THE INVESTMENT ASSOCIATION

EVERSHEDS SUTHERLAND

GUIDANCE ON FCA GUIDING PRINCIPLES ON ESG AND SUSTAINABLE INVESTMENT FUNDS

September 2021

ABOUT THE IA

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. IA members hold in total over one third (36%) of the value of UK publicly listed companies. We use this collective voice to influence company behaviour and hold businesses to account.

ABOUT EVERSHEDS SUTHERLAND

As a global top 10 law practice, and a leading adviser to the asset management industry, Eversheds Sutherland provides legal advice and solutions to a client base which includes market participants of all sizes: from start-ups to multinationals. With over 40 years' experience working with UK investment funds, clients describe us as experienced, creative, and well versed in cutting edge legal work. Our multi-disciplinary funds team works seamlessly to deliver the legal know-how and strategic thinking that our clients need from their advisors. We know our clients' businesses, the industry and markets they operate in, and we know that great relationships yield the best outcomes.

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Please note that this document does not constitute legal advice. IA members are encouraged to seek independent legal advice specific to their circumstances.

IA FOREWORD

There has never been a greater focus on how well investment management firms deliver for their clients and for the wider economy. Investment has a transformative effect and is a driving force for positive change – for our clients, their beneficiaries and the world we all live in. But is that always clear?

Today's savers want to see and understand the impact of their investments on the world around them and to have the confidence that when they invest in a responsible and sustainable investment product, that product is clear and matches their preferences and expectations. That is why investment managers are committed to bringing clarity and consistency to the way the industry describes these products to clients and to make it easier for all savers to understand the opportunities available to them.

At the end of 2019, the IA launched the IA Responsible Investment Framework - the first ever industry-agreed Responsible Investment Framework – and supplementary definitions with which we came together to bring clarity, consistency and choice for the consumer. The Framework does not represent a standard or a label in and of itself. However, it was a major collective step forward and we plan to build on it by working with our members, clients, policy makers, regulators, and all relevant market participants on further signposting of responsible investment products and promoting awareness about the role investment management can play in bringing about a sustainable world.

We know we are not alone in this endeavour to bring about more clarity and choice for the consumer. Building trust and confidence in this market is crucial. Over the past twelve months alone, sales to responsible investment funds of £14 billion represented a third of all UK investor fund sales. Funds under management in responsible and sustainable funds have grown by 95% compared with 19% growth in industry FUM. This growth is a reflection not only of healthy sales but also of robust performance in 2020, as industries such as technology and healthcare benefited from the conditions brought about by the pandemic. The launch of a significant number of ESG funds in the last year has added to FUM growth. Investors are now able to choose from a far greater range of ESG funds but finding and comparing ESG funds is becoming more complex.

The IA therefore welcomes the FCA's Guiding Principles on design, delivery and disclosure of ESG and sustainable investment funds. The Principles are an important part of the UK regulatory architecture to ensure good customer outcomes and a well-functioning fund market with the consumer at the core.

Following the IA's leadership in developing fund communications guidance post the FCA Asset Management Market Study and PS19/4, we are following a similar approach with communications in the area of responsible and sustainable investment. This first edition of industry guidance in partnership with Eversheds Sutherland aims to help our members with the adoption of the FCA Guiding Principles and ultimately help consumers make informed confident choices in purchasing products that meet their needs and preferences. We anticipate that that the document will evolve over time to ensure the industry can meet the expectations of both customers and regulators. We will also shortly be doing further work on language and communication to help further the accessibility and consistency of fund communication materials and we look forward to continue to work with our members, the FCA and all other stakeholders to further shape and drive the sustainable and responsible investment space.

INTRODUCTION

On 19 July 2021 the FCA published its Guiding Principles on design, delivery and disclosure of ESG and sustainable investment funds. Taking the form of a Dear Chair letter, the Guiding Principles are a statement of the FCA's expectations for authorised funds which make specific ESG-related claims.

The Guiding Principles are based on existing rules rather than new ones; many of which are longstanding. This allows the FCA to be more nimble in its delivery of the Guiding Principles and provides firms with an immediate indication of the standard expected. This approach does, however, mean that the Principles have no formal regulatory status, i.e. they do not constitute FCA guidance. But they will undoubtedly become obligatory in practice by being adopted at the FCA fund authorisations gateway and over time through the work of Fund Supervision.

There is a strong connection to the themes raised in FCA PS19/4 following the Asset Management Market Study (AMMS).

SCOPE OF THE GUIDING PRINCIPLES

The Guiding Principles are limited to authorised funds and, although based on a variety of rules, particularly target those funds with retail investors. We expect the Guiding Principles to be applied to QIS in a proportionate way. While the Guiding Principles specifically reference the rules for authorised funds in several places, and do not therefore have a direct read-across to other types of investment products, such as unauthorised AIFs, incoming EEA funds, or segregated mandates, the guiding principles also refer to broader FCA principles and rules and so may be relevant to other products making ESG or sustainability claims as an indication of the FCA's views.

A NOTE ON TERMINOLOGY

The Principles refer both to 'ESG' and 'Sustainability'. It seems likely that any terminology that is synonymous with these phrases, will be captured - including the IA's preferred phrases such as 'responsible investment' and 'sustainability focus'.

The IA will be conducting consumer testing in due course that will focus on terminology.

With those parameters noted, the Guiding Principles are relevant where "an FCA authorised investment fund pursues a responsible or sustainable investment strategy and claims to pursue ESG/sustainability characteristics, themes or outcomes". The FCA states that the Guiding Principles are intended to apply where a fund makes ESG or sustainability claims in its name, investment objective, investment policy or financial promotions. The aim of the Guiding Principles is clearly to avoid the overstatement of ESG/sustainability credentials (greenwashing) in these disclosures. If a fund is simply integrating ESG considerations into mainstream investment processes, care must be taken to ensure that such ESG considerations are not given undue prominence in a fund's disclosures. However, where references to ESG integration are factual and proportionate, the Guiding Principles do not impose additional requirements on the product's Design, Delivery or Disclosure.

While the Guiding Principles are highly relevant for the design of new products, they apply equally to existing ones. The Guiding Principles should therefore be considered ahead of any interaction with the FCA Fund Authorisations team and more broadly for existing products. In terms of bringing existing funds up to standard, we understand that the FCA would expect a firm to consider the Guiding Principles in its next periodic review of a product that makes ESG and/or sustainable claims. If a firm has concerns that a product is significantly out of line with FCA expectations, that firm would need to consider more immediate action.

CONTEXT

Many firms will recognise aspects of the Guiding Principles from their recent experiences with the FCA's authorisations gateway. The Guiding Principles follow years of policy developments which can broadly be summarised as requiring more candid, more descriptive and more consistent investor disclosure.

Key among these is PS19/4 which, through a combination of rule changes and non-handbook guidance, asked firms to consider whether their fund descriptions were aligned with the practical operation of the products. At the same time, the FCA challenged firms to consider whether fund descriptions were comprehensible to investors.

The Guiding Principles feature familiar concepts – clarity, consistency, ease of evaluation etc. We are of the view that the policy precursors to this latest initiative remain relevant and we encourage firms to consider and interpret the Guiding Principles against this backdrop.

The IA previously published papers[1] considering both the clarity of fund descriptions and the way that benchmarks are used and these remain essential reading when considering fund documentation updates.

