

UK SDR: Sustainability Disclosure Requirements, Investment Labels and Anti-Greenwashing Rule

December 2022



UK SDR

The FCA's plans for sustainability disclosure requirements and investment labels are set out in Consultation Paper 22/20, published in late October 2022. They will apply, in the main, to asset managers but will also introduce a general anti-greenwashing rule that will apply to all FCA regulated firms.

Of note, the FCA takes a particular focus: which is to help investors navigate the market: to improve trust in the market and to ensure good information flows. There is a particularly high bar proposed for use of investment labels for UK funds.

Potential regulatory fragmentation will be of concern to UK asset managers, especially in this area in which all aspects are still evolving. And indeed it seems the FCA's plans for regulation in this area will be iterative and so will develop over time.

This Briefing Paper explores the details of the proposals and the impact they may have, particularly for UK asset managers.

SDR: Its aims and scope

The FCA's expressed concern is whether some firms are making misleading sustainability related claims about their products and so consumers find it difficult to navigate the market. Is this criticism justified? Indeed, by raising the issue and publicising the point, is the FCA itself (arguably unjustifiably) reducing consumer trust in the marketplace?

Usefully however, the FCA welcome what they call the growth and diversification in how one can categorise investment approaches and it is perhaps useful that they are not intending to be overly prescriptive in how the products are categorised.

For the present, the SDR proposals are in respect of UK funds and portfolio management. The FCA's summary of scope and timelines is set out in the Appendix 1 to this Briefing Paper.

The FCA propose three key intentions:

- disclosure requirements facilitating the flow of consistent information along the information chain,

increasing transparency in the market and furthering the objective to promote market integrity.

- sustainable investment labels, consumer-facing disclosures and rules for distributors to help to protect consumers by equipping them to navigate the market more effectively and identify products that meet their needs and preferences. Naming and marketing rules will also help to protect consumers by reducing the risk of greenwashing.
- the labels and consumer-facing disclosures will help consumers to compare products more effectively and efficiently, potentially leading to greater competition among similar products in line with the FCA's objective to promote competition in the interests of consumers.

We explore how the proposals fit with each of these intentions in the following paragraphs.

Sustainable investment labels

Although in Discussion Paper 21/4 the FCA had outlined five labels, it is now proposed to introduce three sustainable investment labels aiming to distinguish products based on:

- "intentionality" – and in particular the sustainability objective it is seeking to achieve;
- the "primary channel and investor contribution mechanism" by which the product may plausibly achieve a positive return for environmental or social sustainability.

It is important to note that there is to be no hierarchy between the proposed labels. Each will stand on its own merits and is designed to deliver a different profile of assets and consumer preferences:

The three labels now proposed in Chapter 4 of the Consultation Paper are as follows:

- **sustainable focus**

Description: Products with an objective to maintain a high standard of sustainability in the profile of assets by investing to (i) meet a credible standard of environmental and/or social sustainability; or (ii) align with a specified environmental and/or social sustainability theme.

Consumer-facing description: Invests mainly in assets that are sustainable for people and/or planet.

For sustainable focus funds, the aim will be to invest in assets that a reasonable investor would regard as being environmentally and/or socially sustainable.

The criteria for this category include that at least 70% of the sustainable focus product's assets meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme. This is the only label with a proposed threshold.)

The criteria must be robust, independently assessed, evidence-based and transparent. It would seem that much further work needs to be done to establish what independent elements are required and how these criteria generally will be met.

- **sustainable improvers**

Description: Products with an objective to deliver measurable improvements in the sustainability profile of assets over time. These products are invested in assets that, while not currently environmentally or socially sustainable, are selected for their potential to become more environmentally and/or socially sustainable over time, including in response to the stewardship influence of the firm.

Consumer-facing description: Invests in assets that may not be sustainable now, with an aim to improve their sustainability for people and/or planet over time.

The FCA consider it critical that the proposed regime accommodates investment in assets in transition to becoming more sustainable.

For the sustainable improvers category, whilst not objectively environmentally or socially sustainable at present, they should have the potential to deliver measurable improvements in their environmental and/or social sustainability over time, including in response to the stewardship influence of the firm.

Unlike products under the other two labels, products in this category may be invested broadly across sectors with the firm playing an important role in embedding and accelerating improvements in the sustainability profile of assets, including through its stewardship activities.

- **sustainable impact**

Description: Products with an explicit objective to achieve a positive, measurable contribution to sustainable outcomes. These are invested in assets that provide solutions to environmental or social problems, often in underserved markets or to address observed market failures.

Consumer-facing description: Invests in solutions to problems affecting people or the planet to achieve real-world impact.

For products with the sustainable impact label, they will aim to achieve a positive measurable contribution to real world sustainability outcomes. Unlike the products in the other two labels, these sorts of products would set objectives that target a particular

sustainability profile for their assets. The firm will commit to deliver and report on its contribution to a positive environmental and/or social sustainability outcome through financial as well as other types of investor additionality. To evidence outcomes in line with the stated objective, the manager of the product will be expected to apply industry standard approaches to performance measurement, reporting against rigorous, evidence-based KPIs that capture the investor contribution to positive sustainability outcomes.

For each of the three labelled products, the FCA is developing a set of threshold criteria as well as some implementation guidance.

While seeking to be rigorous and to "raise the bar", the proposals are also intended, thankfully, to provide flexibility to accommodate different sustainability objectives and so facilitate continued evolution and innovation in the marketplace.

