To: UK Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN
From: BlueMark UK Ltd.
Re: Sustainability Disclosure Requirements and Labels Policy
Date: January 25, 2023

Dear Chair Lloyd and the FCA Board:

I am writing this letter on behalf of BlueMark, a specialist independent provider of impact verification and intelligence for the impact and sustainable investing market. BlueMark, founded in January 2020 as a spin-off from the established impact investment consultancy Tideline, works with investors and other organisations around the world, and has its European headquarters in London.

BlueMark was created to meet the market demand for reliable, independent verification of the impact in impact investments, brought on by the rapid growth in this segment of the capital markets. To date, BlueMark has completed over 115 verifications of nearly US$200B of impact-oriented assets under management for institutional investors of varying types and sizes, including both asset managers and asset allocators. BlueMark's verification services are structured around what we view as the two key pillars of accountability for impact performance — an investor's impact management practices (their systems, processes, and capabilities to manage social and/or environmental impact as an integral component of the investment process) and an investor's impact reporting (their transparency about actual impact results).

My own background includes 15 years at JP Morgan where I ran several risk management groups, including for the credit portfolio and emerging markets trading businesses, as well as the firm's sovereign credit ratings advisory business. This experience provided me a first-hand perspective regarding how capital allocation decisions are made and the critical building blocks supporting development of new markets, including smart regulation, adoption of robust voluntary industry standards, and a mechanism to hold actors accountable to both.

Our view on the proposed Sustainable Disclosure Regulation (SDR) and Labels Policy

BlueMark shares the FCA's concerns about the threat of greenwashing and how it can damage trust in the market for sustainable investment products. Our firm's primary goal is to provide the accountability infrastructure necessary to help the sustainable and impact investing markets scale with integrity. From this vantage point, our view is that the intention behind the SDR framework represents a commendable advancement on existing regulatory regimes, with the potential to set a higher bar for investors by increasing accountability for the environmental and societal impacts implied by "sustainability" and "impact" labels.

While we share the FCA's ambition for greater transparency and discipline in fund labelling, we are concerned with the increasing burden faced by our clients as they attempt to navigate the growing landscape of competing voluntary and regulatory guidance. BlueMark would urge the FCA to push for increased harmonisation of international labelling standards, at a minimum by working alongside the SEC and European Commission to define how their various classification schemes relate to one another to reduce market confusion. The work of our sister company, Tideline, offers a useful starting point to help the market understand the expectations a fund manager may face when using a particular sustainability or impact label. These expectations, which have to do with how a manager emphasises *intentionality*, *contribution*, and *measurement* in their investment decision-making, could inform future harmonisation efforts by the FCA.[1]

That said, we recognise the risk posed by overly prescriptive regulation in a market as nascent as this one, and therefore encourage the FCA to leave space for industry groups and voluntary standards bodies to play a role in interpreting and offering further clarity to the market as this and other national frameworks are put into practice over time.

This comment letter specifically responds to three of the questions outlined in the Consultation Paper where BlueMark has the most relevant expertise:

- Q4 regarding the FCA's definitions of sustainable investment activities,
- Q5 regarding the proposed approach to labelling, and
- Q10 regarding requirements for the use of labels and the question of verification.

Q4: Do you agree with our characterisation of what constitutes a sustainable investment, and our description of the channels by which positive sustainability outcomes may be pursued? If not, what alternatives do you suggest and why?

Overall, BlueMark agrees with the FCA's characterisation of what constitutes a sustainable investment due to its cross-cutting requirement that products using any sustainability label have "clear, explicit, and measurable" objectives. In comparison with other market standards and regulations, this definition has the potential to set a higher bar, requiring sustainable products to demonstrate a "plausible, purposeful, and credible" link to positive outcomes for the environment and/or society.