INTERACTION WITH OTHER REGIMES

IA Members will know all too well that there is currently a landscape of competing regulatory initiatives and may rightly have concerns as to how the FCA's Guiding Principles might interact with the categorisations and disclosures that they have been preparing under the EU's Sustainable Finance Disclosure Regulation (SFDR).

While the Guiding Principles do not serve as the UK's 'answer to SFDR', there are clearly areas of overlap for authorised funds. The Guiding Principles were prepared with an awareness of SFDR and we discuss the interaction between the regimes in more detail in the 'Implementation Considerations' section at the end of this document.

[1] https://www.theia.org/sites/default/files/2019-08/20190218-fundcommunicationguidance.pdf

THIS DOCUMENT

In the FCA's own words, "The guiding principles comprise an overarching principle and three supporting principles that focus, respectively, on 'design', 'delivery' and 'disclosure'."

The Dear Chair letter and the Guiding Principles are written in an accessible way. The Guiding Principles are further defined by 'key considerations' and the FCA has helpfully provided interpretative commentary and examples to help firms.

The purpose of this document is to help members implement the Guiding Principles and ensure more consistent customer communications. We do this by providing commentary on each Guiding Principle. Our commentary operates as a supplement to the Dear Chair letter. We thought it appropriate, with the FCA's permission, to replicate portions of their explanations here and provide our commentary alongside it.

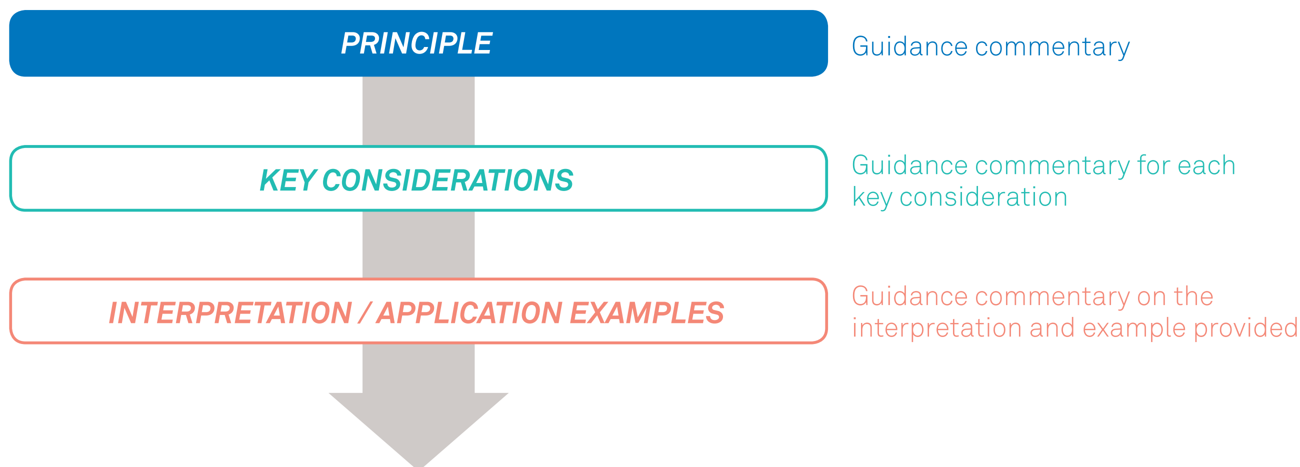
Although the FCA was provided with an earlier copy of this document, and had an opportunity to comment on the analysis within it, it does not endorse the document or its contents.

We incorporate the FCA content in coloured boxes (blue for the principle, green for the key considerations and red for interpretation/examples) and have grouped passages together for ease of reference. Please note that we have subdivided/numbered the Guiding Principles further than the FCA has, to assist with cross-referencing.

The last section of this paper contains some fictitious specimen funds which we have annotated to explain how the Guiding Principles may apply in practice.

As with similar documents issued by the IA, this guidance is not mandatory but sets out ways in which members can address industry-wide issues on the basis of a common framework.

STRCUTURE OF THE MAIN GUIDING PRINCIPLES



THE OVERARCHING PRINCIPLE

FIRMS SHOULD EXPRESS A FUND'S ESG APPROACH CONSISTENTLY

PRINCIPLE

A fund's ESG/sustainability focus should be reflected consistently in its design, delivery and disclosure. A fund's focus on ESG/sustainability should be reflected consistently in its name, stated objectives, its documented investment policy and strategy, and its holdings.

We expect authorised investment funds pursuing a responsible or sustainable investment strategy and that claim to pursue ESG/sustainability characteristics, themes or outcomes to consider the overarching principle, supporting principles and key considerations.

MEETING EXPECTATIONS

Through the publication of the Guiding Principles, the FCA wants to enhance transparency around ESG/ sustainability so that consumers can assess whether the funds meet their needs and preferences.

In some ways this a more focussed application of the principles from the FCA's Asset Management Market Study (AMMS).

COMMON THREAD

While not in the text, we know the FCA expects there to be a 'common thread', which is a clear articulation of an idea that we have seen during the fund authorisations process for some time and which is implicit in PS19/4.

Firms have regularly seen challenge even for traditional financial products if they included a phrase like 'strategic', 'cautious' or 'conservative' in a fund's name without a corresponding reference in the investment policy to explain how the portfolio is managed to cultivate that characteristic.

The concept of a 'common thread' builds on this. It extends beyond the language of the investment objective and policy/strategy, requiring consistency in the fund's reporting.

While it remains the case that objectives may be aspirational and are not guaranteed, it should be expected that a portfolio will reflect the stated investment policy.

'CONSISTENT' OR 'NOT INCONSISTENT'

The FCA expects a fund's ESG focus to be reflected consistently in that fund's name, objectives, investment policy, strategy and holdings.

This raises the question of whether the ESG focus needs to be drawn out in all of these areas, or whether it is sufficient that the actual references made are consistent with each other.

Our understanding is that broadly the FCA expects all of the relevant attributes to be 'not inconsistent' with each other. In other words it is not necessarily required for ESG focus to be referenced in each of the name, the objective, the policy and the strategy.

However, naming is an area of particular focus. Under Principle 1 A, the FCA states an expectation that certain names can only be justified through the inclusion of a disclosure in the investment objective. However, there is no equivalent expectation that a fund with an ESG investment objective must have an ESG-related name (though we imagine firms will want to do so in many cases).

The fund name doesn't have to reflect particular characteristics of the fund but it must not be misleading. For example, there is no need for the name to describe the product as 'responsible' even if it has relevant features. To be more specific, we expect that a fund could still be called "… Equity Portfolio 1" or the "… Dynamic Future Fund" and still have a responsible investment objective, policy and/or holdings (though of course any chosen characteristics for the name should be justifiable).

Conversely, it would not be permissible for a fund to be labelled "…Clean Energy Fund" if the investment policy merely specifies investment in equities with the exclusion of oil & gas stocks (since the policy does not require the holding of any investments which constitute 'clean energy').

However, to the extent possible, we would suggest that any ESG connection between the name, objective, policy and strategy is emphasised: since silence and ambiguity will invite challenge.

BUILDING ON FCA PS19/4

PS19/4 followed a significant period of policy development around the clarity of fund objectives and policies including previous statements of the FCA's expectations (such as FCA Thematic Review 16/3 – Meeting investors' expectations).

