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Dear Sir/Madam,

RE: DP21/4 Response

Introduction

Square Mile is an independent investment consulting and research business that is committed to helping investors build a better future. We work with independent financial advisers and a large range of financial service providers including asset managers, life companies and distribution networks to empower them with the knowledge, tools and support to deliver the best outcomes for their clients. We are widely recognised as one of the leading sources of independent investment research in the UK.

The Square Mile business is founded on qualitative research that aims to help investors ensure their investments are suitable, meet their requirements and that we believe will deliver the stated and desired outcomes. Today, of increasing importance for many, is a desire for those investments to be in line with their broader social conscience (non-financial) outcomes. We are passionate about the change that responsible capitalism brings to the savings market and to the future wellbeing of the planet and society.

There are three arms to our business, each of which has multiple touch points to the increasingly important area of responsible investing and ESG-related issues including climate and climate reporting.

Portfolio Management
Square Mile Investment Services, regulated by the FCA, is the portfolio management arm of our business that provides discretionary and non-discretionary fund management services to over 60 financial adviser firms with over £2.5 billion of assets under management. Included in that are a set of sustainable and impact portfolios.

Consulting and Research
Our consulting and research business aims to empower advisers and asset managers to meet their clients' needs and aspirations. We assess funds across all asset classes and distil this into a circa 300-strong "Academy of Funds" which reflects our conviction in each fund's ability to deliver on its expectation. Our extensive fund research also includes the assessment of the ESG capabilities for each fund and asset manager. We also maintain a list of Academy funds which have a stated responsible objective.

Our "Academy of Funds" is accessed by an average 10,000 active users each quarter. They are able to filter our assessed funds via responsible objectives or ESG scoring. We currently have 46 Responsible rated funds (as at 30 November 2021) included in our Academy.

Our consulting business offers bespoke services to a large range of financial service providers including asset managers, life companies and distribution networks. Our consulting work has often helped asset managers in positioning themselves with their emerging presence in the responsible market.

We also aim to be thought leaders in the industry producing topical commentary on subjects important to financial services, including responsible investment. We also host a number of educational initiatives for financial advisers, such as conferences and webinars, as well as providing insights and commentary to various media sources.

Ethical Money
Square Mile acquired Ethical Money in July 2020. Its long-established research approach, 3D Investing, uses qualitative, in-depth analysis to evaluate a fund within the framework of avoiding doing harm, doing good and leading change. We have developed proprietary tools that enable us to test the veracity of any claims made by a fund manager in relation to being a responsible investment mandate. 3D Investing has provided over 300 initial evaluations of funds and currently has 65 rated funds available on the Square Mile website. 3D Investing continues to offer analysis through their unique framework to help identify key outcomes for responsible investors.

General Comment

We preface our question responses with a general observation.

- Taxonomy

At Square Mile, we are committed to building a common language around "Responsible Investment", the catch all phrase we use with our clients to describe using investments as a force for positive change.
We are very concerned that the FCA could be adding to the confusion in this space. There is already a lexicon of descriptors in use for this area.

The asset manager trade association, The Investment Association, has adopted "responsible" as its umbrella term, the EU has adopted "sustainable" and now the UK regulator has adopted "ESG". It is undoubted that the consumer has little understanding of what ESG stands for or describes, however, there is a better understanding of "responsible" and "sustainable".

The Spectrum of Capital (that has been broadly adopted throughout the industry) has helped to bring in some form of commonality of language within the responsible space. We believe that the FCA using ESG as its umbrella term is adding to confusion rather than aiding the adoption of a common set of terms.
We would appeal to the common sense of the situation and encourage the adoption of a common term, one with which the public can identify and understand. An industry acronym with three distinct and separate components requires further (and confusing) explanation.

Question Feedback

Q1. What are your views on the tiered approach set out in Figure 2? We welcome views on any concerns and/or practical challenges.

Professional investors are readily defined with reasonably clear parameters around the knowledge or expertise that one could expect them to possess. However, the term "consumer" currently relates to a broad group of individuals with varying levels of knowledge, especially in respect of Responsible Investment/ ESG/ Sustainability. Although consumers are becoming more informed thanks to the media and regulatory focus in this space, there is still widespread confusion fueled by a lack of a common language and standardised definitions of terms. We would suggest, therefore, that a two-tiered approach is acceptable, providing that:

- It is easily accessible and framed using a common language and a standard set of definitions that all market participants adhere to at a high level. This will allow for individual groups to apply differing levels of granularity.
- Consumers who wish to access the second tier of information are not precluded.
- The information provided on the lower tier is not dumbed down to the extent that it bears no relation to that provided in the second tier.