The cross-cutting considerations that apply to all three labels will be particularly useful in distinguishing between funds that approach ESG integration solely from the perspective of financial risk and return versus those genuinely pursuing sustainable investment strategies that

[1] Tideline, 'Truth in Impact: A Guide to Using the Impact Investing Label,' 2021, and 'Truth in Climate Impact: A guide to best impact management and labelling practices', 2022

balance impact considerations alongside risk and return. These types of ESG integration funds do not have any place in the SDR framework at all, differentiating the FCA's approach from the SEC's inclusion of a designation for "Integration Funds,"[2] and helping to move the market toward treating basic ESG risk screening and integration as table stakes for prudent investment decision-making.

However, we are concerned that the definitions proposed for the three labels lack the clarity and consistency necessary to ensure they are discernible and useful both to asset managers and retail investors. We believe that a more explicit emphasis on intentionality[3], contribution[4] and measurement[5] would help to simplify and more clearly differentiate the three labels.

1. The sustainable focus label should be clearly differentiated from the other two labels, given that as currently defined, products with this label will lack both intentionality and investor contribution.

    a. This label should have a higher bar for intentionality, requiring active asset selection and management. At this stage in the market's development, passive strategies that do not involve active stewardship cannot be credibly included under any sustainability labels. We would encourage the FCA to define its requirements more explicitly for what constitutes sufficiently active management.

    b. For the sake of harmonisation, the FCA should consider aligning its proposed threshold for assets meeting a 'credible standard' of environmental and/or social sustainability with the SEC's suggested 80%,[6] and should further establish limitations on what assets can constitute the remaining 20%. Without such limits, there is a risk that the harmful effects of a small portion of a product's assets with this label could undermine the benefits of an otherwise sustainable fund. Monitoring requirements may help to address this risk, potentially by introducing an approach aligned to the concept of Principle Adverse Impact screening under SFDR.[7]

    c. Given the continued existence of a wide range of competing sustainability standards, the FCA should provide examples of current standards, such as the Paris Agreement or EU Taxonomy (and once final, the UK Green Taxonomy),

[2] https://www.sec.gov/files/ia-6034-fact-sheet.pdf
[3] *Intentionality* defined as explicitly targeting specific social or environmental outcomes
[4] *Contribution* defined as playing a differentiated role to enhance the achievement of the targeted social or environmental outcomes
[5] *Measurement* defined as monitoring and reporting sustainability/ impact performance based on measurable inputs, outputs and outcomes
[6] We recommend aligning this proposal with 80% bar set by the SEC's proposed Names Rule, as well as including similarly explicit guidelines to address the risks of "drift" and the use of derivatives.
[7] https://www.esma.europa.eu/sites/default/files/library/jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf

which would be considered credible under this label. We commend the FCA for requiring that alignment with these frameworks be independently assessed by an expert third-party.

d. Given the potential that products with this label will include a portion of assets that are not aligned with sustainability objectives, as well as investments made passively, the FCA should consider replacing the label "sustainable focus" with "sustainable oriented."

2. The sustainable improver label places a commendable focus on setting clear and measurable targets against sustainability KPIs. However, the label risks becoming a catch-all for a wide range of products, including those lacking the rigorous approach to intentionality and measurement that would be necessary to ensure that improvements will be made on a timescale that would not have occurred in the absence of the investor's contribution.

    a. We agree with the requirement for products using this label to measure assets' progress over time against clear sustainability KPIs and associated targets.

    b. While we appreciate that goals and timelines will vary across products, the FCA should provide more explicit guidance for target setting to ensure that any firm using this label has calibrated its ambitions relative to (i) the size of the social or environmental challenge to be addressed,[8] (ii) the past performance of the asset, and (iii) a relevant external benchmark, where possible.[9]

    c. Without such guidance, there is a risk of confusion for retail investors, as some 'sustainable improver' products may set a much higher bar or aggressive timeline for improvements in the sustainability profile of their investments than others. For example, a 'sustainable improver' fund investing in shipping companies may seek to improve the carbon footprint of its assets; when setting targets, it should consider baseline data from the individual asset and should benchmark its goals for future emissions to the company's peers and the shipping industry more broadly.