As well as introducing new rules and Non-Handbook guidance, PS19/4 relied on the existing body of rules for the content of prospectuses, KIIDs, NURS KIIs, PRIIPs KIDs and financial promotions. These include obligations such as 'fair, clear and not misleading' and requirements around brevity and comprehensibility. We do however want to highlight some particular aspects relevant to the FCA Guiding Principles:

- FCA considers that relevant elements of the investment strategy should be disclosed in the KIID even if not in the prospectus. In practice this is applied as being relevant to all statements of investment objectives and policies.

- The AMMS Final Report included commentary around the clarity of fund objectives: "We continue to believe that investors could benefit from greater clarity as well as being better able to compare objectives between similar funds."

- The Non-Handbook guidance from PS19/4 on the description of fund objectives and investment policies states the FCA's expectation that "firms should consider how to describe the objectives, investment policy and investment strategy in a concise way and without using jargon, to enable a retail investor to understand the product."

- The PS19/4 rules on benchmarks require the use of a benchmark or an explanation as to how investors can assess the performance of the scheme. The accompanying Non-Handbook guidance includes expectations for non-financial objectives; requiring that:

  - these should be disclosed;

  - their use should be fair, clear and not misleading; and

  - firms should be clear about how they will be measured.

GUIDING PRINCIPLE 1 – DESIGN

FIRMS SHOULD ONLY DESCRIBE OR PROMOTE ESG ATTRIBUTES IN A WAY THAT FAIRLY REFLECTS THE WAY THAT THE FUND IS RUN

PRINCIPLE

The design of responsible or sustainable investment funds and disclosure of key design elements in fund documentation.

References to ESG (or related terms) in a fund's name, financial promotions or fund documentation should fairly reflect the materiality of ESG/ sustainability considerations to the objectives and/ or investment policy and strategy of the fund.

In its October 2019 Feedback Statement (FS19/6) on Climate Change and Green Finance, the FCA stated that it would be challenging firms about potential greenwashing. This Guiding Principle very clearly has that policy in mind and relates not only to the statements in a fund's prospectus, but also its other fund documentation and financial promotions (potentially a much broader category). The overarching theme is proportionality between claims and action.

KEY CONSIDERATION A – FUND NAME

Fund names are subject to restrictions and they must not be misleading. Where a fund uses 'ESG', 'green', 'sustainable,' 'responsible,' 'ethical', 'impact', or related terms in its name, this could be misleading unless the fund pursues ESG/ sustainability characteristics, themes or outcomes in a way that is substantive and material to the fund's objectives, investment policy and strategy.

INTERPRETATION / EXAMPLES

Where a fund uses ESG or related terms [for example, 'ethical', 'sustainable', 'green', 'responsible'] in its name, the FCA expects that the ESG/ sustainability approach will be disclosed in the investment objective of the fund. The FCA would not expect to authorise a fund that contains one of these terms in its name, if its investment objective does not reflect the fund name.

Where a fund uses one of these terms in its name, the FCA considers that this could be misleading unless the investment strategy leads to a material difference in how the fund is managed compared to a fund which did not take such considerations into account. For example, an index tracking fund which excludes a small number of securities, or if the holdings are not materially different from a similar non-ESG index, should not use these terms in its name.

The term 'impact' or 'impact investing' has specific connotations. The FCA considers that a fund which uses the word 'impact' in its name in the context of ESG/sustainability outcomes should only do so if it is seeking a non-financial (real world) impact, and if that impact is being measured and monitored.

This key consideration requires firms to refrain from unjustified references to certain language. This can be seen as an effort to reduce greenwashing and to encourage better articulation of the characteristics of truly sustainable products.

ANTI-GREENWASHING AND PROTECTED NAMES

There is a clear warning that firms without sound reasons for using ESG 'buzzwords' should not include those words in the fund's name or financial promotions.

Where the FCA states that certain names ought to be reflected in the fund's investment 'objective', we understand this to be referring to objectives, policy and strategy generally and not specifically an expectation of incorporating a non-financial objective (unless a non-financial objective is specifically implied in the chosen name). We understand that there needs to be an explanation of any limitation to the investment policy, which would be expected for a sustainable (or similar) fund, and an explanation of how and why the investment strategy merits any terms used. Proportionality should apply – where a fund is being sold with a clear reference to a non-financial outcome then this should be clearly referenced. For example, if a fund references an impact, a firm would need to define what impact outcome the product is looking to achieve, how the firm has incorporated that in to the investment process and how the resulting fund differs from one without those attributes. This would also include a statement at the outset of how these attributes will be measured and reported on an ongoing basis.

BETTER DISCLOSURE

The key consideration around fund names recalls the overarching principle and confirms the need for a 'common thread'. Firms which do have a reason to use these 'buzzwords' need to ensure that this comes through in the way that they describe the product's operation.

It will be insufficient for a product's investment objective, policy and strategy to be silent on ESG aspects if the manager wants to promote the product by reference to these.

This emphasises the need for firms to maintain a holistic understanding of their product's operation, claims and disclosure, including any relevant ESG credentials.

It is worth noting that the Guiding Principles are not targeted at those funds which just integrate ESG considerations into mainstream investment processes. It follows that a mere statement regarding integration should not bring with it the full scrutiny of the Guiding Principles; as long as references to that integration are proportionate.

PROBLEMATIC NAMES

While many funds have no difficulties, naming is one aspect which can cause complications at authorisation. We have set out some illustrative examples below.

- The FCA should be expected to strongly interrogate the use of any term that implies a non-financial outcome – it needs to be clearly explained with associated metrics identified, i.e. what does success look like. In practice we have found that firms often struggle to express what the anticipated real world outcomes will be or how they might expect to assess or measure them.
- Where a name implies a certain kind of approach, but this is not directly reflected in the way the fund operates, the FCA can be expected to challenge.
- We find that the FCA has shown a preference for passive ESG funds to be named in a way that reflects the index (e.g. rather than using the index to justify a name which is better for marketing).
- The words 'ESG' and 'sustainable' are often used interchangeably by the industry but the FCA is likely to expect firms to be consistent. It may need to be persuaded that the terms are truly synonymous if firms intend to use them interchangeably. On a related note, firms may wish to exercise caution when using 'ESG' in the context of retail funds as it is not yet clear that this phrase is sufficiently well understood outside of the industry. Ultimately it is about being clear, fair and not misleading and ensuring, in line with the spirit of PS19/4, that firms need to ensure that terms they use are comprehensible to retail investors.

KEY CONSIDERATION B – OBJECTIVES AND POLICY

The prospectus of a fund must include its objectives and policy. A fund must be managed consistently with these. The annual report of a fund must include the policy and strategy pursued for achieving its objectives and a review of the investment activities during the period. Irrespective of whether its name contains ['ESG', 'green', 'sustainable,' 'responsible,' 'ethical', 'impact'], where a fund claims to pursue ESG/sustainability characteristics, themes or outcomes, these should be appropriately reflected in the fund's objectives and/or policy.

INTERPRETATION / EXAMPLES

For example, a fund which claims to promote positive social change should:

(i) be specific about what this means:

(ii) describe how it aims to achieve this objective through the exercise of its investment policy and strategy; and

(iii) set out how it will monitor and evaluate whether it has done so. If a fund is designed to generate a measurable, beneficial ESG/sustainability impact alongside a financial return, the firm should clearly state the intended 'real-world' outcome.

