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FCA Publishes Final Rules on Sustainability Disclosures and Investment Labelling

The FCA's long-awaited regime seeks to raise standards, increase consumer understanding, and reduce instances of greenwashing.

Key Points:

- A new anti-greenwashing rule will apply to all UK authorised financial services firms from 31 May 2024.
- Investment labels for use by UK asset managers in relation to products that meet positive sustainability criteria will be available for use from 31 July 2024.
- New naming and marketing rules will apply to UK funds that use sustainability-related terms but do not qualify for a label from 2 December 2024.

On 28 November 2023, the FCA published its Policy Statement (PS23/16) containing final rules on its Sustainability Disclosure Requirements (SDR) and investment labelling regime. The FCA originally consulted on this regime in October 2022 (see this Latham blog post). Publication of the final rules was somewhat delayed in light of the volume of feedback received to the consultation.

The FCA is introducing the following key measures:

- An anti-greenwashing rule for all UK authorised firms to ensure that sustainability-related claims are fair, clear, and not misleading
- An investment labelling regime for UK asset managers, comprising four investment labels that may be used for products that seek to achieve positive sustainability outcomes
- New rules and guidance for UK asset managers that market investment funds on the basis of their sustainability characteristics, but which do not use a label

The FCA is also setting consumer-facing disclosure requirements, product- and entity-level disclosure requirements, and requirements for UK distributors to ensure that product-level information is made available to retail consumers. The FCA notes that it plans to consult on extending the regime to portfolio management products and services in early 2024. HM Treasury is also exploring how to apply the regime to overseas funds.

Investment Labelling Regime

This regime is designed to help consumers differentiate between various sustainability objectives and the investment approaches that are designed to achieve those objectives. The FCA originally proposed a set of three investment labels to help consumers understand the sustainability goals that labelled products are seeking to achieve. The final regime contains four labels:

1. Sustainability Focus
2. Sustainability Improvers
3. Sustainability Impact
4. Sustainability Mixed Goals

These labels are all for products that seek positive sustainability outcomes. Investment strategies such as exclusions, negative screening, ESG integration, or basic ESG tilts alone would not be enough to qualify for a label. The fourth label was added in response to concerns raised by respondents to the consultation that products invested in a mix of assets would not qualify for the other three labels. The FCA emphasises that the labels have not been designed as a hierarchy; rather, they reflect different sustainability objectives and investment approaches.

In order to use one of the four labels, a product must meet both general and specific criteria relating to that label on an ongoing basis. This is an area in which the FCA received substantial feedback to its consultation. In light of this feedback, the FCA has made some changes to the criteria. The FCA flags that, as well as simplifying the language, it has restructured the criteria to more clearly set out: (i) the criteria a product must meet, (ii) the requirements that UK asset managers must meet, and (iii) requirements that must be met on an ongoing basis. Helpfully, the FCA has now set a percentage (70%) across all labels for the minimum proportion of assets that must be invested in accordance with the sustainability objective for the product to qualify.

The general criteria are as follows:

- **Sustainability objective.** All products using a label must have a sustainability objective to improve or pursue positive environmental and/or social outcomes as part of their investment objectives. This objective must be clear, specific, and measurable. While the FCA is not introducing a “do no harm” criterion, it will require UK asset managers to identify and disclose if pursuing the positive outcome could result in material negative outcomes in relation to other environmental or social factors.

- **Investment policy and strategy.** At least 70% of the product’s assets must be invested in accordance with its sustainability objective. These assets must be chosen with reference to a robust, evidence-based standard that is an absolute measure of environmental and/or social sustainability. This standard could be based on a methodology or approach that is determined by industry practice, an authoritative body, or proprietary standards. Products may also be invested thematically, provided they meet the required standards. Other assets held must not conflict with the sustainability objective, and UK asset managers must identify and disclose any other assets held in the product, including why they are held. Some limited exceptions apply, including when a manager is still building out a fund’s portfolio.

- **KPIs.** UK asset managers must use KPIs to measure progress against the sustainability objective. KPIs can measure the progress of the whole product or individual assets. The FCA considers that managers are best placed to identify appropriate KPIs for their products. However, the FCA encourages managers to apply industry frameworks and best practices, when relevant. KPIs should deliver a fair representation of the product's progress towards the objective and enable consumers to understand that progress, including through use of contextual and historical information.