    d. This recommendation draws on BlueMark's extensive research on impact reporting, which revealed that only 38% of investors consistently report on their

[8] https://www.unrisd.org/en/activities/news-items/a-new-era-of-authentic-sustainability-assessment
[9] https://thegiin.org/research/publication/iris-impact-performance-benchmarks-overview/

impact results alongside a target that has been calibrated in reference to relevant factors.[10]

e. The Global Impact Investing Network's (GIIN) COMPASS methodology, designed to aid in standardising and comparing impact performance,[11] may be a useful reference as the FCA strengthens its requirements for the use of this label.

3. We are encouraged by the high bar set for investors seeking to use the sustainable impact label, particularly the FCA's emphasis on investor contribution as a key distinguishing characteristic.

    a. The label would be strengthened by an explicit reference to enterprise contribution – that is, a requirement that products classified as sustainable impact invest in companies or assets that provide solutions to critical social or environmental problems.

    b. As written, there is a substantial risk that the sustainable impact label will be applied to products whose theories of change lack coherent logic or rely on untested assumptions. While we strongly support a theory of change requirement for investors claiming impact, the market will require more detailed guidance for what constitutes a clear, high-quality, and well-evidenced impact thesis. This view is based on BlueMark's experience reviewing the impact management practices of a diverse range of asset managers. According to a 2022 BlueMark study on impact management, while 85% of verified investors have a logic model or theory of change, only 15% clearly support the link between their investment strategy and impact outcomes with a robust supporting evidence-base.[12]

    c. We would urge the FCA to consider requiring independent assessment of underlying theories of change for sustainable impact products. Developing a robust theory of change will require specialised expertise in impact measurement and management. Without this requirement for independent assessment, the FCA risks products being labelled as sustainable impact that lack a well-evidenced strategy, thereby increasing the risk of impact-washing.

[10] BlueMark's research on impact reporting, as featured in Raising the Bar and Raising the Bar 2.0, provide additional guidance about the key elements of quality impact reporting that may serve as a reference as the FCA continues to refine this framework and produce market guidance.
[11] https://thegiin.org/research/publication/methodology-for-standardizing-and-comparing-impact-performance/
[12] https://bluemarktideline.com/wp-content/uploads/2022/07/BlueMark_Making-the-Mark_Spotlighting-Leadership-in-Impact-Management.pdf

In sum, the FCA should tighten the definitions for each of the proposed sustainability labels to ensure that they are interpreted and applied consistently, and crucially, that they reduce rather than unintentionally accelerate issues of greenwashing and impact-washing.

Q5: Do you agree with the proposed approach to the labelling and classification of sustainable investment products, in particular the emphasis on intentionality? If not, what alternatives do you suggest and why?

The FCA's focus on intentionality is a significant and positive differentiator in the SDR framework, and one that aligns well with BlueMark's view of impact investing and the guidance on "Truth in Impact Labelling" introduced by our sister organisation, Tideline.[13] The SDR framework's emphasis on intentionality becomes especially evident when considering the uplifts that will be required for current SFDR products to qualify for the SDR categories – in particular, our understanding is that SFDR Article 8 products with basic ESG integration or negative screening will not, without demonstrating higher levels of investor engagement and stewardship, qualify for an SDR label. The same is true for Article 9 SFDR products with a sustainable investment strategy relying only on the enterprise contribution of the underlying assets.

In BlueMark's view, the FCA's emphasis on both intentionality and investor contribution – through activities including asset selection, portfolio construction, and investor stewardship – represents an important and welcome change in the market, encouraging investors to examine the value they are able to add through active channels of stewardship and engagement, influencing asset prices and the cost of capital, and contributing to sustainability goals by allocating capital to underserved markets. The FCA's acknowledgement that both enterprise and investor contribution – and the link between the two – are critical for creating effective sustainability strategies is a major advancement for sustainable investing standards.

