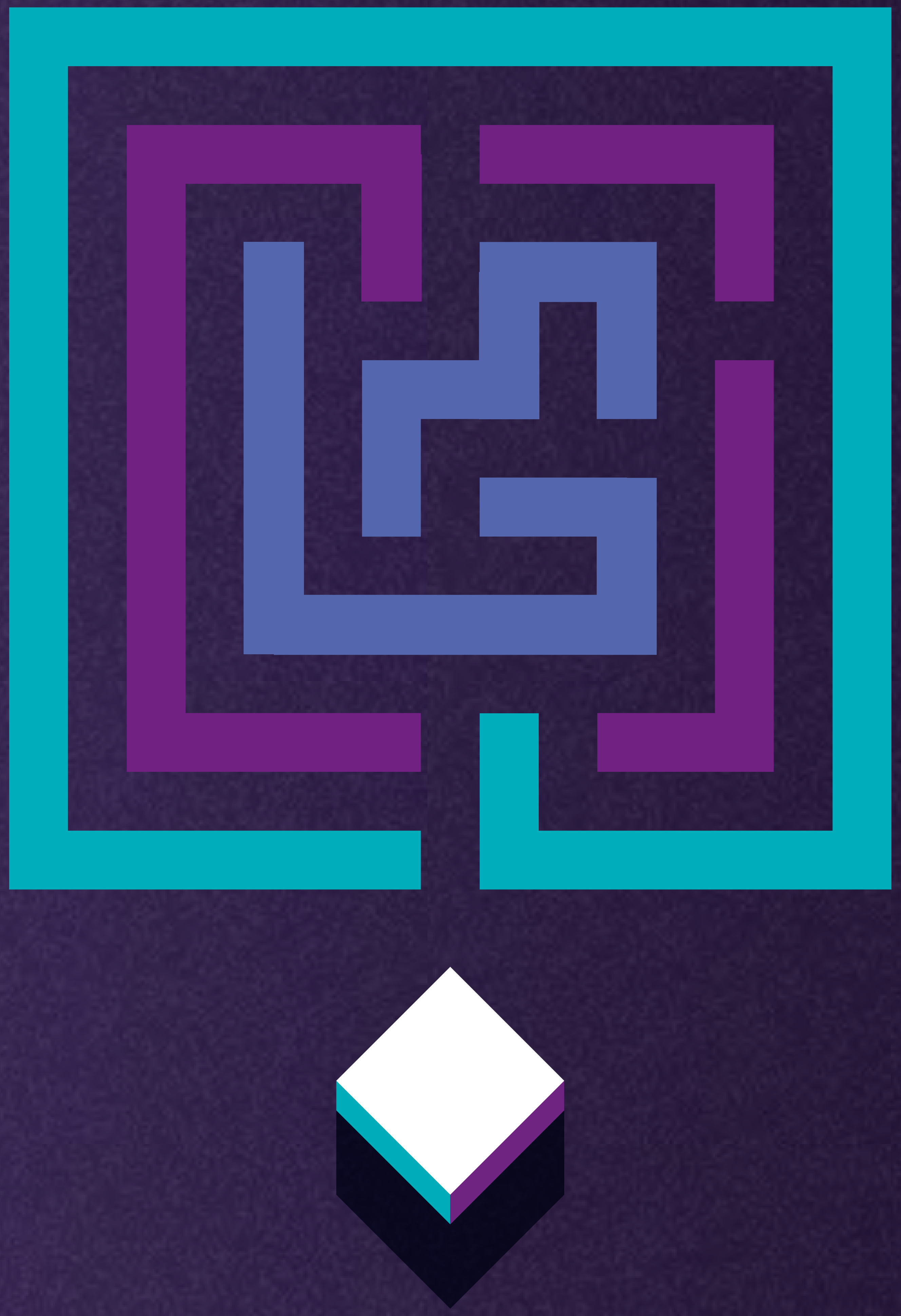
'Greening finance'

Disclosing sustainability

Two key initiatives in particular stand out from the report: the UK 'Green Taxonomy', and the Sustainability Disclosure Requirements. The government has also indicated that there will be future developments in terms of regulation and authorisation of ESG data providers.

The taxonomy will be consulted upon in Q1 2022, and is similar to, but not equivalent to, the EU's Taxonomy Regulation. The aim is to ensure consistency of terminology across the industry, so that all participants – from regulators to fund managers to end investors – have a common understanding of the different definitions used in relation to green finance. This will enhance transparency and help to protect investors from 'greenwashing', whereby 'green' terminology is misapplied in order to wrongly persuade investors of the sustainability attributes of a product.

More immediately on the radar is the SDR; a discussion paper is open for responses at time of writing, which also encompasses a new proposed approach to the 'labelling' of sustainable funds.