- **Resources and governance.** UK asset managers must ensure there are appropriate resources, governance, and organisational arrangements to support delivery of the sustainability objective. This includes ensuring there is adequate knowledge and understanding of the product's assets as well as a high standard of diligence in the selection of any data or other information used to inform investment decisions for the product.

- **Stewardship.** UK asset managers must identify and disclose the stewardship strategy needed to support the delivery of the sustainability objective, including activities they expect to take and outcomes they expect to achieve. However, managers do not need to be able to demonstrate a causal link between their activities and outcomes achieved. Managers must also set out an escalation plan to be able to take action when assets do not demonstrate sufficient progress towards the sustainability objective and/or KPIs.

The below table outlines the key criteria for each label:

Sustainability Focus	• The sustainability objective must be consistent with an aim to invest in assets that are environmentally and/or socially sustainable, determined using a robust, evidence-based standard that is an absolute measure of sustainability.
Sustainability Improvers	• The sustainability objective must be consistent with an aim to invest in assets that have the potential to improve environmental and/or social sustainability over time — determined by their potential to meet a robust, evidence-based standard that is an absolute measure of sustainability. • UK asset managers 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. They must also obtain robust evidence to satisfy themselves that the assets have the potential to meet the standard. • UK asset managers should note that stewardship should support delivery of the sustainability objective.
Sustainability Impact	• 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, determined by the potential of those assets to meet a robust, evidence-based standard that is an absolute measure of sustainability. • UK asset managers must specify a theory of change setting out how they expect their investment activities and the product's assets to achieve a positive impact. • UK asset managers must specify a robust method for measuring and demonstrating the positive impact of both the assets the product invests in and the asset manager's investment activities.
Sustainability Mixed Goals	• Products with a sustainability objective to invest in accordance with a combination of the sustainability objectives for the other labels. • UK asset managers must identify (and disclose) the proportion of assets invested in accordance with any combination of the other labels.

Key attributes for each label are set out in Annex 2. Where UK asset managers are required to use a robust, evidence-based standard, an independent assessment (internal or external) must confirm the standard is fit for purpose. Managers must prepare and retain a record as to the basis on which the label has been used. Managers will need to ensure that the general and specific criteria continue to be met on an ongoing basis, review their use of a label at least annually, and possibly revise their use of labels or cease to use a label if appropriate. Managers using the labels must include an FCA graphic associated with the relevant label along with details as to where the consumer-facing disclosure can be accessed. Managers need to notify the FCA when they use a label and when they revise or stop using a label.

The FCA explains that the labelling criteria accommodate both active and passive funds. For the latter, the product needs to track an index that meets the criteria for a label. However, the FCA flags that UK asset managers considering KPIs for passive funds may need to undertake a deeper assessment and ensure a detailed understanding of the index methodology. Managers also need to be prepared to react appropriately when changes are made to the index.

Feeder funds will be able to use a label where the purpose is to reflect the sustainability objective of the master fund. The feeder fund will only be able to use the same label as the master and must meet the relevant FCA requirements such as providing access to relevant disclosures. There are no specific rules for funds of funds; managers will need to navigate how the rules apply to their situation.

The FCA notes that, if a UK asset manager chooses to label a product, the manager remains responsible for that classification. While the FCA's Fund Authorisation team may review and challenge the labels that managers have applied, it will not formally approve or endorse use of a particular label. The FCA plans to monitor uptake of labels and supervise the use of labels. The FCA highlights that it will use available market intelligence to help it uncover instances where managers may be in breach of SDR requirements.

Naming and Marketing Rules

The FCA is introducing new rules for UK asset managers that will apply to products made available to retail investors that do not use one of the four sustainability investment labels, but which use sustainability-related terms. The FCA had originally proposed to restrict such products from using any sustainability-related terms in their product names and marketing. However, most feedback to the consultation suggested that the FCA's proposed approach was too restrictive. Therefore, the FCA has tried to strike a balance by allowing products that do not use a label to use sustainability-related terms (such as "green", "climate", and "social") in product names and marketing if they meet the FCA's product name, disclosure, and statement conditions. However, the restriction will not apply when managers make short, factual, non-promotional statements about a product. The aim is to assist consumers with differentiating between products that use a label, and products that have sustainability characteristics but do not qualify for a label.