If an AFM relies exclusively or largely on ESG data provided by a third-party, including ESG data which determines which securities qualify to be included (or which determine the weighting of securities) in an index which a fund is tracking (or uses as a [target/constraining/comparator benchmark], to make judgements about ESG matters, it should disclose this as part of the additional information required to be included in the prospectus.

Where a fund might hold securities, potentially at a reduced weighting, which an investor might not expect given the ESG/sustainability focus of the fund, this should be clear in the prospectus, including the circumstances when such securities might be held and the purposes for which they will be held.

FOCUS ON THE FUND'S MANDATORY DOCUMENTS

In this key consideration, the FCA focuses on two formal mandatory documents; the prospectus and the annual report. While any significant change to the prospectus ought to be translated into other documents including the KIID and factsheet (following the principles in the Asset Management Market Study), the choice to focus on the prospectus is significant. Updates to the objectives and policy in the prospectus require FCA approval (and, of course, consultation with the depositary). Therefore all updates will necessarily pass through the FCA Authorisations Team, who will have an opportunity to test firms' claims.

NON-FINANCIAL OBJECTIVES

The key point here, and borne out in interactions with fund authorisations, is that non-financial objectives need to be carefully considered and articulated.

The example given, of 'positive social change' or 'social impact' poses difficulties because (i) the outcomes are a step removed from the fund – they are in the hands of individual investee companies; and (ii) social effects are presently much more difficult to quantify and measure.

REFERENCE TO THIRD PARTY DATA AND INDICES

The use of indices was a major focus under PS19/4. Guiding Principle 1 takes this further asking firms to disclose any use of benchmarks for judgements about ESG matters. That could, for example, be using selecting stocks from the constrained universe of a specialist benchmark. Additionally, exclusive/heavy use of third party ESG data has to be disclosed. That could be relying on companies with a high score under a third party's proprietary rating.

In terms of disclosing the identity of the third-party provider, as a minimum, for an investor to perform adequate due diligence, the FCA would probably expect sufficient detail on the methodology to be disclosed as opposed to the identity of the third party provider. That said, the name of the provider could be disclosed if it has sufficiently transparent and publicly available methodology. Furthermore, disclosure of a specific third party provider would probably be expected where there is unquestioning reliance – i.e. if a firm mechanically screens out (for example) all companies rated below a certain level by one specific provider, then this should be disclosed.

FUNDS THAT HOLD SECURITIES

Where a fund holds securities, the FCA expects the fund documentation to make this clear. An example is where a fund that invests in quasi sovereign bonds in a country with poor ESG credentials – in abstract, all holdings could be in the lower quartile of ESG ratings globally but in practice the fund may seek to allocate to 'less bad' securities out of that limited universe. In this case, we expect the FCA would look for clear explanations as to the nature of the baseline underlying securities/index and how the manager plans to improve on the situation and where the resulting portfolio will end up in relative and in absolute terms.

KEY CONSIDERATION C – INVESTMENT STRATEGY

An AFM is required to disclose information about a fund in its prospectus which investors would reasonably require for the purpose of making an informed judgement about investing in a fund. Where a fund claims to pursue ESG/sustainability characteristics, themes or outcomes, we expect that this information should include key elements of the strategy.

For example:

- *the investible universe, including investment limits and thresholds*
- *any screening criteria (positive or negative) that it applies*
- *specific E, S or G characteristics/themes or 'real world' (non-financial) impacts that it pursues*
- *the application of benchmarks/indices, including any tilts to mainstream benchmarks, and expected/typical tracking error relative to the benchmark*
- *the stewardship approach of the fund*

INTERPRETATION / EXAMPLES

Where a fund integrates ESG considerations into mainstream investment processes (with no material ESG orientation in the fund design/strategy), we do not expect to see prominent ESG claims in the fund's name or documentation, or ESG positioned as a key part of that fund's offering.

The description of a fund's strategy should provide sufficient information for a consumer to be able to distinguish between offerings that pursue ESG/ sustainability characteristics, themes or outcomes in different ways.

For example, consumers should be given sufficient information to be able to distinguish between funds with the following (non-exhaustive) characteristics:

- *avoiding exposure to investments with certain characteristics – eg, by applying a negative screen to exclude companies that fail to meet international recognised standards, such as the UN Declaration of Human Rights; or by avoiding exposure to certain sectors, such as oil and gas companies*
- *applying a positive screen to promote particular sustainability characteristics or themes – e.g., apply a tilt to the benchmark in an index strategy to overweight companies with particular characteristics (such as emissions-based thresholds); or invest predominantly in companies engaged in certain activities (such as water and waste management)*
- *pursue a positive impact*
  - *through direct investment in new sustainable projects (eg, project financing of clean energy initiatives)*
  - *by influencing change through active investor stewardship (eg, encouraging companies to sign up to net-zero commitments/move towards greener investments).*

The FCA obviously wants to know how the fund will deliver its ESG attributes. It isn't clear how a manager will be able to assess what level of information would be needed for an investor to compare two unrelated products, but one clear takeaway is that a level of detail will be required. Clearly sentences such as "We consider ESG factors when making investment decisions" will be insufficient. It also follows that ESG risk integration should not be overamplified.

We would assume that the reference to closure of the investible universe is only relevant to the extent that the investible universe is constrained (e.g. through a screened index).

The FCA seems to be in support of product segmentation – they would like investors to be able to determine where on the responsible investing 'spectrum' a product appears (whether negative screening, positive screening, pursuing a positive impact etc). The categories described do show overlap with the IA's own Responsible Investment Framework[2] which may provide a helpful sense check for firms. The key again here seems to be specificity.

Stewardship, which is also discussed below, is explicitly called out for discussion. Here it may be helpful for firms to consider identifying the stewardship approach of the fund, specifically whether the product utilises stewardship/engagement in line with their house approach, or if stewardship is used as an explicit tool in the pursuit of a sustainability objective.

KEY CONSIDERATION D – STEWARDSHIP APPROACH

An AFM must develop adequate and effective strategies for exercising voting rights to the exclusive benefit of the fund, ensuring that the exercise of voting rights is in accordance with the investment objective of the fund. AFMs are also subject to the requirements in COBS 2.2B either to develop an engagement policy covering certain areas, or to explain why they have not done so. Where investor stewardship forms part of a fund's responsible or sustainable investment strategy, we consider that the AFM should develop an engagement policy that complies with COBS 2.2B.6R and clarify how stewardship contributes to meeting the fund's intended ESG/sustainability characteristics, themes, or outcomes.

INTERPRETATION / EXAMPLES

Where stewardship is part of an active investment strategy, it should be clear how monitoring, engagement and voting activity in respect of ESG/sustainability matters is integrated with its investment decisions, and how escalation and divestment decisions are made.

NEED FOR A SHAREHOLDER RIGHTS DIRECTIVE (COBS2.2B)-COMPLIANT ENGAGEMENT POLICY

Firms are required to have an engagement policy under COBS 2.2B, however, this is on a 'comply or explain' basis. Here the FCA is stating that firms whose investment policy depends on a stewardship or engagement strategy ought to have an engagement policy that complies with COBS 2.2B.6R.