Principles and cross-cutting rules

For each of the sustainable investment labels, reference will need to be made to the following:

- five overarching Principles – the general criteria:
 - sustainability objective;
 - investment policy and strategy;
 - KPIs;
 - resources and governance; and
 - investor stewardship.
- some key (cross-cutting) considerations associated with each of the overarching Principles;
- certain category-specific key considerations relevant to their particular label.

Details of the Principles and the underlying cross-cutting rules are summarised in the extracts from the Consultation Paper in Annex 2 to this Briefing Paper.

Note that in Chapter 4 at Box 9 on page 49, the FCA set out several areas where they think that existing investment products with sustainability related features do not meet the relevant criteria. Firms should carefully review Box 9 when considering how to label their funds.

Operating the label regime

Where a firm chooses to use a label, it must keep a record as to the basis on which the label is being used. Legal and compliance teams will need to have systems in place so that they establish the initial categorisation and use of product labels, and then review the position at least annually as well as prior to any proposed changes to a labelled product. All initial decisions, and reviews of decisions, must be appropriately recorded.

Recording the thought process and decision making process and supporting evidence will be as important as other outputs from firms' compliance with the rules. Note that paragraph 4.73 indicates that the FCA will expect firms to provide such a record to the FCA should it request it.

If firms do not meet the qualifying criteria for any of the three sustainable label categories, the rules will prevent them from using a sustainable label for their in-scope products.

For portfolio management agreements or arrangements, 90% of the total value of the products in which it invests must meet the qualifying criteria for the same label in order for it to use the label, and the firm must then make the disclosures for each of the underlying products available to consumers. One might ask why 90% is selected, and what is to be done for mandates investing in a number of UK funds?

Where labels are used, a firm must use the relevant graphic when displaying the label and the FCA will seek to trademark and set out the relevant graphics on its website once the rules are final - and that label must be included in consumer-facing disclosures, pre-contractual disclosures and sustainability product reports. (The FCA will also produce a dedicated webpage setting out further information on the labels to which firms may also choose to hyperlink from the relevant digital medium.) The firm must notify the FCA that they are using the label within a month and there will be a dedicated mailbox for this when the rules are finalised.

Were there to be any change of categorisation, there must be notification to investors at least 60 days before the change comes into effect. The FCA refer at paragraph 4.76 to the COLL 4.3 obligations and their expectation that a change in the use of a label will constitute at least a significant change under the requirements.

Disclosures

Clear disclosures are clearly key in achieving the FCA's objectives of providing information to consumers and helping consumers navigate the market.

The disclosure requirements set out in the Consultation Paper are a starting point from which the FCA will develop rules and guidance over time. For example, they will add greater specifics to both product and entity level disclosure requirements as the International Sustainability Standards Board ("ISSB") develops its sustainability disclosure standards. For the present, they are encouraging firms to consider the Sustainability Accounting Standards Boards ("SASB") metrics when making sustainability related disclosures.

A summary of the initially proposed disclosure items is set out in the FCA's table below:

	Product-level			Entity-level
	Detailed		Summary	Detailed
Disclosure type	Pre-contractual	Sustainability product report (Part B)	Consumer-facing	Sustainability entity report
Sustainability objective	X	X	O	
Progress towards objective		X	O	
Investment policy and strategy	X		O	
Stewardship (approach)	X		O	
Stewardship (KPIs), where applicable		X		
Unexpected investments (ie those a consumer may not typically associate)	X		O	
Ongoing reporting on sustainability metrics/KPIs		X	O	
Resourcing/governance relating to delivery of sustainability objective				X
Governance, Strategy, Risk Management, Metrics & Targets				O

Source: FCA Consultation Paper 22/20, paragraph 5.22, pages 54/55

Consumer-facing disclosure requirements

Consumer-facing disclosures comprise:

- additional requirements in pre-contractual materials – sustainability objective, investment policy/strategy be added to the existing requirements, e.g. for the prospectus, and
- a sustainability product report, with sustainability performance metrics requirements to be added to the existing TCFD product report requirements.

Key features of the new disclosures include:

- **location**
The FCA propose that disclosures be made available in a prominent place on the relevant digital medium for the firm, i.e. the main product webpage or a page on a mobile application etc. For products that qualify for a label, the consumer-facing disclosure should be no more than one mouse click away from where the label is presented. This could be by a hyperlink next to or underneath the label. In publishing the consumer-facing disclosure, it must be easy for consumers to identify the product to which it relates as well as the label, where relevant, and access links to other relevant product level disclosures.
- **standalone document**
The FCA intend that firms produce a consumer-facing disclosure as a new standalone document. Firms are to provide the consumer-facing disclosure alongside documents that present other key investor information – PRIIPs and KIDs. All these documents could be located on product pages and there should be clear signposting from the consumer-facing disclosure to the relevant document.

HM Treasury is intending to undertake a review of retail investor disclosures at some stage – which one assumes means a review of the Key Information Document disclosure requirements. This may affect sustainability related disclosures in due course.
- **no template**
It is useful that there is no rigid format proposed. No template is offered for disclosures, but there is encouragement to the industry to consider developing a market-led template based on content and format used in the FCA's behavioural research and its rules once finalised.

- **timing and disclosures**

Reliable information must support decision making and so consumers must have disclosures available at the same time as the label – i.e. provisionally 30 June 2024.

Disclosures must be reviewed and updated at least annually thereafter and must remain consistent with the label where applicable.

- **need to have regard to the Consumer Duty**

The FCA specifically refer to the new Consumer Duty, and that this will mean that firms will need to ensure that communications meet the information needs of retail customers; are likely to be understood; and equip retail customers to make decisions that are effective, timely and properly informed. All of the communication concerns will be relevant to sustainability-related disclosures. And the FCA think it likely that firms will need to carry out their own testing on consumer-facing disclosures under the SDR rules.