Broadly, the FCA's product name, disclosure, and statement conditions require the following:

- The product must have sustainability characteristics, and the product's name must accurately reflect those characteristics (the sustainability characteristics of a product should be material to that product, meaning, for example, that at least 70% of its assets have sustainability characteristics).
- The terms "sustainable", "sustainability", "impact", and any variation of those terms must not be used (labelled products will also not be able to use the term "impact" unless they apply the Sustainability Impact label).

- UK asset managers must produce the same types of disclosures as required for a labelled product (consumer-facing, pre-contractual, and ongoing product-level disclosures).

- UK asset managers must also produce and prominently publish a statement to clarify that the product does not have a label and the reasons why.

- In the case of a feeder fund, the product must only include in its name terms that are consistent with those used by the relevant master fund, and the UK asset manager must provide clients with easy access to the disclosures referred to above and produce the relevant statement.

Managers complying with these rules will also need to consider which sustainability-related terms are appropriate to use and how terms may be interpreted by consumers.

Disclosures

The FCA is introducing related disclosure requirements for UK asset managers that fall into three buckets:

1. Consumer-facing disclosures

Consumer-facing disclosures are intended to provide consumers with better information on the key sustainability characteristics of investment products in a simple, accessible, and consumer-friendly way to help consumers assess whether those products meet their needs and preferences. While the FCA originally proposed that such disclosures should be prepared for all funds, it has decided that it is more proportionate to only require such disclosures for products using a label and products using sustainability-related terms in their naming and marketing.

The consumer-facing disclosure must exist in a stand-alone document and be presented in a prominent place on the product webpage, app, or other digital medium, alongside other key investor information. It must also be no more than two pages long. There is no set template for this disclosure, although the FCA encourages the development of an industry-led standard. However, the FCA has prescribed certain content. For example, UK asset managers must include details of any types of assets held for reasons other than to pursue the sustainability objective and why these are held.

Disclosures must be published from the date the label is first used, or by 2 December 2024 for products without a label but using sustainability-related terms in their naming and marketing. UK asset managers must review and update these disclosures at least annually. Disclosures for products with labels must, at a minimum, be updated to reflect progress towards achieving the sustainability objective.

2. Detailed product-level disclosures

Detailed product-level disclosures are aimed at institutional investors, as well as retail investors who may want more information. These disclosures will need to be prepared for all products using a label and products using sustainability-related terms in their naming and marketing. There are two key types of disclosure:

- Pre-contractual disclosures

- Ongoing product-level disclosures

UK asset managers will be able to cross-reference relevant information from ongoing disclosures in their pre-contractual disclosures. Pre-contractual disclosures will not need to be updated annually, but must be updated as soon as reasonably practicable when revising or ceasing to use a label.

Pre-contractual disclosures must be published from the date the label is first used, or by 2 December 2024 for products using sustainability-related terms in their naming and marketing. Ongoing product-level disclosures must be: (i) published 12 months after the label is first used and annually thereafter, and (ii) provided to eligible clients on demand from 2 December 2025.

3. Entity-level disclosures

Entity-level disclosures will apply to all UK asset managers with AUM above £5 billion (regardless of whether they use labels or sustainability-related terms), with staggered implementation dates. The entity-level disclosure rules will apply to asset managers with AUM above £50 billion from 2 December 2025. From 2 December 2026, the entity-level disclosure rules will apply to UK asset managers with AUM above £5 billion.

However, the FCA encourages smaller UK asset managers to consider producing these disclosures on a voluntary basis. Managers will need to disclose the relevant information annually in a "Sustainability Entity Report", which builds from the TCFD Entity Report. Managers will be required to disclose their governance, strategy, risk management, and metrics and targets in relation to managing sustainability-related risks and opportunities. Additionally, managers that use labels or sustainability-related terms in their naming and marketing must also include details of their resources, governance, and organisational arrangements in relation to those products. Managers will be permitted to cross-refer to other group disclosures if certain conditions are met. The FCA encourages the development of industry-led guidance to further specify the types of information that may be useful for managers to disclose.

Distributors

Under the new regime, UK distributors of products in scope of the investment labelling or naming and marketing regimes will be required to ensure that labels and consumer-facing disclosures are made available to retail investors. These can be communicated using a digital medium or the medium the firm would ordinarily use to communicate with customers and must be kept up to date. UK distributors will be expected to make the labels and consumer-facing disclosures available to retail investors as soon as reasonably practicable after the UK asset manager produces them, so in practice UK distributors may need to start complying with this requirement shortly after 31 July 2024. In relation to overseas products, UK distributors will need to include a prominent notice to alert investors that the product is not subject to the UK labelling and disclosure requirements. The notice must either be in a prominent place on the relevant digital medium with a link to the related FCA webpage, or communicated using the medium the distributor would ordinarily use. The notice must be applied to products by 2 December 2024.

