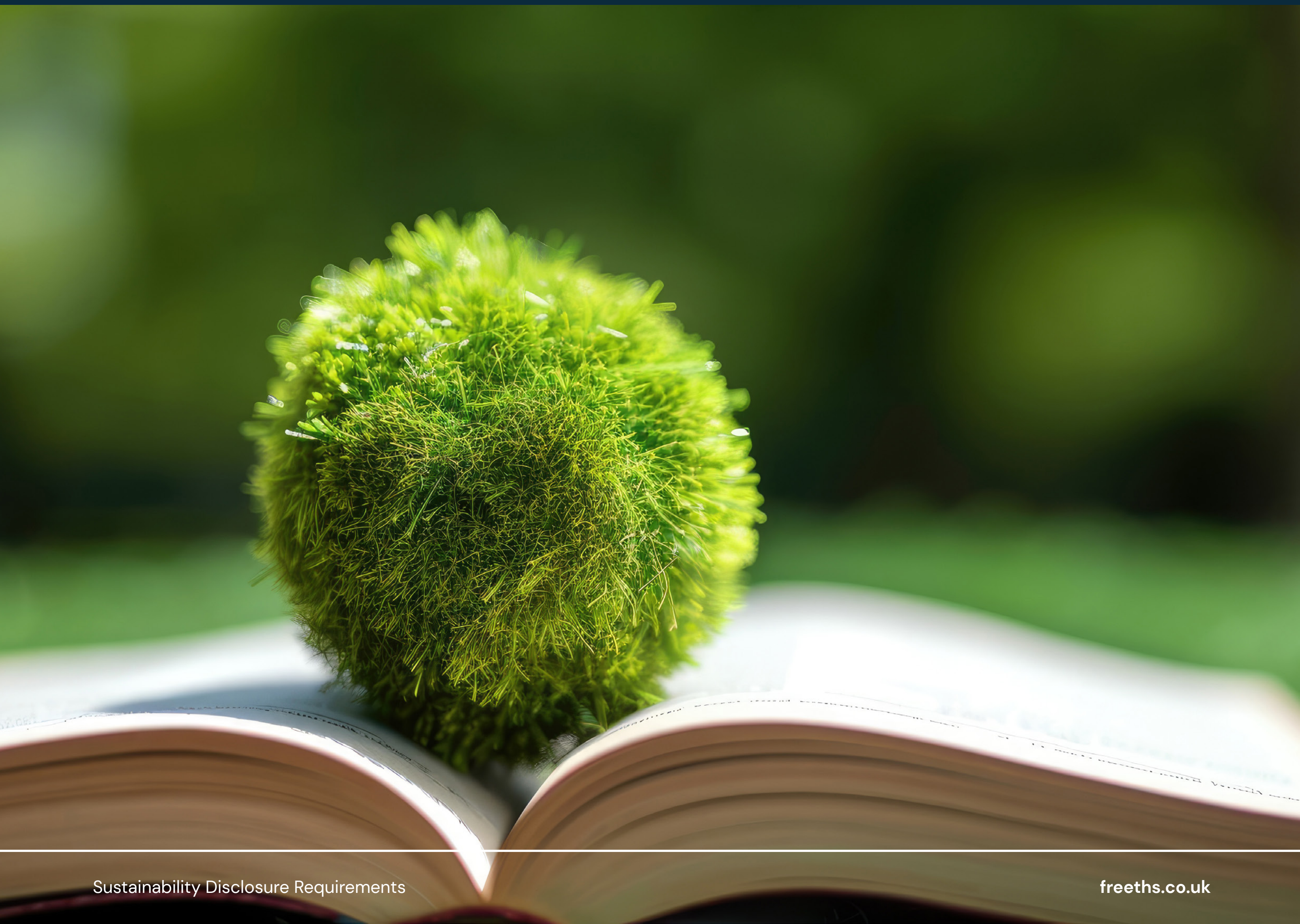
Sustainability Disclosure Requirements



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Sustainability Disclosure Requirements: what does it mean for fund managers?