In the following paragraphs, we look in more detail at the specific proposals relating to the detailed product and entity-level disclosures.

Detailed product level disclosures

In addition to the abovementioned disclosures directed at retail investors, it is important that more detailed disclosures are available to other investors and other stakeholders – and indeed retail investors who may wish to access more information.

Detailed product level disclosures are to be made in two forms of existing documentation. These apply to products that qualify for a label or adopt sustainability-related policies and strategies. Other products are not subject to these pre-contractual disclosure requirements. Further, these disclosures only apply to UK fund products.

- **pre-contractual disclosures:** fund prospectus, prior information document

Firms must display the sustainable investment label for the relevant product and make pre-contractual disclosures relating to each of the five Principles.

The FCA propose that disclosures relating to the investment policy and strategy, i.e. Principle 2, be

made in a dedicated section of the fund prospectus so they are clearly identified.

At this stage, the fund prospectus or prior disclosure document required under FUND 3.2 for full scope UK AIFMs will be the only pre-contractual materials in scope of the FCA's proposals. The FCA will consider whether to expand the list of pre-contractual materials as they consult and expand the scope of products covered over time. For now, if the fund prospectus or prior information document are not the relevant pre-contractual material for the in-scope product, for example AIFs managed by small AIFMs, the firm must make the pre-contractual disclosures available in Part A of the Sustainability Product Report – and ensure investors are made aware of the contents of the report before they invest.

Thankfully though, no disclosures are required which mirror the EU SFDR's "do no significant harm" approach.

It is intended that the first pre-contractual disclosures must be made available at the same time as the labelling and consumer-facing disclosures, i.e. provisionally 30 June 2024. This means firms preparing Part A of the sustainability product report will be required to publish that part one year earlier than Part B of the reports.

- **sustainability product report:** building from the TCFD product report

Within pre-contractual disclosures, as mentioned above, for some products where the in-scope product does not have a fund prospectus or prior information document, the sustainability product report will include the pre-contractual information as required - referred to as Part A of the report. Where produced, this **Part A** must be published in a prominent place or on a relevant digital medium for the firm, e.g. a webpage where the product is offered.

All firms using a sustainable investment label will be required to produce disclosures to help clients and consumers assess ongoing performance and progress towards meeting its stated objective - this is referred to as **Part B** of the report.

Producing disclosures on sustainability-related performance of their products on an ongoing basis is the intention of "Part B" – a dedicated sustainability

product report which builds on the Taskforce on Climate-Related Financial Disclosures (TCFD) product report.

The FCA intend that firms produce disclosures on the sustainability-related performance of their products on an ongoing basis, in a dedicated sustainability product report which builds from the TCFD product report. Initially, these will only be required for products that qualify for a sustainable investment label. All firms using a sustainable investment label will be required to produce disclosures to help clients and consumers assess ongoing performance and progress towards meeting the stated objective.

Over time, the sustainability product report is intended to be the baseline of sustainability-related metrics and firms will be required to disclose these in respect of all in-scope products regardless of whether the product uses a label or not. This though is not proposed at this stage.

Sustainability product reports must be published in a prominent place on the main webpage for the business of the firm, e.g. with a link from the homepage. A firm may choose to cross-reference between its sustainability product report (Part B) and its sustainability entity report where relevant.

The first disclosures under Part B of the sustainability product report must be published no later than 24 months after the FCA's rules enter into force, i.e. provisionally 30 June 2025. This will align with the deadline for publishing the TCFD product report. Disclosures should be updated on an annual basis and in any case remain consistent with the sustainable investment label, including updating them in accordance with any changes to the label.

Firms providing portfolio management services will not be required to produce their own sustainability product reports. However, they must provide retail investors with easy access to relevant disclosures, e.g. by hyperlinking (Part A, where applicable, and Part B).

On demand reporting is envisaged for some relationships. The FCA is proposing that disclosures be made to clients upon their request one per year. This formalises what might otherwise be available informally as part of the usual client relationship management process, although it might assist some clients who do not have the relevant bargaining power to secure responses to requests. The

FCA will require a firm to respond to an eligible client's request in a reasonable time and in a reasonably acceptable format to meet their information needs. The FCA is encouraging firms to provide broadly equivalent disclosures to any client who requests them, i.e. regardless of their eligibility to request it under the rules.

Detailed entity level disclosures

In addition to information on sustainability-related features of investment products, the FCA is to require all in-scope asset managers to produce a **sustainability entity report**.

An entity level report must be published in a prominent place on the main webpage for the business of the firm, e.g. with a link from the homepage. It may incorporate disclosures required under the TCFD rules, or include a hyperlink to the TCFD entity report.

As with the TCFD entity report, the sustainability entity report must include a statement signed by a member of senior management confirming that the disclosures comply with Chapter 4 of the ESG Sourcebook. This will confirm that the disclosures accurately reflect the firm's own approach to managing sustainability risks and opportunities.

At this stage, the FCA is proposing to require core entity-level disclosure requirements based on the TCFD's four recommendations:

- the governance around sustainability-related risks and opportunities;
- the actual and potential impacts of sustainability-related risks and opportunities on their businesses, strategy and financial planning, where such information is material;
- how the firm identifies, assesses and manages sustainability-related risks; and
- the metrics and targets used to assess and manage relevant sustainability-related risks, where such information is material.

