FCA Dear AFM Chair Letter Authorised ESG & Sustainable Investment Funds: improving quality and clarity

What does it mean for organisations and how can BCS help?

On 19 July 2021, Authorised Fund Manager (AFM) Chairs of FCA-regulated firms received a letter calling on them to take action to address some of the weaknesses identified in the ESG and sustainable investment market. Through the letter, the FCA encouraged firms to address the weaknesses in the quality of ESG/sustainable investment fund applications and to enhance the level of disclosure provided to end investors by setting guiding principles to enable firms to accurately reflect the fund's responsible or sustainable investment strategy, both at the time of application and on an ongoing basis.

The guiding principles identified through the letter include:

Overarching principle: a fund's ESG/sustainable investment focus to be reflected consistently in its design, delivery and disclosure

Principle 1: the design of responsible or sustainable investment funds and disclosure of key design elements in fund documentation

Principle 2: the delivery of ESG investment funds and ongoing monitoring of holdings

Principle 3: 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

The FCA expects firms to apply these principles now, when submitting fund applications and in managing funds on an ongoing basis.

The letter comes at a time where European ESG regulatory initiatives for wealth and asset managers, including the Sustainable Finance Disclosure Regulation (SFDR) and EU Taxonomy Regulation, are progressing at full speed. The FCA has provided links to these regulatory initiatives, particularly SFDR, through the guiding principles which are complementary to the obligations that firms servicing EU clients will be familiar with. Nevertheless, with the European ESG regulatory landscape constantly evolving and the FCA's recent release of its climate and sustainability-related initiatives, highlighted through the 2021-2022 FCA Business Plan, firms servicing both UK and EU clients will need to be prepared to comply with a large volume of complex ESG regulatory requirements, spanning multiple deadlines.

Overarching principle: Consistency
• Reflect the ESG/sustainable investment fund's focus consistently in its design, delivery and disclosure • Applies to any funds that claim to pursue ESG/sustainability characteristics, themes or outcomes

Principle 1: The design of responsible or sustainable investment funds and disclosure of key design elements in fund documentation	
Fund name	• Align the name of the fund to its objectives, investment policy and strategy, ensuring the name does not mislead investors • Where funds use 'ESG', 'green', 'sustainable,' 'responsible,' 'ethical', 'impact', or related terms in the name: - the sustainability approach should be disclosed in investment objectives - the investment strategy should be materially different in comparison to a fund that does not consider ESG/sustainability - if the fund uses the term 'impact' or 'impact investing', non-financial (real world) impacts should be measured and monitored.
Investment policy and objectives	• Update and manage the investment policy and objectives in fund prospectuses to reflect the fund's ESG characteristics, themes or outcomes. Where impact investing is considered, this includes reference to the intended real-world outcome • Include, within the annual report of the fund, the policy and strategy pursued for achieving its objectives and a review of the investment activities during the period • Disclose in fund prospectuses the reliance on third-party ESG data, where applicable
Investment strategy	• Provide sufficient information in the fund's investment strategy highlighting the key ESG/sustainability elements (e.g., positive or negative screening criteria, specific ESG characteristics/themes, real world (non-financial) impacts, application of benchmarks/indices, stewardship approach)) • Above not required for funds that integrate ESG considerations into mainstream investment processes
Stewardship approach	• Develop adequate and effective strategies for exercising voting rights to the exclusive benefit of the fund • Develop an engagement policy in line with COBS 2.2B requirements, or explain why not • Where investor stewardship forms part of a fund's responsible or sustainable investment strategy, 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

Principle 2: The delivery of ESG investment funds and ongoing monitoring of holdings	
Resources to support delivery	• Employ investment professionals with appropriate skills and experience, technological inputs and ESG/ sustainability-specific research, data and analytical tools to support delivery of fund's ESG/sustainability characteristics, themes or outcomes
Data, research and analytical tools	• Oversee ESG/sustainability research, data and analytical tools to support the fund delivery process through the resources employed • Conduct due diligence, model validation and ensure data governance on any data, research and analytical resources relied upon (including from third-party providers) • Evaluate data and research methodologies and identify gaps in comparison to the fund's objectives
Holdings	• Ensure underlying fund holdings reflect any ESG/sustainability characteristics, themes or outcomes that have been disclosed or claims that have been made

Principle 3: 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	
Easy availability	• Take appropriate steps to enable consumers to access relevant ESG/sustainability-related information to support their investment decisions and monitor outcomes
Pre-contractual disclosures	• Include relevant and accurate accompanying information on the fund's ESG/sustainability focus in pre-contractual fund documentation (e.g., prospectus / KIID, and any marketing materials) and present this in an accessible, clear, succinct and comprehensible manner
Ongoing performance reporting	• Disclose information on how well fund is meeting its objectives (i.e., intended ESG/sustainability characteristics, themes or outcomes) to consumers on an ongoing basis (e.g., in annual and half-yearly reports). This includes, Key Performance Indicators (KPIs), non-financial (real world) outcomes and stewardship strategy, where applicable

How can BCS help?

BCS Consulting has extensive experience supporting financial institutions in ESG capability development and ESG framework adoption. We have assisted clients in a broad range of ESG related challenges, including the development of Sustainable Finance product taxonomies, TCFD reporting, Climate PRA SS3/19 compliance, Stewardship Reporting, SFDR and broader ESG regulatory compliance objectives.

With deep expertise in mobilising, developing, and publishing ESG disclosure, BCS Consulting is well positioned to assist organisations in implementing the FCA's guiding principles for AFM Chairs. Please contact **Hector.Fontaine@bcsconsulting.com**, our Sustainable Finance Lead for further information.

About the Authors

Hector Fontaine
Sustainable Finance Lead

Hector is the Sustainable Finance Lead for BCS Consulting. He has deep expertise and significant experience in managing risk and sustainability, gained by supporting a large number of financial institutions. He frequently speaks at industry events and has authored numerous ESG publications and articles, including the BCS Consulting ESG Banking Benchmark Report, the BCS TCFD Global Progress in the Banking Sector Report 2021 and the BCS PRA Dear CEO Letter paper (Managing Climate-related Financial Risks). Hector also holds an APRM qualification from the Professional Risk Managers' International Association.

Katie Ryan
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Katie is an experienced ESG consultant specialising in the wealth and asset management sector. As well as supporting firms in mobilising ESG operating models, Katie supports firms to develop appropriate regulatory disclosure, including SFDR, TCFD, Shareholder Rights Directive II and The Stewardship Code. Katie co-authored The BCS Accelerating ESG Regulatory Landscape paper in 2020.

Frank Glock
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Frank is a Sustainable Finance Consultant with strong risk management and ESG experience, specialising in the wealth and asset management industry. He has worked with firms on upcoming ESG regulatory initiatives, such as the EU Taxonomy, SFDR and TCFD, and has supported firms in understanding the data and operating model considerations to effectively implement ESG requirements.

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