The Financial Conduct Authority (FCA) has introduced a new regime for sustainability disclosure requirements (SDR) and investment labels. The regime aims to build transparency and trust in the market for sustainable investment products, and to help consumers make informed choices. The regime will apply to UK asset managers of certain investment products, such as authorised funds and alternative investment funds (AIFs).

In this update, we explain what the new requirements are and the implications and challenges for fund managers and consumers in the UK.

Anti-greenwashing rule

The anti-greenwashing rule **will apply from 31 May 2024 to all FCA-authorised firms who make sustainability-related claims about products and services**. The rule requires firms to ensure that their sustainability-related claims are fair, clear and not misleading, and supported by adequate and reliable evidence.

The new rule aims to prevent greenwashing and enhance consumer protection and market integrity in the sustainable investment sector.

Fund managers will need to review and update their product names, marketing materials, disclosures and governance arrangements to align with the rule and the FCA's supporting guidance as well as the criteria for the four investment labels (please see below).

They will also need to monitor and report on the progress their products are making towards achieving their sustainability objectives and KPIs. The FCA is currently consulting on its guidance for the anti-green washing rule.

Naming and marketing rules

The naming and marketing rules will apply to UK asset managers who use sustainability-related terms in product names and retail-facing marketing materials from 2 December 2024. The rules restrict the use of certain sustainability-related terms (e.g. "ESG", "green", or "sustainable") in product names and retail-facing marketing materials, unless the product uses a sustainable investment label. **The scope of the rules covers all investment products that are marketed as sustainable, regardless of whether they have a sustainability label or not.**

Fund managers will need to ensure that the use of sustainability-related terms in their product names and marketing is accurate and consistent with the product's label. This may require fund managers to review and revise their existing products and strategies, as well as their disclosure and reporting practices, to comply with the new requirements and avoid potential regulatory sanctions or reputational damage.

Investment labels

Investment labelling will apply to UK asset managers who want to market a product as sustainable, regardless of whether the product is an AIF or a non-fund product. The labels will be available for firms to use from 31 July 2024.

The FCA has proposed four labels: Sustainability Focus, Sustainability Improvers; Sustainability Impact; and Sustainability Mixed Goals, which are summarised below: The '70%' referred to below applies to the gross value of a product's assets.

- **Sustainability Focus: invests mainly in assets that focus on sustainability for people or the planet.** The sustainability objective must be consistent with an aim to invest at least 70% in assets that are environmentally and/or socially sustainable. Other assets must not be in conflict with the sustainability objective.

- **Sustainability Improvers: invests mainly in assets that may not be sustainable now, but have the potential to improve their sustainability in time.** The sustainability objective must be consistent with an aim to invest at least 70% in assets that have the potential to improve environmental and/or social sustainability over time. Firms will need to identify the period of time by which the product and/or its assets are expected to meet the standard (including short and medium-term targets)

- **Sustainability Impact: invests mainly in solutions to sustainability problems with an aim to achieve a positive impact for people or the planet.** The sustainability objective must be consistent with an aim to achieve a pre-defined positive, measurable impact in relation to an environmental and/or social outcome – and an investment of at least 70% of assets in accordance with that aim.

- **Sustainability Mixed Goals: invests mainly in a mix of assets that either focus on sustainability, aim to improve their sustainability over time, or aim to achieve a positive impact for people or the planet.** The sustainability objective is to invest at least 70% in accordance with a combination of the sustainability objectives for the other three labels. The firm must disclose the proportion of assets invested in accordance with any combination of the other labels – but the specific requirements for each of the other labels must be met.

The labels for sustainable investment products are intended to provide consumers with a clear and consistent way to identify and compare different products based on their sustainability features and impact. However the labels also pose some implications and challenges for fund managers, such as:

- **Choosing the appropriate label for the product:** Fund managers will need to analyse their product's investment strategy, portfolio composition, and impact measurement to determine which label best suits their product. They will also need to consider the commercial viability and attractiveness of their product under the chosen label, as well as the potential regulatory and reputational risks of not qualifying for a label or using an inappropriate label.