Given this starting point, there are differences from the EU SFDR entity-level disclosure requirements – so for example there will be no requirement to disclose principal adverse impacts.

Despite the level of detail within the proposed new rules, the FCA indicate that the rules seek to be as flexible as

possible and to enable firms to make disclosures at the level of consolidation that "would be most decision useful". There therefore could be cross-referencing to detailed entity level disclosures produced in a group level or affiliate report, provided that all of the FCA's requirements for cross-referencing are satisfied. (However, in-scope firms must produce a separate consumer-facing disclosure as required under the FCA's Rules and there may be different types of disclosures for consumers based on requirements in different jurisdictions. The consumer-facing disclosures must also accompany the sustainability investment label and so are tailored to provide key information that will help consumers better understand the sustainability-related features of a labelled product, and this in turn should protect customers by reducing the scope for firms to greenwash their products.)

Sustainability entity reports will have phased implementation (similar to the approach in introducing TCFD-aligned disclosures). Asset managers with above £50 billion in AUM will be required to make their first disclosures by 30 June 2025, with smaller firms, excluding those with under £5 billion in AUM, required to make their first disclosures one year later (and these thresholds will be reviewed after three years of climate-related disclosures).

Disclosures must be updated on an annual basis.

Transition plans

Reference is made in CP22/20 to the UK being the first net zero-aligned financial centre – an announcement the Chancellor made during COP26 in November 2021. This included plans to require listed companies, asset managers and asset owners to disclose transition plans that consider the Government's net zero commitment or explain why not. The Government's high level Taskforce to develop a gold standard for transition plans, with the FCA represented on the Steering Group and Delivery Group of the UK Government's Transition Plan Taskforce ("TPT") is acknowledged. The TPT is to develop a sector neutral transition plan framework, sector specific guidance and user and "preparer guidance" to support the development, disclosure and assessment of transition plans, with initial outputs to be published in Q4 2022.

As regards the FCA's initiatives in finalising the TCFD-aligned disclosure rules, it provides guidance to clarify that a firm headquartered in, or operating in, a country

that has made a commitment to a net zero economy is encouraged to consider the extent to which it has considered that commitment in developing and disclosing its transition plan.

The FCA is committed to drawing on the Taskforce's output to strengthen its disclosure expectations and to encourage well-governed and credible transition plans by listed companies and regulated firms. It will also encourage a globally coherent approach to transition plan disclosures, coordinating with bodies such as the Glasgow Financial Alliance for Net Zero and ISSB (both of which are also represented on the TPT Delivery and Steering Groups).

Naming and marketing

Once products have been given the relevant label – or not – then there is a new level of consideration of the words that can and cannot be used in respect of fund products.

At the core of the proposals is the longstanding notion that names of products must be accurate and not misleading but the FCA's proposals introduce some very specific constraints.

The intention is that labels and disclosures should help consumers more effectively navigate the market for ESG and sustainable investment products but the FCA do not think that is sufficient. Consequently:

- **anti-greenwashing rule**

This is to be a general anti-greenwashing rule applicable to all regulated firms, in a way, building on the existing requirements around clear, fair and not misleading communications.

There is a proposed new Rule 3.3 in the ESG Sourcebook whereby any firm, whether undertaking sustainability in-scope business or not, and including firms that approve financial promotions for unauthorised persons, must ensure that any reference to the sustainability characteristics of a product or service is:

"(1) *consistent with the sustainability profile of the product or service; and*

(2) *clear, fair and not misleading."*

- **product names and marketing materials**

Restrictions are proposed around names and marketing of investment products marketed to retail investors which do not qualify for a label.

Under the proposed ESG 3.3.2R, there is expansion on this general concept so that a firm must not use certain terms in relation to the naming or marketing of a sustainability product: ESG, climate, sustainable or sustainability, green, transition, net zero, impact, responsible, sustainable development goals or SDG, Paris-aligned, or any other term which implies that a sustainability product has sustainability characteristics.

- **Particular restrictions relevant to firms that do undertake sustainability in-scope business**

A firm that is using the sustainability label 'sustainable focus' or 'sustainable improvers' in relation to a sustainability product must not use the word 'impact' in the name of that product.

Where a firm does undertake sustainability in-scope business in relation to a sustainability product that has an agreement or arrangement to provide a retail client with portfolio management and does not use a sustainability label under ESG 3.1.1R(2)(b), it may, in the name, pre-contractual materials or other marketing communications relating to that sustainability product, use these terms, providing that:

- (1) 90% of the total value of the products in which the relevant portfolio invests use a sustainability label; and
- (2) the terms are not used in a way that is misleading.

Note though that the prohibitions on use of such terminology do not apply for the purposes of disclosing factual information in pre-contractual disclosures, the summary of information in consumer-facing disclosures, and any other disclosures a firm may be required to make where a firm adopts sustainability-related investment policies and strategies integral to their investment policy and strategy. Firms must obviously be able to describe these in correct factual terms and in a proportionate way in pre-contractual disclosures.

The FCA's intention is to ensure that all regulated firms ensure that the naming and marketing of financial

products and services in the UK is clear, fair and not misleading, and consistent with the sustainability profile of the product or service and specifically is proportionate and not exaggerated. The intention is that having these explicit rules will enable the FCA to challenge firms where they think there is potential greenwashing occurring.

The question is whether the proposed rules are too prescriptive and would preclude firms giving clear, fair and not misleading descriptions of the ESG aspects of their products or investment styles and policies.