Q2. Which firms and products should be in scope of requirements for labels and disclosures? We particularly welcome views on whether labels would be more appropriate for certain types of products than for others, please provide examples.

We believe that all firms and products should be in scope of the requirements for labels and disclosures regardless of size, objective, or intention. This is for two key reasons, the first being that it enables consumers to make the most informed investment decision by allowing them to fully compare products and choose what best suits their personal investment aims. It will also hopefully encourage further change and the broader market to move in the direction of responsible capitalism, which is our ultimate goal.

Q3. Which aspects of these initiatives would be particular, or any others, would be particularly useful to consider (for example in defining terms such as responsible, sustainable and impact) and how best should we engage with them?

At a high level, we at Square Mile have long been advocating for the industry to adopt a common language or shared set of definitions when it comes to terms such as "responsible". All of the feedback we have received from clients and industry colleagues alike would support this. Therefore, we believe that all the groups highlighted here, and, in particular, the Investment Association, the CFA Society (UK), the Impact Investing Institute and the FCA, should work together to create one framework which can be consistently referenced by all market participants at a broad level and can become more granular in application. This would also be applied in general product labelling. In essence, if we don't have a standardisation of terms, we do not believe that products can be considered as comparable.

The TISA initiative for developing templates based on the feedback gathered from consumer engagement could be useful. However, we do not believe the output of this should be separated into an 'ESG factsheet'. Instead, this information should all become embedded into the current information provided to consumers i.e., one document that is a comprehensive summary of the key facts on the fund.

Q4. Do you agree with the labelling and classification system set out in Figure 3, including the design principles we have considered and mapping to SFDR? We welcome views on further considerations and/or challenges.

We believe there to be several issues with the labelling and classification system as it currently stands. The principal one being that we do not believe the labels to be accessible or helpful to consumers. For example, using terms like “transitioning” and “aligned”, which are not commonly used especially with regards to finance, provide no true context as to what consumers can expect from a fund.

They also tend to relate specifically to climate related activities, whilst the majority of responsible investment funds will be broader in scope. Finally, we believe them to misleading when used in this context. We say this because we believe that “transitioning” implies something is improving and with what has been described by FCA as fitting into this category that is not necessarily the case. “Aligned”, meanwhile, indicates that something is fully aligned to an objective and again this is not the case based on the identifying criteria provided.

The term “responsible” is inconsistent with the other categories and provides no context as to how the use of the term will be qualified, the use of the term ‘not promoted as sustainable’ is not a helpful term for consumers to give clarity in terms of what they can expect. Finally, the labelling system as it currently stands does not account for the very established market of ethical exclusions funds which we believe is a material oversight.

Based on this feedback, we would suggest reframing the labels to something similar to the definitions we have provided below which align to the “Spectrum of Capital” (a stylised adaptation from OECD (2019), “Social Impact Investment, the Impact Imperative for Sustainable Development.”) We have road-tested these terms with hundreds of advisers who are using the document with their clients to help explain the various investment options in this area. We would also recommend that the suggested label of ‘not promoted as sustainable’ be dropped and the term be replaced with ‘Traditional,’ which we believe consumers will be able to easily understand.

Full document can be accessed here:
https://www.squaremileresearch.com/Portals/0/ResponsibleInvestment/SquareMileWhat_type_of_investor_Final.pdf

Q5. What are your views on 'entry-level' criteria, set at the relevant entity level, before products can be considered 'Responsible' or 'Sustainable'? We welcome views on what the potential criteria could be and whether a higher entity level standard should be applied for 'Sustainable' products. We also welcome feedback on potential challenges with this approach.

The UK Stewardship Code represents best practice and should therefore be adhered to anyway, whilst the UN PRI has become an industry level tick box which is not meaningful to the consumer in terms of output or impact – for example, mere membership of an organisation does not reflect a commitment to being a vocal advocate. We are aware that this could become fraught with challenges. However, we believe that if entity level information is disclosed, it needs to be done so using a standard set of comparable criteria which is meaningful to consumers and enables them to understand what firms are actually doing in respect of embedding responsible/sustainable policies and practices. That being said, we believe the FCA should provide firms with these criteria and the metrics against which they should measure their performance. We would also ask for firms to provide investors with a 'mission statement' as to their intent and the reasons for this to provide further context. Products that are being identified as "responsible" or "sustainable" should also have a clearly articulated description within their mandate as to what they are aiming to achieve from a "responsible" or "sustainable" perspective which can be understood and measured by consumers.