- **Demonstrating how the product meets the label's criteria:** Fund managers will need to provide evidence of how their product meets the specific criteria and standards for the chosen label, such as disclosing their sustainability objective, strategy, KPIs, and stewardship approaches. They will also need to disclose any trade-offs or negative impacts that their product may have on other sustainability aspects, and how they mitigate or manage this. Fund managers may face some difficulties in applying the criteria and standards for the different labels, especially for products that have a mix of sustainability goals or invest in assets that are not clearly sustainable or impactful.

- **Reporting on the product's sustainability performance:** Fund managers will need to report on their product's sustainability performance and impact, both to the FCA and to the consumers, using clear and consistent metrics and indicators. They will also need to adopt new reporting frameworks and methodologies, as well as ensure the accuracy and reliability of the data they use. They will include verifying and validating their impact claims.

Consumer-facing and detailed disclosures

The consumer-facing and detailed disclosures apply to UK asset managers who offer products with an investment label. These are concise and accessible disclosures that explain the key sustainability-related features of an investment product, such as its sustainability objective, investment approach, and performance. Firms must make these disclosures available to consumers before they invest and on an ongoing basis.

The scope of the disclosures covers two types of information: consumer-facing and detailed:

- The **consumer-facing product-level disclosures** are concise and accessible and explain the key sustainability-related features of an investment product, such as its sustainability objective, investment approach, and performance. Ongoing product-level disclosures must either be published (i) 12 months after the label is first used, or (ii) provided to eligible clients on demand from 2 December 2025.

- The **detailed** and **entity level disclosures** are more comprehensive and granular and provide additional information on the sustainability-related features and performance of investment products, as well as how firms manage sustainability-related risks and opportunities across their business. These disclosures are targeted at a wider audience, such as institutional investors and consumers seeking more information. The rules will apply to larger firms (asset managers with above £50 billion in AUM) first from 2 December 2025 and to smaller firms (with above £5 billion in AUM) from 2 December 2026.

The new disclosures are intended to provide consumers with better, more accessible, and more comparable information about the sustainability features and performance of different products. However, they also pose some implications and challenges for fund managers, such as:

- **Ensuring that the disclosures are clear, accurate, and consistent with the product's label and sustainability-related claims:** Fund managers will need to review and update their existing products and strategies, as well as their disclosure and reporting practices, to comply with the new requirements and avoid potential regulatory sanctions or reputational damage. They will also need to ensure that the disclosures are understandable and relevant for consumers, and that they do not contain any misleading or exaggerated information.

- **Complying with the FCA's reporting standards and templates:** Fund managers will need to adopt new reporting frameworks and methodologies, as well as ensure the accuracy and reliability of the data they use. They will also need to follow the FCA's reporting standards and templates, which are aligned with the EU's Sustainable Finance Disclosure Regulation (SFDR) but tailored to the UK context and objectives. This may require fund managers to invest in new systems and processes, as well as to train their staff and stakeholders on the new requirements.

Requirements for distributors

There are also requirements which apply to firms that distribute investment products to retail investors in the UK, such as financial advisers, platforms, and intermediaries.

The scope of the requirements covers product information and consumer advice:

- The **product information** aspect requires distributors to obtain and provide consumers with the consumer-facing disclosures and the labels of the products they distribute.

- The **consumer advice** aspect requires distributors to consider the sustainability preferences and needs of consumers when providing advice or guidance on investment products, and to explain how the products they recommend align with those preferences and needs.

The requirements for distributors aim to improve the quality and availability of information and advice for consumers who are interested in sustainable investment products. However, they also pose some implications and challenges for fund managers, namely around collaborating and communicating effectively with distributors on providing the above information.

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Conclusion

The SDR regime will help fund managers and consumers to make more informed and responsible decisions that align with their sustainability preferences and values, and to avoid being misled by greenwashing or vague claims. The regime will also create a level playing field and foster innovation and growth in the market for sustainable investment products, which is expected to increase significantly in the coming years. Fund managers will need to prepare for and comply with new rules and standards but also embrace the opportunities and benefits that the changes will bring.

Freeths can advise on all aspects of the new SDR regime, including whether or not your firm or the products that you are offering are 'in-scope' and whether they qualify for a sustainable investment label and how this can be reflected in the overall 'investment policy' and 'strategy'.

Please contact Shraiya, Isabel, Adam or George for more information.

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