Requirements for distributors

The role of distributors is clearly important. Quite rightly, in connection with the Consumer Duty, it is one area on which there is considerable focus at present, given the fact that so many product manufacturers are disconnected from the underlying investors.

In relation to distributors' relevance to SDR, the FCA propose that, where in-scope products are offered to retail investors and have a sustainable investment label, distributors must display that label prominently on the relevant digital medium and provide access to the accompanying consumer-facing disclosures. In other words, the information which the product manufacturer must provide must be provided through to the underlying investor. Distributors will also have to keep such information updated with changes a firm makes to the label and disclosures.

As mentioned below, there is to be a temporary measure for overseas funds which are not included in the UK SDR regime at the outset alerting investors that the product is based overseas and is not subject to the FCA's sustainable investment labelling and disclosure requirements.

Timetable

The intention is for the FCA to set out final rules in a Policy Statement by the end of the first half of 2023.

The FCA are planning for the rules under this proposed regime to come in one year after they publish their final rules subject to consultation feedback, and so likely not until 30 June 2024.

The anti-greenwashing rule will however come in immediately on publishing the Policy Statement in 2023.

Further work

Clearly the proposals in CP22/20 are only a starting point.

The proposed scope for the FCA's initial proposals – for UK funds and portfolio management services – leaves some gaps, notably:

- **overseas funds**

It is noted that many overseas funds are sold into the UK. A separate consultation is expected to follow in due course on how these proposals may be applied in respect of overseas funds, and hopefully soon, given that there are a large number of these and a level playing field is to be preferred.

The issue of overseas fund products not being included in the UK SDR regime initially is acknowledged and, as a temporary measure, a statement will need to be included for such products alerting investors that the product is based overseas and is not subject to the FCA sustainable investment labelling and disclosure requirements.

- **the wider marketplace**

The need to look across the marketplace is also recognised. In particular in Chapter 8, it is acknowledged that pension products should be reviewed. Whilst climate-related disclosures for pension providers and their products came in with PS21/24 and the DWP introduced TCFD-aligned governance and disclosure requirements for trustees of larger occupational pension schemes, this still leaves work to be done. The FCA will explore further whether and how to apply a labelling and classification regime, as well as accompanying disclosure requirements and naming and marketing rules, to some pension products.

- **rules for asset owners**

The FCA is also seeking views on expanding the regime to FCA regulated asset owners in respect of their investment products. They are also proposing targeted rules for distributors of investment products to retail investors in the UK.

In "Next Steps" at paragraph 8.19 of the Consultation Paper, there is an even longer list of areas in which expansion of the regime is envisaged over time, including:

- **financial advisers** – and whether they take into account sustainability matters in their investment advice and understanding investor preferences – a separate consultation is planned;
- **listed issuers** – adapting TCFD-aligned disclosure rules for listed issuers to reference the ISSB standards once finalised;
- **disclosure of transition plans** – building on TCFD-aligned disclosure rules and, in doing so, draw on any outputs of the Government's TPT;
- **taxonomy-related disclosure requirements** – considering how to update product-level disclosure requirements, to include relevant disclosures once the UK Green Taxonomy is created;
- **sustainability-related metrics** – adding a baseline of core sustainability-related metrics for firms to disclose in respect of all products, once further ISSB sustainability disclosure standards are developed;
- **entity-level disclosures** – requiring more specific and granular disclosures for different sustainability topics in line with the development of future ISSB standards.

International coherence?

It is important for the UK regulator to introduce its initiatives on sustainability disclosures and investment labels soon so that asset managers can plan for their UK businesses – and in a way which fits within the work which they have already undertaken to accommodate the existing EU SFDR – and other initiatives developing in other jurisdictions globally. Even if the UK's approach has a distinct focus, will it be a good fit?

Thankfully the FCA have confirmed (paragraph 2.9) that in developing the climate-related disclosure rules, they consider the TCFD-aligned disclosure rules to be a starting point and they will build on those requirements over time. Both the existing TCFD-aligned disclosure rules and the ISSB's draft general sustainability disclosure

requirements have informed the proposed disclosure requirements in CP22/20. The FCA's proposals also take into account, and are consistent with, the IOSCO Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management which introduces disclosures consistent with the TCFD's Recommendations as well as disclosures to help investors better understand sustainability-related products promoting consistency, comparability and reliability in disclosure and helping to prevent greenwashing.

Whilst the FCA indicate that, so far as possible, they are looking to achieve international coherence, notably with SFDR in the EU and the SEC proposals in the US. Nonetheless, these proposals do diverge quite markedly and will certainly give asset managers which typically run fund ranges in the UK, Luxembourg and/or Dublin some challenges.

In paragraph 4.64 of the Consultation Paper, the FCA indicate that, regardless of their commitment publicly to implement rules that are coherent with the international frameworks and standards as far possible, the FCA's proposals must be appropriate for the UK market. In other words, there will be divergence. Clearly the distinctions between the UK and other requirements for disclosures are going to be quite marked. The FCA have included a high level mapping of the key disclosure items under the FCA's proposals to the EU SFDR and the SEC's proposal in Annex 1 of CP22/20.

Whilst the regime proposed is stated to be compatible with those in the EU and the US, the FCA indicate that their starting point is different and, as a result, there are differences in their approach. Whereas in the EU and US the intention is to categorise products principally to determine disclosure requirements, in the UK the rationale is to categorise products so as to help consumers identify sustainable investment products and navigate the market. So the FCA's criteria are designed to set a high bar for products that make sustainability claims, which is seen as important so as to help clamp down on greenwashing against a backdrop of trust concerns.