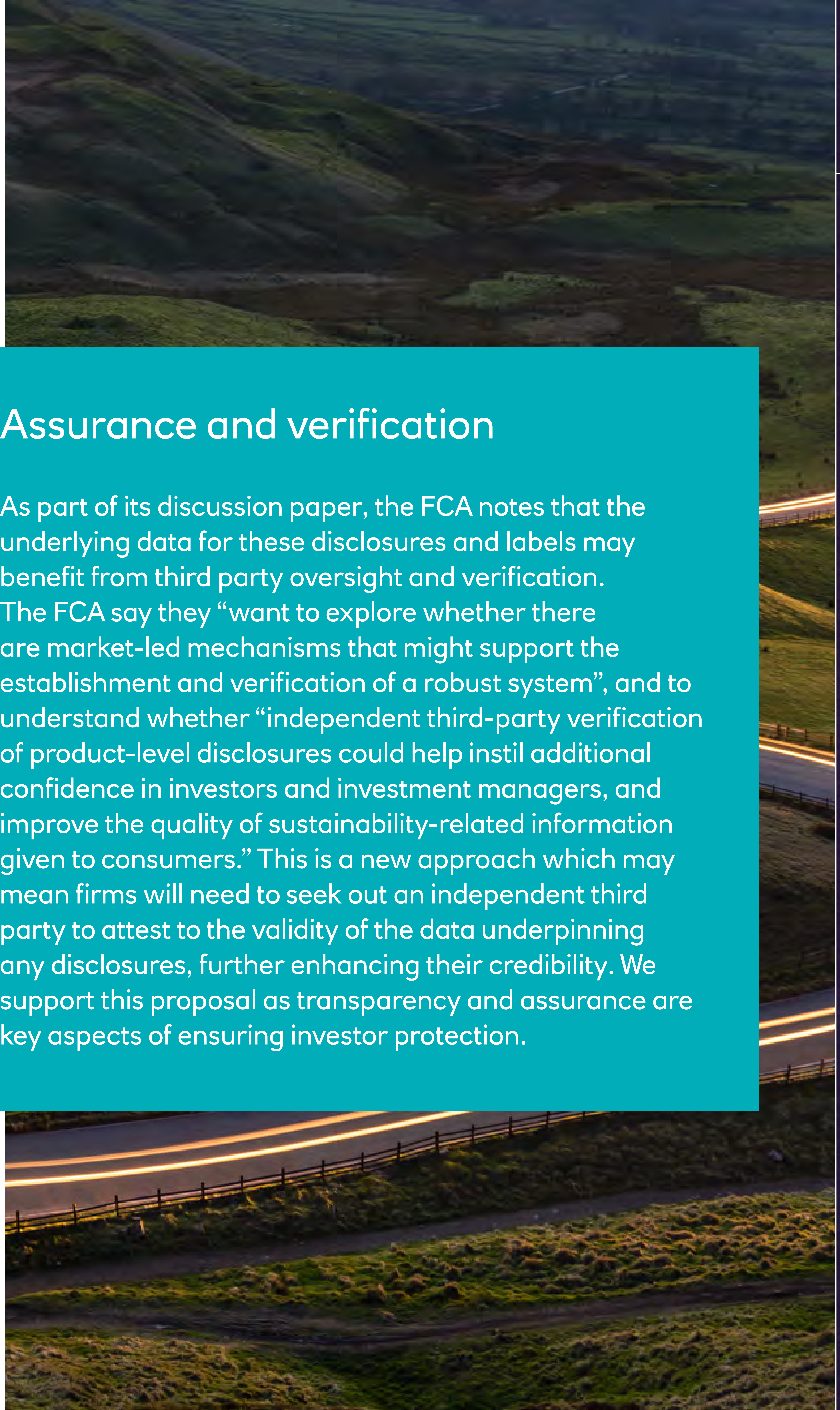


‘Greening finance’

Green labels

The discussion paper proposes that new labels and disclosures be introduced on an entity level and on a product level so that retail investors and professional investors can objectively understand the credentials of ESG funds. The aim is for this information to be presented in a standardised and accessible way, which is fair, clear and not misleading. The FCA is proposing a product label which would classify a fund in terms of its sustainability characteristics (e.g. ‘not sustainable’, ‘responsible’, ‘transitioning’, ‘aligned’, ‘impact’), as well as well as consumer-facing disclosures so that retail investors better understand how a product measures up to its aims.

The FCA is also proposing detailed disclosures for institutional and professional investors. The SDR will operate in a similar way to Taskforce on Climate-related Financial Disclosures (TCFD) reporting, which will be mandatory for asset managers in the UK from 2023. Where TCFD looks at the impact of climate change on a firm and on its products, the SDR will look at the impact of firms and products **on** climate change: a subtle but significant distinction.



Assurance and verification

As part of its discussion paper, the FCA notes that the underlying data for these disclosures and labels may benefit from third party oversight and verification. The FCA say they “want to explore whether there are market-led mechanisms that might support the establishment and verification of a robust system”, and to understand whether “independent third-party verification of product-level disclosures could help instil additional confidence in investors and investment managers, and improve the quality of sustainability-related information given to consumers.” This is a new approach which may mean firms will need to seek out an independent third party to attest to the validity of the data underpinning any disclosures, further enhancing their credibility. We support this proposal as transparency and assurance are key aspects of ensuring investor protection.

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Next steps

The discussion paper closes on 7 January. It comprises 20 questions. A full consultation paper will be issued in Q2 2022. No date has so far been provided for implementation, either of the SDR, labelling or the taxonomy, at this stage.

NWTDS view

We are beginning to see specific examples of how the government and regulators are putting ESG-related aspirations into practice. For firms, this means a greater duty in terms of assurance of ESG claims and data, enhanced reporting, and more probing by the FCA to ensure claims made are justified. This suite of regulatory reforms, while increasing the compliance load on firms, will ultimately drive a more transparent and competitive market for sustainable funds with investor protection at its heart, which is to be welcomed as this market shows every sign of continuing to gather momentum, and inflows.

Depositary Insights

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