[2] https://www.theia.org/sites/default/files/2019-11/20191118-iaresponsibleinvestmentframeworkglossary.pdf

In practice we expect that many firms who choose not to have an engagement policy have made this choice because SRD focusses on equities, and this may not be relevant to their investment strategy. Where this is the case, in keeping with the spirit of the FCA's expectations, firms may wish to look to the UK Stewardship Code 2020 which takes account of a broader range of asset classes.

STEWARDSHIP DISCLOSURE AT PRODUCT LEVEL

Firms often prefer to keep disclosures on their stewardship approach at a firm level rather than product level. This is in keeping with the focus of the FRC's Stewardship Code (which has been supported by the FCA) which encourages signatories to the Stewardship Code, to report at the firm/house level: "The reporting expectations do not require disclosure of stewardship activities on a fund-by-fund basis or for each investment strategy. However, the information provided should give a clear indication of how stewardship activities differ across funds, asset classes and geographies proportionately to their operations."[3]

This is also consistent with how the stewardship is typically applied in practice; with firms utilising the aggregate voice of all their holdings across the firm to influence investee company behaviour.

Our expectation is that firms will be able to refer to a firmwide approach to stewardship and engagement where this applies. However, where a fund has a bespoke/specific approach to stewardship/ engagement or where this is integral to the investment policy, the firm ought to articulate how this approach will help them to meet the specific ESG/sustainability characteristics of the fund taking care not to over-emphasise the potential results of engagement.

DIVESTMENT

The interpretative guidance explains that firms should be clear about how divestment decisions are made. In this stewardship context, divestment is usually as a result of an investee failing to meet the manager's expectations on certain long term risks to long-term value of the company or specific ESG concerns. However, a fund may need to divest for other reasons (e.g. due to explicit screening criteria such as controversy screening or even more traditional breaches of investment powers) so firms may need to be careful with their choice of words when preparing their disclosure.

[3] https://www.frc.org.uk/investors/uk-stewardship-code

GUIDING PRINCIPLE 2 – DELIVERY

FIRMS SHOULD ENSURE THAT THEIR RESOURCES AND OPERATIONAL CAPABILITY CAN DELIVER THE FUND'S OBJECTIVE IN THE WAY DESCRIBED TO INVESTORS

PRINCIPLE

The resources (including skills, experience, technology, research, data and analytical tools) that a firm applies in pursuit of a fund's stated objectives should be appropriate. The way that a fund's ESG investment strategy is implemented, and the profile of its holdings, should be consistent with its disclosed objectives on an ongoing basis.

This Guiding Principle again targets greenwashing but from a different angle. It sets an expectation that a firm should build sufficient confidence that the resources it deploys in delivery of the fund's investment policy and strategy are fit for purpose in meeting its stated objectives.

This Guiding Principle examines the substance behind a firm's claims and to us this appears targeted at senior management. It will be interesting to see how the FCA goes about supervising this Guiding Principle and whether firms will be interrogated about internal resources at the fund authorisations gateway. Generally, at the fund authorisations gateway, the FCA looks to understand the process and data that the manager utilises to achieve the fund's objective. From experience, it would look for evidence that the portfolio holdings were reflective of the objectives and that the manager proposed to report outcomes consistent with the objectives and the methods used in the investment process.

KEY CONSIDERATION A – RESOURCES TO SUPPORT DELIVERY

A fund can only be authorised by the FCA if its aims are reasonably capable of being achieved. This would include any ESG aims or purposes. An AFM must have and employ effectively resources to achieve the proper performance of its business activities. We expect a firm managing a fund that pursues ESG/sustainability characteristics, themes or outcomes to apply appropriate resources to do so.

INTERPRETATION / EXAMPLES

Appropriate resources to support delivery can include investment professionals with appropriate skills and experience, technological inputs and ESG/sustainability-specific research, data and analytical tools.

This key consideration reflects and supports the recent trend for Fund Authorisations to 'look under the hood'.

While we imagine that many firms will feel that their personnel are appropriately experienced and are armed with the best tools available, ultimately firms shouldn't be claiming to be doing something without the resource to support it. More broadly, firms may wish to review their existing knowledge and competence programmes and ensure that the relevant training and qualifications are recorded. Firms may want to document an assessment of appropriate technological inputs for their ESG strategies to evidence compliance.

KEY CONSIDERATION B – DATA, RESEARCH AND ANALYTICAL TOOLS

Where a firm uses ESG/sustainability research, data and analytical tools to support its fund delivery process, it should employ appropriate resources to oversee this. It should also consider due diligence on any data, research and analytical resources it relies upon (including when third-party ESG ratings, data and research providers are used) to be confident that it can validate the ESG/sustainability claims that it makes.

INTERPRETATION / EXAMPLES

A firm should take appropriate steps to:

- *monitor the research, data and analytical tools used*
- *assure the quality of inputs by conducting appropriate due diligence, model validation and data governance.*
- *understand how data and research inputs are sourced and derived (including relevant methodologies) and consider carefully how any gaps and limitations in such inputs may impact achievement of the fund's stated objectives.*

DATA DUE DILIGENCE

Our first thought is that we expect this to be a requirement relating to matters that take place behind the scenes but which will not, in general, need to be articulated in investor disclosure. We note also that this also reflects the requirements of the UK Stewardship Code 2020.

Firms should not be making claims based on information they do not understand or have not evaluated and avoid situations where they are running an ESG portfolio but the data underlying it is not appropriate. Without encouraging firms to over-engineer compliance solutions, we anticipate that there could be noteworthy compliance costs for some firms associated with evidencing that this consideration is met – from data mapping to due diligence assessments to auditability.

The statement that firms ought to be able to validate the claims it makes based on data may be a concern, noting the well documented issues with data availability, consistency, and reliability in some areas. We note here the FCA's recently closed consultation on ESG in capital markets (CP21/18: Enhancing climate-related disclosures by standard listed companies) which included questions on the role of ESG data and rating providers.

POLICY DIRECTION

This is one area where the FCA's decision to rely on existing rules is most emphasised.

This clearly supports the aim of ensuring that mass market retail products have high standards of regulation. However, there are analogous products and services for which this Guiding Principle would seem equally relevant (for example: segregated mandates; investment trusts; and incoming EEA funds).

KEY CONSIDERATION C – HOLDINGS

Where a fund pursues ESG/sustainability characteristics, themes or outcomes, the AFM should take into account whether a reasonable investor would consider that the fund's holdings reflect any ESG/sustainability characteristics, themes or outcomes that have been disclosed or claims that have been made.

INTERPRETATION / EXAMPLES

Where a fund states that it will invest in companies contributing to 'positive environmental change', a consumer might reasonably expect fund disclosures to demonstrate how the profile of the fund's holdings and other elements of its strategy, such as the exercise of investor stewardship, contribute to outcomes related to matters such as biodiversity and the climate transition. Where holdings might appear contradictory to an ESG investment strategy, the AFM should consider explaining this apparent inconsistency to end investors.

We think this can be seen as a 'no surprises' consideration and perhaps a salient reminder to avoid ambiguity (e.g. not to conflate climate change and the environment) to avoid false expectations.

The FCA Fund Authorisations team already questions portfolio holdings to ask for an explanation of how they accord with the investment strategy.

Portfolio level information is required to be published in the half-yearly and annual reports. If holdings are inconsistent, or perceived to be inconsistent with their being held in an 'ESG' fund, firms should explain why they might hold such stocks (for example, to reduce tracking error versus a mainstream fund / because they want to influence / see the company transitioning). Firms might ask themselves whether an investor or a journalist would be surprised to see a particular stock without further explanation.