The wish for the UK to be a trusted centre for sustainable investment and to place the UK at the forefront of sustainable investment internationally is a laudable aim. Clearly robust regulatory standards should be maintained in the UK.

The question is how consistent they should be so as to facilitate asset managers which operate globally to some degree to comply effectively in these areas. One suspects that these UK SDR proposals, if implemented as drafted, would present additional challenges for global firms.

Implementation challenges for UK asset managers

The FCA are proposing both a comprehensive and a demanding set of disclosures and labelling regime which will require speedy consideration. There is the prospect of final rules being issued in the first half of 2023 – and indeed the anti-greenwashing rule coming in soon, within the first half of 2023.

It is important to acknowledge that initiatives taken by firms towards net zero and responsible investing cannot be viewed in isolation:

- **They must dovetail and be reviewed carefully for how it should dovetail with product-related matters.**

So, for example, a firm cannot target its own net zero and change investment strategies without looking, primarily from the product and investor viewpoints, at how products are promoted to customers and sold to customers: the investment strategy explained to the customers, and the customer's desire for those products and understanding of them.

A firm must look at each product on its own merits and consider the relevant objectives for it, and customer understanding of those objectives – which primarily currently focus on investment returns versus benchmarks. How would limiting the investment choice by introducing net zero and RI constraints potentially affect returns and will the benchmark remain appropriate?

- Further, recent exceptional geo political developments and possible changes in governments' approaches towards their own net zero commitments, may have consequences for firms' approaches – and potentially with a slowdown in the feasibility for firms to move towards net zero.

UK SDR

UK investment management firms generally will need to consider carefully the relevant disclosures for their portfolio management services.

For managers with UK fund ranges, there is much to be done to consider how these UK SDR proposals should be accommodated. Given that most UK fund managers operate in Luxembourg and/or Dublin too, they have already implemented the EU SFDR requirements for their Luxembourg and Dublin fund ranges and they were perhaps hoping for more consistency with the UK SDR proposals. As it is, with the high bar which is being proposed by the FCA, there are particular challenges which will need careful, specific consideration.

It may well be that UK asset managers will wish to comment on some aspects of the FCA's proposals before the end of the consultation period on 25 January 2023 so as to make the UK SDR regime achieve its aims but yet be practicable for implementation.

Appendix 1: Summary of UK SDR scope and timelines

Element of the regime	Firm	Product	Main location	Timelines	Chapter
Sustainable investment labels Labels can be used for products marketed to retail investors, and for those marketed to institutional investors, if the firm chooses to do so and meets our qualifying criteria. If not, firms marketing to retail investors must meet our naming and marketing rules	Firms carrying out portfolio management UK Undertakings for Collective Investment in Transferable Securities (UCITS) management company Investment company with variable capital (ICVC) that is a UCITS scheme without a separate management company Full-scope UK Alternative Investment Fund Manager (AIFM) Small authorised UK AIFM	Authorised funds (excluding feeder funds and funds in the process of winding up or termination) Unauthorised Alternative Investment Funds (AIFs), including investment trusts	Relevant digital medium (website, mobile application) at which the product is offered	12 months after the date of the PS (provisionally 30 June 2024)	CP – 4 Draft instrument – ESG 3.1 and 3.2
	These are collectively referred to in this CP as 'in-scope firms'	Portfolio management services can only use a label if 90% or more of the value of all constituent products in which they invest qualify for the same label These and the products in the row above are collectively referred to in this CP as 'in-scope products'		18 months after the date of the PS (provisionally 30 December 2024)	

Appendix 1: Summary of UK SDR scope and timelines

Element of the regime	Firm	Product	Main location	Timelines	Chapter
Consumer-facing disclosures	All in-scope firms marketing in-scope products to retail investors, regardless of whether they qualify for and choose to use a label, but excluding firms providing portfolio management services	All in-scope products, except portfolio management services	Relevant digital medium (website or mobile application) at which the product is offered	12 months after the date of the PS (provisionally 30 June 2024)	CP – 5 Draft instrument – ESG 4.2
		Firms providing portfolio management services will not be required to produce consumer-facing disclosures, but will instead be required to provide an index of the underlying in-scope products, linking to their label and consumer-facing disclosure, as applicable		12 months after the date of the PS (provisionally 30 June 2024)	
Pre-contractual disclosures	All in-scope firms using a sustainable investment label, excluding firms providing portfolio management services Firms not using a label but where sustainability-related features are integral to the investment policy and strategy (excluding firms providing portfolio management services)	All in-scope products, excluding portfolio management services Firms providing portfolio management services will not be required to produce pre-contractual disclosures, but will instead be required to provide access to the pre-contractual disclosures for the underlying in-scope products (or under the 'on demand' regime below)	Fund prospectus Prior information document as required under FUND 3.2 Or otherwise Part A of the sustainability product report (including where the firm is only required to provide the contents of this report on-demand)	12 months after the date of the PS (provisionally 30 June 2024)	CP – 5 Draft instrument – ESG 4.3