Q6. What do you consider to be the appropriate balance between principles and prescription in defining the criteria for sustainable product classification? We welcome examples of quantifiable, measurable thresholds and criteria.

We would argue for principles based but with the provision of guidelines, for example, sustainable mandates should state specific objectives that can be assessed and evidenced using standardised metrics, where possible. This involves setting the right level of expectations for the consumer. For example, for an ethical exclusions fund, consumers should be able to expect clearly articulated exclusions criteria which denote whether exclusions are applied completely or on a threshold basis, why they are being applied and what happens if they are breached.

Q7. Do you agree with these high-level features of impact investing? If not, why not? Please explain, with reference to the following characteristics.

We believe the BSI's PAS 7431 definition of impact to be the more widely accepted and utilised within the market - and should be the one that should be applied, as it allows for consistency at a high level, whilst also enabling groups to become more granular in respect of elements such as an additionality. We strongly believe including the other definitions stated in the document could lead to confusion amongst consumers and are also difficult to consistently measure and/or evidence, such as additionality.

Q8. What are your views on our treatment of transitioning assets for?

- *a) The inclusion of a subcategory of 'transitioning' funds under the 'sustainable' label?*
- *b) Possible minimum criteria, including minimum allocation thresholds, for 'sustainable' funds in either sub-category?*

Whilst we agree that stewardship can be an important aspect of driving positive change in respect of corporate practice, it is very difficult to track the effect of this at an individual fund level, in terms of how much of the change was driven by that fund manager's influence and the amount of effort and intent being deployed. It would also be difficult to make sure the approaches being used are consistent, comparable, and meaningful to consumers. If the term “transitioning” is to be used, we believe it also must be carefully framed to ensure that consumers understand what transitioning actually means in practice and how important supporting these companies on their journeys is to be achieving the necessary change in respect of social and environmental challenges.

Q9. What are your views on potential criteria for “Responsible” investment products?

We believe there needs to be more clarity as to what would be expected from these funds in terms of their ‘responsible’ or ‘sustainable’ intentionality and objectives. It is currently too broad in scope and therefore there is a risk that it could lead to greenwashing, especially if funds are just integrating ESG analysis into their processes, which could be applied to any fund in the market, responsible or not. The definition also does not account for the fact that many funds in what we would term the responsible practices category (see definition below) apply exclusions criteria.

Responsible practices definition

A responsible practices fund manager considers the operational practices of investee companies and supports ‘best practice’ and the use of engagement to encourage companies to improve their environmental and social performance.

Example: Investment in a retailer which requires suppliers to treat their employees well and seeks to reduce the environmental impact of its operations.

Be aware – you may be exposed to controversial industries, since the objective is to encourage improvements within companies.

Q10. Do you agree that there are types of products for which sustainability factors, objectives and characteristics may not be relevant or considered? If not, why not? How would you describe or label such products?

We do agree with this statement and would reiterate our belief that ESG analysis can be applied to any fund within the market. We would term funds not demonstrating ‘sustainability factors, objectives and characteristics’ as ‘traditional’ and would categorise these products as using ESG as a risk mitigation or opportunistic tool, rather than as a method of seeking sustainable outcomes.

Q11. How do you consider products tracking Climate transition and Paris-aligned benchmarks should be considered?

We believe there is the risk here that we could be forcing fund management groups to classify their products into a category that we cannot currently measure properly. Therefore, until such time as there is greater clarity, data, and consistency to enable the appropriate tracking and measurement of funds in this category, we do not feel comfortable making a recommendation in terms of how they should be classified. Otherwise, we feel we will be contributing to the creation of a future problem whereby consumers’ RI aims in respect of these products will not have been accurately achieved.

Q12. What do you consider the role of derivatives, short-selling and securities lending to be in sustainable investing? Please explain your views.

We acknowledge that the contribution of derivatives, short-selling and securities lending are not readily identifiable in terms of delivering sustainable outcomes. However, we also do not believe that this means they shouldn't be employed as tool in the deployment of efficient portfolio management. Therefore, we would say that fund management groups need to be transparent about what they are doing and why and ensure that the use of these methods are appropriate in respect of the fund's mandate. This information should then be presented to the consumer in a way which is accessible, and which enables them to make the right investment decision for them.