GUIDING PRINCIPLE 3 – DISCLOSURE

INVESTOR DISCLOSURE SHOULD BE USER-FRIENDLY TO ENABLE INFORMED DECISION MAKING AND EVALUATION. PERIODIC REPORTING SHOULD REFLECT THE FUND'S PROGRESS AGAINST ITS ESG ATTRIBUTES

PRINCIPLE

Pre-contractual and ongoing periodic disclosures on responsible or sustainable investment funds should be easily available to consumers and contain information that helps them make investment decisions.

ESG/sustainability-related information in a key investor information document should be easily available and clear, succinct and comprehensible, avoiding the use of jargon and technical terms when everyday words can be used instead. Funds should disclose information to enable consumers to make an informed judgement about the merits of investing in a fund. Periodic fund disclosures should include evaluation against stated ESG/ sustainability characteristics, themes or outcomes, as well as evidence of actions taken in pursuit of the fund's stated aims.

KEY CONSIDERATION A – EASY AVAILABILITY

A firm should take appropriate steps to enable consumers to access relevant ESG/sustainability-related information to support investment decisions and monitor outcomes – including, to the extent possible, where a fund is marketed via a distribution platform.

INTERPRETATION / EXAMPLES

Where a firm relies on third-party data and analytical tools to support its fund disclosures, it should provide (subject to intellectual property considerations) interpretative information, describing relevant methodologies used and highlighting any material data considerations/ limitations.

This principle sets a clear expectation that fund disclosures should be sufficient for a consumer readily to access and understand all relevant ESG/ sustainability information, both on a pre-contractual and ongoing basis.

This has very clear undertones of the Asset Management Market Study which found that it is difficult for investors to know what to expect from their fund and to assess whether or not their fund is performing against relevant objectives, including those set by the fund manager. To help this, PS19/4 sets out that disclosure of non-financial objectives should 'be clear about how they will measure whether those objectives are being met, and should provide ongoing information to investors. Ultimately, the FCA wants firms to take steps to enable investors to understand all relevant ESG information as far as possible.

While there is an obligation on asset managers to ensure onward dissemination of information through the distribution chain, it is frustrating that there remains no corresponding obligation on platforms to comply with such a request as the Guiding Principles don't cover platforms or other distributors. It seems to us that 'appropriate steps' in this case will mean an amendment to platform agreements (and future templates). The issue then is what is the 'ask'? Will firms provide a single document that houses all relevant aspects, should investors be directed towards a website?

KEY CONSIDERATION B – PRE-CONTRACTUAL DISCLOSURES

We expect information on a fund's ESG/sustainability focus to be made available to consumers in relevant regulatory fund documents and be reflected in any accompanying marketing material in a clear, fair and not misleading way. The information should be presented in an accessible way that is clear, succinct and comprehensible, and that forms a sufficient basis to support consumers in making informed investment decisions.

INTERPRETATION / EXAMPLES

We expect the firm to take appropriate steps to include relevant and accurate information on a fund's ESG/sustainability focus in pre-contractual fund documentation (e.g. prospectus / K(I)ID, and any accompanying marketing materials), presenting its disclosures in a way that can readily be interpreted by consumers. For example, if a fund aims to create 'positive sustainability impact', we expect its disclosures to include clear examples of the real-world impact that it is pursuing, how it proposes to achieve the target impact (eg, its screening criteria exclude investments in fossil-fuel companies), and how performance against this stated objective will be evaluated on an ongoing basis (eg, metrics, criteria).

This again reiterates key concepts from the AMMS, clarity of communications and consistency of disclosure. The key challenge will be communicating the new jargon of sustainability in a way that is accessible to consumers.

KEY CONSIDERATION C – ONGOING PERFORMANCE REPORTING

A firm should take appropriate steps to make information on how well a fund is meeting its stated objectives (i.e. intended ESG/sustainability characteristics, themes or outcomes) available to consumers on an ongoing basis (for example in annual or half yearly reports). Such information should enable consumers to monitor whether their expectations are being met.

INTERPRETATION / EXAMPLES

Key Performance Indicators (KPIs). *Where a fund applies quantifiable targets, reporting should include relevant KPIs, along with sufficient supporting information to enable end investors to interpret performance data, in a way that is not misleading. For example, a fund that invests in companies with 'green' characteristics in their targets (eg, carbon emissions, green revenues) should include KPIs on these characteristics in its ongoing performance reporting.*

Non-financial (real world) outcomes. *Where a fund pursues non-financial outcomes, performance against such outcomes should, as far as reasonably feasible, be reported in a measurable and quantifiable way, using relevant standards/frameworks and methodologies, as appropriate. Where a fund pursues less measurable non-financial aims, performance against these should be evidenced and evaluated, with examples of actions taken in pursuit of these aims. For example, where relevant, we expect evidence of a fund's 'positive sustainability impact' to be provided on an ongoing basis to investors.*

Stewardship: *Where stewardship forms an integral part of a fund's delivery strategy, the firm should articulate clearly, on an ongoing basis, how the execution of its stewardship strategy has supported the achievement of its stated objectives.*

Periodic reporting against sustainability has rapidly evolved in recent years and we imagine that this consideration reflects the general direction of travel. Nevertheless, we know that pre-contract and periodic disclosure will typically be owned by different parts of firms and therefore there is a need to ensure that the entire suite of disclosure is aligned. In particular, it will be relevant for firms to identify what the KPIs and measurable/quantifiable outcomes are for each product. Where funds are utilising stewardship, firms should consider fund level data as well as ensuring that they have case studies for stewardship outcomes achieved for holdings in the particular fund and specifically how the stewardship approach has contributed to the ESG or sustainability objectives of the fund.

PROSPECTUS CHECK LIST

We have drafted a reference sheet that can be consulted when considering prospectus disclosures. Please do, however, note that since many of the Guiding Principles will apply in a very product-specific way (e.g. around consistency or simply the specific approach employed by the manager), it is not possible to produce a comprehensive 'checklist'. Instead we are able to provide a distillation of the more defined, one size-fits-all Guiding Principles.

Name	• If the following (or related terms) are present: 'ESG', 'green', 'sustainable,' 'responsible,' 'ethical', 'impact', is their use justified?	
Investment objective and policy	• Are all relevant 'real world' (non-financial) objectives/impacts disclosed? Are these articulated so as to be measurable? • Are the funds' claims around the pursuit of ESG/sustainability characteristics, themes or outcomes, appropriately reflected in the objective and investment policy (see our 'consistent' vs 'not inconsistent' commentary)? • Is the substantial or exclusive use of third party ESG data disclosed?	
Investment strategy	• Is the investible universe clear, including investment limits and thresholds? • Is any relevant screening criteria (positive or negative) disclosed? • Are any specific E, S or G characteristics/themes disclosed? • What is the stewardship approach of the fund? • In line with the above, what is the fund's approach to escalation and divestment?	
Benchmark	• Is the use of any benchmarks/indices disclosed? • Where used, are any tilts to mainstream benchmarks disclosed? • Where relevant, what is the expected/typical tracking error relative to the benchmark	
General	• Does the prospectus contain information that helps consumers make investment decisions? • Does the information in the prospectus or elsewhere enable consumers to make an informed judgement about the merits of investing in the fund? • Are all necessary references to external sources of information disclosed? • Is there an explanation as to how performance against real world objectives will be measured and where reporting can be found?	