The Anti-Greenwashing Rule

The anti-greenwashing rule requires all FCA-authorised firms to ensure that any reference they make to the sustainability characteristics of their financial products and services are consistent with the sustainability characteristics of the product or service and are fair, clear, and not misleading. The FCA highlights that sustainability-related references can be present in, but are not limited to, statements, assertions, strategies, targets, policies, information, and images. The anti-greenwashing rule provides an overlay to the standards already set by the FCA such as the Principles for Businesses, the Consumer Duty, and the Guiding Principles for UK asset managers set out in the Dear Chair letter issued in July 2021 (see this Latham blog post). The anti-greenwashing rule also supplements applicable consumer protection law and general advertising rules, which are relevant to sustainability-related claims.

In light of the feedback received to the consultation, the FCA is consulting on guidance on the anti-greenwashing rule, to provide firms with more clarity on the FCA's expectations. Broadly, the draft guidance explains that sustainability references should be:

- Correct and capable of being substantiated
- Clear and presented in a way that can be understood
- Complete, in that they should not omit or hide important information and should consider the full life cycle of the product or service
- Fair and meaningful in relation to any comparisons to other products or services

The draft guidance also gives practical examples of communications that would not meet the FCA's expectations. The consultation (GC23/3) runs until 26 January 2024. The FCA is proposing that the new guidance will come into force on 31 May 2024, alongside the anti-greenwashing rule. The FCA listened to respondents in pushing back the start date of the anti-greenwashing rule, which had been intended to come into effect immediately upon publication of the Policy Statement. The FCA notes that it will monitor for signs of greenwashing from a range of sources, including complaints to the Supervision Hub, intelligence gathered on the quality of applications sent to the Fund Authorisations team, and broader supervisory intelligence.

Future Expansion

The FCA emphasises that the SDR and labelling rules are only a starting point. It intends to develop the regime in future, including by consulting on extending the regime to portfolio management services in early 2024. HM Treasury will also explore how to extend the regime to overseas recognised funds (which would require legislative change). Further, the FCA will (i) consider extending the regime to pension products and insurance-based investment products in the medium-term, (ii) work with financial advisers to assist with how they can support customers choosing sustainable investments, and (iii) continue to build on its disclosure requirements to reflect both UK and international developments. The FCA plans to carry out a post-implementation review of the regime after three years.

Interaction With EU SFDR

The FCA had designed the SDR with a view to improving upon some of the difficulties experienced with the EU SFDR regime. The FCA has included a revised mapping to the SFDR requirements in Annex 3 to PS23/16. It also notes the ongoing review of the SFDR (see this Latham blog post) and the fact that the European Commission is considering whether to pivot towards a labelling regime (since the SFDR regime has been used as a labelling regime in practice, rather than the disclosure regime it was intended to be). The FCA emphasises that, as the UK is one of the first jurisdictions to introduce investment labels, it is ready to coordinate with the EU authorities on this issue. Market participants will no doubt hope for a strong alignment between the two regimes in future. The FCA has also set out a summary of the SDR label qualifying criteria and the relevant information under SFDR that firms may leverage to support meeting the SDR requirement. We have replicated this in Annex 3.

Annex 1 — Overview of the Regime

Measure	Scope	Timing
Anti-greenwashing rule	All UK authorised firms in relation to sustainability-related claims about their products and services	Applies from 31 May 2024
Investment labels	UK asset managers (and their UK-domiciled products marketed in the UK)	UK asset managers can begin to use labels with accompanying disclosures from 31 July 2024
Naming and marketing rules	UK asset managers, when sustainability-related terms are being used for UK-domiciled products marketed to retail investors in the UK that do not use one of the investment labels	Apply from 2 December 2024
Consumer-facing disclosures	UK asset managers in scope of the investment labels and naming and marketing rules	Must be published at the same time as the label is first used, or by 2 December 2024 for products without a label but using sustainability-related terms in their naming and marketing
Product-level disclosures	UK asset managers in scope of the investment labels and naming and marketing rules	Pre-contractual disclosures must be published at the same time as the label is first used, or by 2 December 2024 for products without a label but using sustainability-related terms in their naming and marketing Ongoing disclosures must be published 12 months after the label is first used and annually thereafter, and provided to eligible clients on demand from 2 December 2025
Entity-level disclosures	UK asset managers with AUM of £5 billion or more, in respect of UK funds	Required from 2 December 2025 for UK asset managers with AUM above £50 billion, and 2 December 2026 for UK asset managers with AUM above £5 billion
Distributors	UK authorised firms that distribute products in scope of the investment labels and naming and marketing rules, and overseas funds, to retail investors in the UK	Labels and consumer-facing disclosures must be made available to retail investors as soon as reasonably practicable after the asset manager produces them; relevant notice must be applied to overseas products by 2 December 2024