Appendix 1: Summary of UK SDR scope and timelines

Element of the regime	Firm	Product	Main location	Timelines	Chapter
Ongoing sustainability-related performance information	All in-scope firms using a sustainable investment label, except firms providing portfolio management services and UK AIFMs managing unauthorised AIFs not listed on a recognised exchange	All in-scope products, excluding portfolio management services and unauthorised AIFs not listed on a recognised exchange Firms providing portfolio management services will not be required to produce Part B of the sustainability product report but will instead be required to provide access to the relevant reports for the underlying in-scope products	Part B of the sustainability product report	24 months after the date of the PS (provisionally 30 June 2025)	CP – 5 Draft instrument – ESG 4.5
	Firms providing portfolio management services and Firms that are UK AIFMs managing unauthorised AIFs not listed on a recognised exchange using a label	Firms that are providing portfolio management services or are AIFMs managing unauthorised AIFs not listed on a recognised exchange will be required to provide information equivalent to the content of a Part A (pre-contractual disclosures) as applicable and Part B sustainability product report to clients on demand, where those clients require the information to meet their own legal obligations	'On-demand' regime	24 months after the date of the PS (provisionally, first requests from 1 July 2025)	CP – 5 Draft instrument – ESG 4.5
Entity-level disclosures	All in-scope firms with assets under management (AUM) of £5 billion or more (on a 3-year rolling average)	Overall assets managed in relation to in-scope business	Sustainability entity report	Firms with £50 billion or more in AUM 24 months after the date of the PS (provisionally 30 June 2025) Firms with less than £50 billion but with £5 billion or more in AUM 36 months after the date of the PS (provisionally 30 June 2026)	CP – 5 Draft instrument – ESG 4.6

Appendix 1: Summary of UK SDR scope and timelines

Element of the regime	Firm	Product	Main location	Timelines	Chapter
Anti-greenwashing rule	All regulated firms	All firms' products and services	All marketing and communications	Immediately on publication of the PS (provisionally 30 June 2023)	CP – 6 Draft instrument – 3.3. (in particular ESG 3.3.1R)
Naming and marketing rules	All in-scope firms marketing in-scope products to retail investors, that do not use a label	All in-scope products	All in-scope product names, marketing and communications	12 months after the date of the PS (provisionally 30 June 2024)	CP – 6 Draft instrument – 3.3
		Firms that are providing portfolio management arrangements will be exempt from the naming and marketing rules when 90% or more of the value of constituent products qualify for any label		18 months after the date of the PS (provisionally 30 December 2024)	
Distributors	Firms that are distributors of in-scope products to retail investors (including platforms and advisers)	All in-scope products distributed to retail investors	Relevant digital medium (eg website, mobile app) at which the product is offered	12 months after the date of the PS (provisionally 30 June 2024)	CP – 7 Draft instrument – 3.1

Source: FCA Consultation Paper 22/20 Table 1: Summary of scope and timelines (pages 20-23)

Appendix 2: Principles and cross cutting rules

Principle 1: Sustainability Objective

Principle 1, Sustainability Objective. A sustainable investment product must have an explicit environmental and/or social sustainability objective.

Key considerations (cross-cutting)

1. A firm must determine the product's sustainability objective in clear, specific and measurable terms as part of its investment objectives.
2. A firm must ensure the product's sustainability objective has a plausible, purposeful, and credible link to an environmental and/or social outcome.
3. A firm must have adequate processes in place to
 - monitor the product's performance against its sustainability objective; and
 - provide ongoing performance reporting to investors (ie clients and consumers)

Category-specific criteria

Sustainable Focus	Sustainable Improvers	Sustainable Impact
<p>The sustainability objective must align with requirements in the 'investment policy and strategy' section below ie to invest predominantly (at least 70%) in assets that meet a credible standard* for environmental and/or social sustainability, or that align with a specified environmental and/or social sustainability theme.</p> <p>*A credible standard is one that is robust, independently assessed, evidence-based and transparent.</p>	<p>The sustainability objective must align with requirements in the 'investment policy and strategy' section below ie to invest in assets that have the potential to become more environmentally and/or socially sustainable over time, including in response to active investor stewardship.</p>	<p>The sustainability objective must be to achieve a pre-defined, positive, measurable real-world environmental and/or social outcome.</p>

See **Chapter 5** (pre-contractual disclosures) for the disclosures relating to Principle 1 and **Appendix 2** for the implementing guidance.

Appendix 2: Principles and cross cutting rules

Principle 2: Investment Policy and Strategy

Principle 2, Investment Policy and Strategy. A firm's investment policy and strategy for the sustainable investment product must be aligned with its sustainability objective.

Key considerations (cross-cutting)

1. A firm must develop and implement an investment policy and strategy aligned with the product's sustainability objective.
2. A firm must ensure that the product is invested in accordance with its investment policy and strategy on an ongoing basis.
3. A firm must determine its investible universe and the asset-level selection criteria it applies to meet a target environmental and/or social sustainability profile of assets, in specific and measurable terms, including
 - how the firm assesses the product's assets against the criteria
 - how the criteria relate to the target environmental and/or social profile of assets
 - how the target environmental and/or social profile of assets aligns with the product's sustainability objective
 - the conditions under which an asset ceases to meet its specified criteria for asset selection
4. In the case of an index-tracking product, a firm must satisfy itself that the index provider's methodology for index-construction aligns with the product's sustainability objective and its target environmental and/or social sustainability profile. The firm must retain the responsibility for ensuring that the index methodology reflects the product's sustainability objective and complies with all relevant requirements to use a label on an ongoing basis.
5. A firm must have appropriately designed policies and procedures in place to determine, measure, monitor, evaluate and report to investors (ie clients and consumers) on the environmental and/or social sustainability profile of assets on an ongoing basis.
6. A firm must identify any investment made by a product that a reasonable investor (ie client or consumer) might consider to be in conflict with the sustainability objective, and the investment policy and strategy of the product.

See **Chapter 5** (pre-contractual disclosures and sustainability product report) for the disclosures relating to Principle 2 and **Appendix 2** for the implementing guidance.