IMPLEMENTATION CONSIDERATIONS

TIMING

While the Guiding Principles were issued via a 'Dear Chair Letter' which is non-binding, they are based on existing rules which are binding and therefore essentially apply now with no lead in time. As stated in the Introduction, to bring existing funds up to standard, we understand that the FCA will expect a firm to consider the Guiding Principles in its next periodic review of a product that makes ESG and/or sustainable claims whether that fund is in line with the Guiding Principles. If a firm has concerns that a product is significantly out of line with FCA expectations, that firm would need to consider more immediate action. All new applications to the FCA (whether for new products or existing ones) will need to be considered with the Guiding Principles in mind.

SCOPING SUGGESTIONS FOR LEGACY PRODUCTS

As the earlier commentary indicates, the Guiding Principles will require more precision about, and alignment between:

- The fund name;
- Stated objectives, policy and strategy of funds;
- The investment process (include use of benchmarks as appropriate); and
- Reporting of performance,

and it follows that firms will have to review the fund documentation of all potentially in-scope funds. Document suites should be considered collectively to ensure that the 'common thread' approach is in play and that periodic reporting is aligned with objectives.

The Guiding Principles have relevance to any FCA-authorised funds referring to ESG or sustainability concepts in their name, investment objective, investment policy or financial promotions.

As also noted in the Introduction, while the Guiding Principles specifically reference the rules for authorised funds in several places, and do not therefore have a direct read-across to other types of investment products, such as unauthorised AIFs, incoming EEA funds, or segregated mandates, the guiding principles also refer to broader FCA principles and rules and so may be relevant to other products making ESG or sustainability claims.

When carrying out reviews, it is important also that firms consider that the Guiding Principles have very considerable wider relevance in the context of the PS19/4 requirements, which could mean that there are internal lessons from experience to date in other parts of the fund range.

A lot of existing products will need significant added detail (e.g. around stewardship). Integrating this neatly (and keeping it concise) will take more effort than adding boilerplate paragraphs.

Finally, there will be a significant amount of behind-the-scenes compliance work to be carried out around data due diligence and knowledge and competence.

THE NEED FOR APPROVAL AND INVESTOR ENGAGEMENT

Where legacy products are updated, firms will need to consider the usual tests regarding the need to seek FCA approval and engage with investors.

The triggers for these actions are considered extensively in the IA-Eversheds Sutherland May 2019 paper on Q&A on implementation of PS19/4[4]. Broadly, any change of investment objective or policy will require FCA approval.

The Guiding Principles may also result in changes to the management of a fund, particularly Guiding Principle 2 on delivery, which may prompt considerations as to whether changes may be necessary. If firms were to make such changes, investors will need to be notified of changes in advance, typically with 60 days' notice. Changes to clarify and enhance disclosure may benefit from lesser notification requirements (as was common

[4] https://www.theia.org/system/files/private-downloads/2019-05/20190508-iaevershedsperformancemeasurespaper.pdf

with AMMS). This remains an assessment for firms to make with the depositary. However, our recent lived experience with Fund Authorisations is that firms are being challenged if providing less than 60 days' notice and asked to consider the scale of the changes and the extent to which investors were aware of the point being clarified at the time of investment.

"We note that there are links between the draft guiding principles and other regulatory initiatives, such as the EU's Sustainable Finance Disclosure Regulation (SFDR). We acknowledge that many UK authorised firms are applying SFDR requirements in respect of their EU business. The intent of these guiding principles is to be complementary to obligations under SFDR."

INTERACTION WITH SFDR

The Guiding Principles and SFDR are separate regimes that cover similar ground. They need to be considered independently but the disclosures under them cannot be inconsistent with each other.

The FCA explicitly acknowledges SFDR as a parallel regime that may need to be considered, and states that the Guiding Principles should be complimentary, although there is no discussion of the practical interaction of the regimes.

We expect that, for the most part, disclosures under the two regimes can co-exist and inform each other without either interfering with the other. While firms may classify their products for SFDR purposes, only a limited number are currently attempting to make SFDR updates to UK products. For those UK products that will make SFDR updates, the disclosures should be somewhat isolated (even if repetitive). The Guiding Principles are most likely to affect the core investment objective and policy whereas much of the SFDR disclosure will be in a self-contained annex. Compliance with SFDR is very unlikely to be sufficient for meeting the requirements of the Guiding Principles.

It is also the case that classification of funds under SFDR (e.g. Art 6/8/9) has no status under the Guiding Principles.

However, in a practical sense, the Guiding Principles is most concerned with funds that would fall under Article 8 or 9 of SFDR.

A product that falls only under Article 6 of SFDR may need to consider the Guiding Principles in a limited way. For example, such a fund might incorporate basic ESG risk management and will need to ensure that any claims made are not overstated.

Other key questions include:

- Can the SFDR Annex be included with UK funds? The SFDR Annex has no regulatory status in the UK. That said, as long as it is clear, fair and not misleading and does not make any claims that contradict other existing UK rules and the expectations in the Guiding Principles, following discussion with the FCA, it is our understanding that the SFDR Annex disclosures may be made available for UK funds. Firms will need to consider whether SFDR disclosure is appropriate for each population of their UK investors noting that some of the concepts in the SFDR disclosure may not be 'clear' for all investors.

- Do the requirements of SFDR and the Guiding Principles conflict around data? The Guiding Principles expect data assurance and this should complement and enhance SFDR. The area of potential tension is that SFDR requires disclosure that firms may not otherwise be comfortable making. Firms applying the Guiding Principles would need to understand any underlying assumptions, proxy data reliance etc. in their SFDR data.

LIST OF EXAMPLE FUNDS

THREE FICTITIOUS SPECIMEN FUNDS ANNOTATED TO EXPLAIN HOW THE GUIDING PRINCIPLES MAY APPLY IN PRACTICE

EXAMPLE 1

Name	The EXAMPLE UK Ethical Equity Fund	Reference to 'ethical' in the name clearly falls within **Guiding Principle 1** and would be the starting point in a 'common thread'.
Investment Objective	The Fund seeks capital growth 2.5% greater than that of the [INDEX] after fees, over five year periods.	There are no stated non-financial or real world outcomes. This is acceptable as long as the 'ethical' aspect is borne out elsewhere.
Investment Policy	The Fund invests at least 80% in the shares of UK companies (those companies domiciled or incorporated in the UK or which make a significant amount of their revenue there).	The FCA seeks specific terminology around 'UK funds'. They will be looking for a statement that the company is domiciled or incorporated in the UK. UK listing (unless in conjunction with these other criteria) will not be accepted without changing the name.
	The Fund does not invest in the shares of companies involved in the manufacture or sale of alcohol, tobacco, weaponry or pornography.	Presumably it is these exclusions that are considered to make the portfolio 'ethical'. How significant are these? **[Guiding Principle 1 A]** How much do they reduce the investable universe by? If for example screening reduces the investible universe by only a few percent, it may not be sufficient to warrant the overt references to being 'ethical' **[Guiding Principle 1 A and 1 C]** Why is the remainder of the portfolio considered ethical? **[Guiding Principle 1 A]** How do the exclusions work? Are there thresholds and exemptions? For example, the 'sale of alcohol' might imply that supermarkets and perhaps even haulage companies are excluded. **[Guiding Principle 1 C]**
	The Fund may also invest in bonds issued by companies. It may hold cash and similar investments to meet obligations and investor redemption requests.	Are the investments in the bonds subject to the same screening? **[Guiding Principle 1 C]**
	The fund may use derivatives for efficient portfolio management	Further to previous IA guidance, consider whether investors will understand this term.