Annex 2 — Key Attributes of Product Labels

	Sustainability Focus	Sustainability Improvers	Sustainability Impact	Sustainability Mixed Goals
Objective	To invest in assets that are environmentally or socially sustainable determined by a robust, evidence-based standard of sustainability	To invest in assets that have the potential to become more sustainable over time, determined by their potential to meet a robust, evidence-based standard of sustainability over time	To achieve a predefined, positive, measurable environmental and/or social impact	To invest in assets that meet or have the potential to meet a robust, evidence-based standard for sustainability, and/ or invest with an aim to achieve positive impact
Link to positive environmental or social outcome	Indirect	Indirect	Direct	Indirect and direct
Standard of sustainability	Product's assets are determined using the standard	Product's assets have the potential to meet the standard	Can be used to select assets that have the potential to contribute to positive, measurable impact	Combination
KPIs	Measure the sustainability of the assets	Measure the assets' sustainability improvements	Measure the positive impact (both the impact of the assets and the investor's contribution)	Measure the sustainability and improvement of the assets, and/or impact of both the assets and investor contribution
Stewardship	To support assets in remaining sustainable/ delivering long-term value	To support and accelerate improvements over time	To support assets in delivering positive impact	To support assets in remaining sustainable/ accelerate improvements over time/ delivering positive impact

Source: FCA

Annex 3 — Comparison of SDR and SFDR Requirements

	SDR requirement	SFDR requirement/information to leverage
Product	Sustainability objective that is clear, specific, and measurable	Some products may have a sustainability objective (e.g., Article 9 funds)
	At least 70% of its assets invested in accordance with a robust, evidence-based standard that is an absolute measure of environmental and/or social sustainability	Proportion of investments with a sustainability objective/promoting sustainability characteristics. However no specific link to a robust, evidence-based standard
	Robust and evidence-based KPIs to measure performance against the sustainability objective	Measure the attainment of the sustainable investment characteristics/objective through sustainability indicators
Firm	Identify material negative environmental and/or social outcomes that may arise in pursuing the sustainability objective	Disclosure of principal adverse impacts
	Identify assets held for reasons other than to pursue the sustainability objective	Disclosure of the proportion of investments with a sustainability objective/promoting sustainability characteristics
	Monitor performance of the product in achieving the sustainability objective	Measure the attainment of the sustainable investment characteristics/objective through sustainability indicators
	Have an investment policy for achieving the sustainability objective and investment strategy for what the product invests in	Disclosure of investment strategy, monitoring, etc.
	Have an escalation plan in setting out the actions to be taken if the assets do not demonstrate sufficient performance against the sustainability objective	Disclosure of engagement policies. (Firms may need to expand on this to set out an escalation plan under SDR)
	Obtain independent assessment of the standard for sustainability to confirm that it's appropriate for asset selection/fit for purpose	Disclosures on whether assurance is provided under SFDR. However, "independent assessment" in SDR is only limited to the sustainability standard (which can be via internal processes)

	SDR requirement	SFDR requirement/information to leverage
Firm	Ensure there are appropriate resources, governance, and organisational arrangements, commensurate with the delivery of the sustainability objective	No specific requirement under SFDR
	Identify and apply the investor stewardship strategy needed to deliver the sustainability objective, including the expected activities and outcomes	Disclosure of engagement policies. (Firms may need to expand on this requirement under SDR e.g., for other forms of stewardship)
	Where a product tracks an index, firms must only select an index that aligns with the general and specific criteria	No specific requirement under SFDR
	Ensuring the labelling criteria are met on an ongoing basis	Monitoring requirements. (Firms may need to expand to capture all SDR requirements)

Source: FCA

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