Appendix 2: Principles and cross cutting rules

Category-specific criteria

Sustainable Focus	Sustainable Improvers	Sustainable Impact
<p>The firm must ensure that at least 70% of the product's assets either meet a credible standard of environmental and/or social sustainability; or align with a specified environmental and/or social sustainability theme.</p> <p>If reasons for beyond the firms' control, the assets cease to meet the requirements above, the firm must take action to restore compliance as soon as reasonably practicable, having regard to the interests of the firm's investors (ie clients and consumers).</p>	<p>The firm must ensure that the product is invested in assets that have the potential to become more environmentally and/or socially sustainable over time, including in response to active investor stewardship.</p>	<p>The firm must specify:</p> <ul style="list-style-type: none"> • a theory of change, in line with the product's sustainability objective, emphasising how its investment process aims to contribute to addressing either environmental and/or social problems • a robust method to measure and demonstrate that its investment activities have had a positive environmental and/or social sustainability impact • its escalation plan should the real-world outcome no longer plausibly be achievable, including potential divestment of assets

See **Chapter 5** (pre-contractual disclosures and sustainability product report) for the disclosures relating to Principle 2 and **Appendix 2** for the implementing guidance.

Appendix 2: Principles and cross cutting rules

Principle 3: Key Performance Indicators

Principle 3, Key Performance Indicators. A firm must specify credible, rigorous and evidence-based KPIs that measure a sustainable investment product's ongoing performance towards achieving its sustainability objective.

Key considerations (cross-cutting)

1. A firm must have in place KPIs that are relevant to and aligned with the product's sustainability objective.
2. A firm must monitor the product's performance against its sustainability objective on an ongoing basis, with reference to its specified KPIs.

Category-specific criteria

Sustainable Focus	Sustainable Improvers	Sustainable Impact
In specifying KPIs to assess performance of the product, a firm must ensure that those KPIs include metrics that demonstrate the ongoing alignment of the product's assets with a target environmental and/or social sustainability profile, and the product's ongoing adherence to asset-level sustainability features in accordance with its investment policy and strategy.	<p>In specifying KPIs to assess performance of the product, a firm must ensure that those KPIs include metrics that demonstrate:</p> <ul style="list-style-type: none"> • a clear and measurable target for improvements in the sustainability profile of the assets in which the product invests • the long-term sustainability profile of a product's assets, as projected over a period of more than one year • the extent to which improvements in the sustainability of a product's assets have been achieved over time, including through investor stewardship • how the firm's stewardship strategy has been applied to support improvements in the environmental and/or social sustainability of assets, in accordance with the sustainability objective • the stewardship activities undertaken in relation to improving the sustainability profile of the product's assets in accordance with its sustainability objective; the outcomes achieved (including any improvements in the sustainability profile of the product's assets over time); and matters escalated (in accordance with the expectations under Principle 5, Stewardship, below) • how the product's assets meet the asset-level selection criteria • the changes (if any) in the sustainability profile of the product's assets over time, distinguishing between any improvement or deterioration in the sustainability profile of individual assets and changes arising from asset rotation 	In specifying KPIs to assess performance of the product, a firm must apply enhanced impact measurement and reporting based on industry best practices.

See **Chapter 5** (sustainability product report) for the disclosures relating to Principle 3 and **Appendix 2** for the implementing guidance.

Appendix 2: Principles and cross cutting rules

Principle 4: Resources and Governance

Principle 4, Resources and Governance. A firm must apply and maintain appropriate resources, governance and organisational arrangements commensurate with the delivery of the sustainable investment product's sustainability objective.

Key considerations (cross-cutting)

1. A firm must apply and maintain the following resources as appropriate for supporting and achieving the product's sustainability objective and the delivery of its investment policy and strategy:
 - investment professionals with appropriate skills and experience
 - technological inputs and research
 - data and analytical tools
 - where appropriate, oversight by any governing body in relation to the product; and
 - other resources as appropriate
2. A firm must carry out due diligence on any data, research and analytical resources it relies upon (including when third-party ESG data service providers are used), ensuring that any gaps and shortcomings identified are documented and appropriately mitigated.
3. A firm must maintain the arrangements and resources it has in place to oversee the sustainability research, data and analytical tools that it uses and ensure that these remain fit for purpose in supporting the product's sustainability objective on an ongoing basis.
4. A firm must maintain governance and organisational arrangements that appropriately support and incentivise the high-quality delivery of its investment policy and strategy in line with the product's sustainability objective.

See **Chapter 5** (sustainability entity report) for the disclosures relating to Principle 4 and **Appendix 2** for the implementing guidance.

Appendix 2: Principles and cross cutting rules

Principle 5: Stewardship

Principle 5, Stewardship. A firm must maintain its active investor stewardship strategy and resources (at firm-level or product-level) in a manner consistent with the sustainable investment product's sustainability objective.

Key considerations (cross-cutting)

1. A firm must apply its stewardship strategy and resources appropriate for achieving the product's sustainability objective.
2. Where stewardship plays a significant role in its investment policy and strategy for a sustainable investment product, the firm must specify credible, rigorous and evidence-based KPIs that relate to the contribution of stewardship activities and outcomes to the achievement of the product's sustainability objective [see also Principle 3, KPIs].
3. A firm must monitor its stewardship performance against any KPIs that are relevant to the delivery of the product in line with its sustainability objective.

See **Chapter 5** (pre-contractual disclosures and sustainability product report) for the disclosures relating to Principle 5 and **Appendix 2** for the implementing guidance.

Source: FCA's Consultation Paper 22/20 (Chapter 4)



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