Other notes	*PS19/4 would require further disclosure around the choice and use of the benchmark (which would be a target benchmark). Typically this would be included in a discrete section. Any ESG-related use of the benchmark should be disclosed* ***[Guiding Principle 1 B]****. The FCA might also ask why the benchmark is suitable if it is not itself an ethical benchmark.* *The current language does not articulate whether the fund is actively or passively managed.* *There is likely insufficient detail around the manager's investment strategy. Will the UK companies in the portfolio be from a particular sector, be of a particular market capitalisation, will they be growth stocks, value stocks etc.* *There are no references to the approach to stewardship* ***[Guiding Principle 1 C and D]*** *What happens if an existing stock falls foul of the policy? Will there be divestment? How quickly?* ***[Guiding Principle 1 D]***

EXAMPLE 2

Name	The EXAMPLE Sustainable European Equity Fund	Reference to 'sustainable' in the name clearly falls within **Guiding Principle 1** and would be the starting point in a 'common thread'.
Investment objective and policy	The Fund's objective is to achieve long term capital growth by investing primarily in equity-related securities of companies headquartered, listed or doing substantial business in Europe (excluding the UK).	Following AMMS, the FCA will not permit a phrase like 'primarily' to be used and will require a quantified minimum or range instead. The FCA may also ask for a phrase like 'long term' to be converted into an absolute number or range of years. This allows the objective to be measured and follows AMMS.
	The Fund is actively managed and invests in 35-50 high quality businesses such as those featuring: - reliable cash flows - structural competitive advantages - reliable high returns on operating capital - a high degree of resilience to change - an attractive market valuation	Are these characteristics what makes the fund sustainable? These read like 'sustainable' return characteristics (e.g. reliable returns) rather than 'sustainable' in the sense of environment and social matters. **[Overarching Principle]**
	The Fund considers the risks to the fund posed by environmental, social, and governance factors and has implemented a policy for managing and mitigating these risks as part of its investment decision making.	This paragraph is really describing ESG risk management integration. It doesn't say whether risk management is mandatory at the time of selecting investments or rather is some sort of overlay.
	We generally invest in listed companies, specifically those we think have good prospects for growth or which are undervalued in the market. We also engage with the companies we invest in to ensure that they meet the highest standards.	Despite the use of 'generally', it is likely that all of the companies will be listed. The FCA might be interested in whether there are unlisted companies and what this does to liquidity. The stewardship sentence is weak. It doesn't add very much and doesn't cover the level of detail required **[Guiding Principle 1 C and D]**: - Is engagement only with the companies in the portfolio? - What are the 'highest standards'? - Does this extend to voting etc? - What is involved when the firm does 'engage')
	For further details see EXAMPLE.com/sustainableinvesting	Possibly innocent, but risk management and engagement can only tenuously be described on their own as 'sustainable investing' so the manager may want to consider the implication of this link.

Other notes	*We expect the FCA to have reservations over the use of 'sustainable' in the name of this product as currently drafted. While there are products on the market using 'sustainable' in a non-ESG sense, combined with other references, an investor might legitimately misinterpret the meaning.* ***[Overarching Principle, Guiding Principle 1 A, and Guiding Principle 3]*** *PS19/4 would require further disclosure around the choice and use of any benchmark. This fund doesn't disclose a target or constraining benchmark in the investment objective/policy, but may have a comparator. Typically this would be included in a discrete section. Any ESG-related use of the benchmark should be disclosed.* ***[Guiding Principle 1 B]*** *There is no detail on what the portfolio can consist of other than 'equity-related securities'. What other asset classes are available? What about cash positions? What about derivatives?*

EXAMPLE 3

Name	The EXAMPLE Positive Impact Fund	Reference to 'sustainable' in the name clearly falls within Guiding Principle 1 and would be the starting point in a 'common thread'. Positive Impact implies that the fund will support real world outcomes.
Investment Objective	The Fund seeks to grow by 2% (after fees) each year by investing in the companies that have the biggest positive impact on society. There is no guarantee that the fund will grow by this amount each year (or at all over any period) and you could lose money.	Although this investment objective section includes a reference to 'positive impact', this is really a prelude to the investment policy rather than being an independent objective. The FCA is likely to interrogate what positive impact the fund will actually have/support and whether the fund truly seeks a measurable positive impact. It is possible that if it does not, the name will not be permissible **[Principle 1 A and 1 B].**
Investment Policy	The Fund will invest in companies that the manager considers will have a positive impact on society based on its own research.	Here we see that 'positive impact' is going to be a subjective assessment by the manager. This will need to be explained further. **[Principle 1 A and 1 B].** What does 'investment in companies' comprise here? Is this equities and corporate bonds? Following AMMS, the FCA is likely to ask whether there is a minimum level of investment.
	The Fund invests in companies that support the United Nations Sustainable Development Goals. Examples would include clean energy companies or those supporting the education sector.	What does 'support' mean? Is this companies that have stated their support for the SDGs, or those which the manager thinks are contributing to the goals? How much support? How many goals need to be supported? What practical progress needs to be shown? **[Guiding Principle 1 C]**. The UN SDGs might be thought of as being 'impactful' but 'impact on society' might be thought of as a 'Social' reference. It would be good to know if the focus is all 17 SDGs or just social ones. The examples given might have a disproportionate sway on an investor's impression of what the composition of the portfolio might be. It will be important that these are a fair reflection of its composition. **[Overarching Principle, Guiding Principle 2 C, Guiding Principle 3]**.

	Potential investments are screened in accordance with our sustainable investment policy. The Fund doesn't invest in businesses with substantial interests in: Aerospace/Defence Brewers or Distillers Casinos or Gambling Metals Mining Tobacco Utilities	The FCA is likely to interrogate what 'substantial interests' are, and want to understand how this will work. As above, what are the thresholds? Will the manager divest etc? **[Guiding Principle 1 B, 1 C and 1 D].** It might be helpful if the manager explained why these investments are screened out.
	We can invest in other investments that do not meet our definition of having a positive impact as long as they do not have a negative effect on that objective. These may include other transferable securities, money market instruments, cash and near cash.	'Transferable securities' is a broad category and the FCA is likely to request more specificity. It still isn't clear whether the fund's main investments are shares or corporate bonds. Transferable securities could be either of these.
	We can use derivatives for investment purposes or for efficient portfolio management.	The FCA will expect to understand how derivatives are being used for investment purposes both in a general sense and any use to meet the impact theme.
Other notes	*PS19/4 would require further disclosure around the choice and use of any benchmark. Typically this would be included in a discrete section. As this is an absolute return product, it may not have a benchmark.* *There are no references to the approach to stewardship* ***[Guiding Principle 1 C-2]*** *Are there any exceptions to the exclusion policy?* ***[Guiding Principle 1 C-3]*** *What happens if an existing stock falls foul of the policy? Will there be divestment? How quickly?* ***[Guiding Principle 1 C-2]***	

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