Q13. What are your views on streamlining disclosure requirements under TCFD and SDR and are there any other jurisdictional or other limitations that we should consider?

We would agree that there should be a streamlining of disclosure requirements under TCFD and SDR which would enable correlation and comparability between different markets and their products. If different jurisdictions are using markedly different regimes it will lead to further confusion and could also perpetuate misguidance. Another issue that we would highlight here is the fact that several fund groups are increasingly mapping to the UN SDGs; a framework which is becoming well-socialised amongst consumers. However, the links being made by some fund groups could be described as tenuous at best and so there is a significant risk of greenwashing and/ or mis-selling when it comes to achieving a consumer's responsible/ sustainable aims. Therefore, we believe there should be stricter guidance for fund group's as to how they apply, align to and report against this framework.

Q14. What are your views on consumer-facing disclosures, including the content and any considerations on location, format and scope?

We believe that everything should be incorporated into the most used piece of collateral; the fund's factsheet, something which is already being done by a number of responsible/ sustainable product providers. However, we would say that there needs to be a greater consistency of application across all factsheets, in terms of the information being provided and the metrics used for both financial and non-financial performance. This should also be framed using a common language and shared set of definitions in respect of responsible/ sustainable information to allow ease of comparability.

Q15. What are your views on product-level disclosures, including structure, content, alignment with SFDR and degree of prescription?

We would agree with the suggestions regarding the provision of additional information and transparency with regards to product level disclosures. We also agree with the useful types of information suggested. In terms of SFDR, close alignment within reason would be preferred and prescription wise, we believe it needs to be principle based but with clear and strong guidelines. Historically, principle-based regulation has had no guidelines which has led to a very wide interpretation, something which cannot occur in respect of responsible/sustainable disclosures and outcomes.

Q16. What are your views on building on TCFD entity-level disclosures, including any practical challenges you may face in broadening to sustainability-related disclosures?

Entity level disclosures are key but there should be some consistent metrics against which they report which are broader in scope than just environmental metrics. We believe you should be able to see a direction of travel, not just a snapshot. Anything accounting based is just a moment in time and doesn't show if good or bad or the direction of travel. The disclosures need to be accessible and helpful to the consumer, enabling them to choose a good fund. We also believe the requirements shouldn't penalise smaller companies if they can't meet disclosure requirements. Case studies could be an example, we believe you shouldn't get too hung up on data all the time.

Q17. How can we best ensure alignment with requirements in the EU and other jurisdictions, as well as with the forthcoming ISSB standard? Please explain any practical or other considerations.

Ultimately, we believe that there should be a commonality of terminology across jurisdictions, wherever possible, to ensure the best possible outcome for the consumer. Using a framework such as the TCFD could be a bedrock around which we build this commonality. Also, as part of the investment labelling regime, fund management groups could state something like 'in our view this is comparable to an article 8 or 9 fund' to allow investors to compare products more easily.

Q18. What are your views on the roles of other market participants in communicating sustainability-related information along the investment chain?

We believe that all market participants have a role to play in communicating sustainability-related information along the investment chain, provided that we are all using a shared language and/or a standard set of definitions, something which Square Mile has been actively advocating for the last two years. We believe this to be an urgent priority as market participants are already using different terms which is leading to confusion and could also lead to misguidance.

Q19. Do you consider that there is role for third-party verification of the proposed approach to disclosures, product classification and labelling and organisational arrangements of product providers? Do you consider that the role may be clearer for certain types of products than others?

We believe that 'self-classification' is possible here, as long as there is clear guidance provided by the FCA as to how this should be assessed, and these assessments are regularly reviewed to ensure there is no misinterpretation or misrepresentation. When it comes to third party verification, we believe that there is a vibrant market of third parties who are making independent assessments available to the investor community and that choosing one approach will lead to a narrow interpretation of how to assess sustainable products.

Q20. What approaches would you consider to be most effective in measuring the impact of our measures, including both regulatory and market-led approaches, and should disclosures be provided in a machine-readable format to better enable data collection and analysis?

Yes, disclosures should be in a machine-readable format and would agree with the proposed method of gaining feedback directly from consumers and via engagement with firms and groups such as the CFRF. We would also encourage discussion with third parties, such as research firms.

Square Mile has been actively advocating for the last two years for common language in the responsible investment space. We would be happy to provide clarity on any of the above points mentioned and to be engaged in further consultation on the topic if required.

Yours sincerely,

Richard Romer-Lee
Chief Executive Officer