We recognise that the current proposed regulation is intended to apply primarily to asset managers with retail clients who invest in listed markets, meaning that the framing of intentionality and contribution used by the FCA is limited to those strategies most common to those investors, primarily public equity and fixed income. To make this regulation more relevant and transferable to a wider range of financial market participants, BlueMark would urge the FCA to consider a broader definition of investor contribution. For example, in private markets, where impact investing practices are more well established, additional 'intentional' investment strategies include more direct influence via taking meaningful ownership stakes and governance roles at portfolio companies.

[13] https://tideline.com/wp-content/uploads/2021/08/Tideline_Guide-to-Impact-Labeling_2021.pdf

Q10: Does our approach to firm requirements around categorisation and displaying labels, including not requiring independent verification at this stage, seem appropriate? If not, what alternative do you suggest and why?"

BlueMark would urge the FCA to require independent verification of labelling. Without this added accountability mechanism, there is a risk that this ambitious regulation falls short of its potential for increasing market integrity and protecting consumers. The private sector can play an important role in helping to ensure the integrity of investor's sustainability claims, while also reducing enforcement burdens on the public sector.

Feedback on this question in earlier consultation rounds raised important points.[14] Some respondents raised the point that requiring verification would increase consumer trust in the labels, providing credibility to the regime. Others noted that making verification mandatory would significantly increase the costs and burden of participating in the regime, disadvantaging smaller firms and disincentivising uptake of the labels. We would encourage the FCA not to overreact to this risk; BlueMark's experience has shown that it is both possible and desirable for firms to calibrate the scope, and therefore the cost, of impact verification services to investors of all sizes. We have already done this by providing a 50% discount on standard pricing to firms under an AUM threshold, due to our belief that independent verification is critical to helping the impact and sustainable investing markets scale with integrity. The FCA could also consider advocating for public sector financing to help defray the costs of verification for smaller players in the field.

A genuine cost-benefit analysis of the value of independent verification should conclude that they provide a hugely beneficial service to the market. Importantly, independent verifications can facilitate a more optimal and efficient flow of capital to sustainable investments. Verification can also help to push investors to a higher standard of practice by enabling a greater degree of accountability and comparability, thereby encouraging critical self-reflection and continuous improvement. We expect that the costs of impact verification and audits will increasingly be accepted as a cost of doing business – in the same way that the costs of financial audits are commonly accepted – and will help to reduce diligence costs for asset allocators and owners. The absence of such an accountability mechanism creates additional costs that, while less visible, are ultimately borne by various stakeholders, including retail investors.

Should the FCA establish a verification requirement for these labels, BlueMark recommends that the FCA additionally offers guidance to the market on the credentials necessary for firms to complete these assessments. Specialised sustainability and impact measurement and management expertise will be critical, as those conducting these assessments will require this experience and

[14] https://www.fca.org.uk/publication/discussion/dp21-4.pdf

knowledge to credibly review firms' theories of change, sustainability KPIs, and approaches to investor contribution and intentionality.

In conclusion, we welcome FCA rulemaking on this important topic as key to the continued growth and fidelity of the impact and sustainable investing markets. While we have several suggested refinements, we believe the proposed SDR framework could represent an important step forward to increase trust and transparency in the investment management industry.

For this framework to be successful, we want to emphasise three closing points:

- The *FCA should push for increased harmonisation with other labelling standards and frameworks, at a minimum by working alongside the SEC and European Commission to define how their various classification schemes relate to one another to reduce market confusion and improve capital allocation.*
- *There should be tighter definitions and clearer guidelines on what is expected of asset managers to qualify for the labels, while still leaving room for flexibility and interpretability as the sustainable investment market continues to evolve.*
- *The final regulation should include a requirement for independent verification of alignment with a chosen label, with a particular focus on the expected qualifications of a verifier to ensure a degree of authority and accountability.*

We thank the FCA for the opportunity to submit public comments and look forward to engaging in the next steps of this process. Please feel free to send any questions about this comment letter or BlueMark's perspective on impact verification to info@bluemarktideline.com.

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