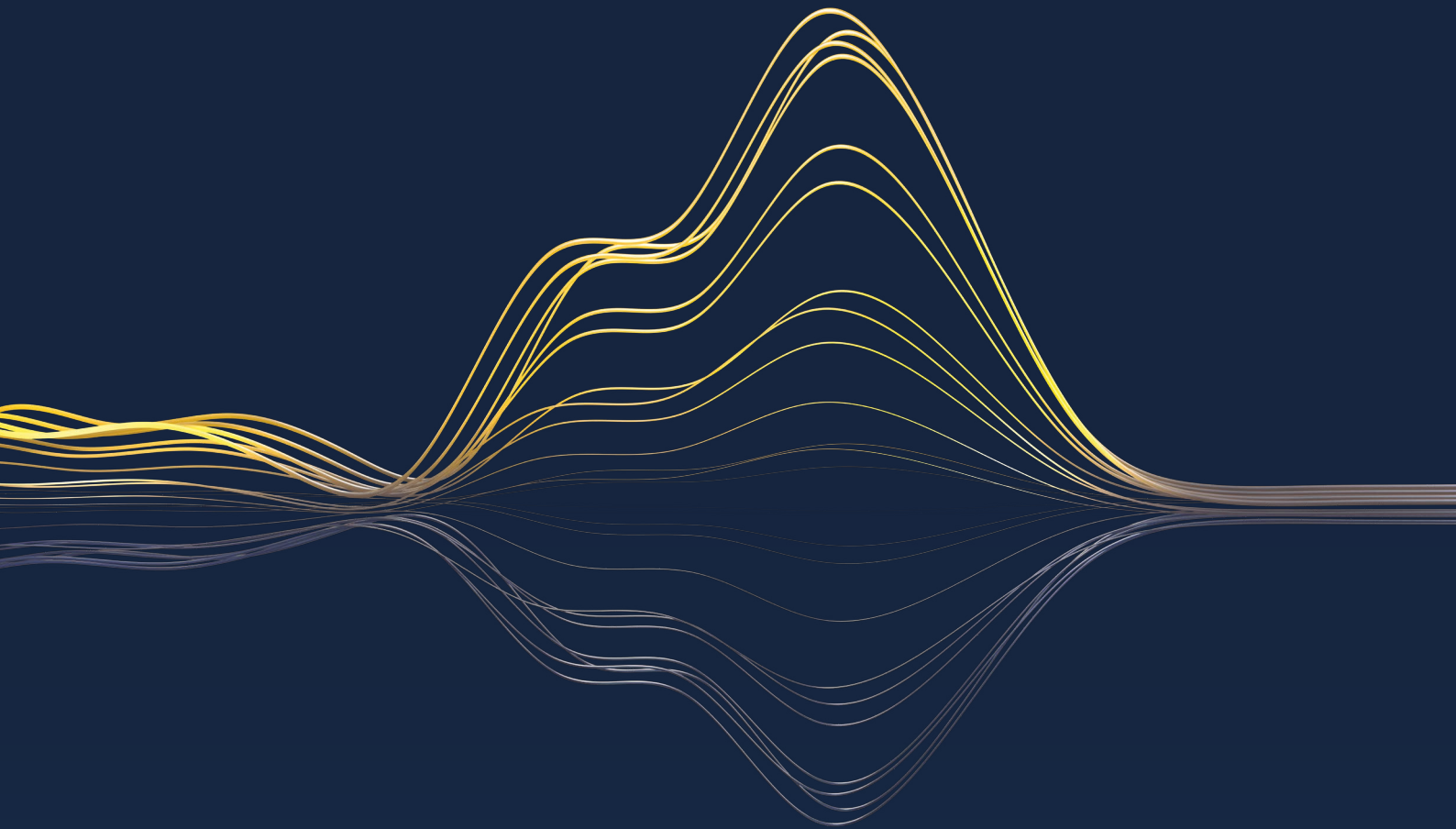


A HIGH LEVEL GUIDE TO THE FINAL FCA RULES AND  
OUR COMMENTARY ON DIVERGENCE AND LESSONS LEARNED FROM EU SFDR

# UK Sustainability Disclosure Requirements (SDR) and Investment Labels



# Introduction, scope and timelines

On 28 November 2023, the FCA published its long-awaited [Policy Statement](#) and final rules on the Sustainability Disclosure Requirements (SDR) and investment labels regime, with respect to ESG labelling rules, disclosure, naming and marketing, and anti-greenwashing rules. This client briefing summarises the new regime, and the expected impact on UK and overseas funds and firms.

The Policy Statement follows the FCA's consultation in Q4 of 2022 which received 240 responses, resulting in two delays to the final rules being published. Despite the breadth of sources contributing to the regime, this Policy Statement incorporates many of the proposals previously suggested. The new rules also include important modifications and amendments, which take account of input from market participants and which, according to the FCA, will help to address investors' "lack of confidence" with respect to the authenticity of sustainability-related claims.

The new package of measures:

- introduces a fourth investment product label "sustainability mixed goals" to accommodate mixed strategies;
- clarifies that there will be no need for firms to demonstrate a causal link between stewardship activities and ESG outcomes;
- introduces a requirement to identify and disclose whether pursuing positive ESG outcomes might result in negative environmental and/or social outcomes;
- introduces a new Anti-Greenwashing Rule (AGR) that applies to all UK regulated firms and a new [consultation](#) on supporting guidance for the AGR.

The SDR is designed to apply to UK asset managers and distributors, although the anti-greenwashing rule will apply to all FCA-authorised firms. At present, portfolio management services are outside of the scope of the regime; but the FCA is intending to consult on

rules for portfolio management services in early 2024. It remains to be seen whether the UK SDR will apply to non-UK funds and products marketed into the UK (and if so, how and when). The FCA pointedly notes that this is a matter for HM Treasury to consider as part of the broader overseas funds' regime. Although the FCA has stated that the SDR is compatible with the EU's Sustainable Finance Disclosure Regulation (EU SFDR) and proposals being developed in the US, there are clear differences between the regimes that firms will need to carefully navigate and consider.

## Commentary

The FCA doesn't have the power to extend the SDR to overseas funds marketed to UK investors as this power rests with HM Treasury. But the FCA expects there will not be a level playing field for UK funds versus those funds accessing the UK market via, for example, the National Private Placement Regime. With an election looming by January 2025 at the latest, it remains to be seen how high a priority the overseas extension of the SDR will be for the government. But it appears inevitable that non-UK funds and products will be brought into the scope of SDR eventually. Clearly it would be preferable if legislation could be fast-tracked. For now, a spilt commencement seems very likely given the lead time that non-UK market participants would need to be able to comply in time.

From a timeline perspective, the proposed rules will be staggered and will come into effect in stages. Market participants have been given a few weeks, until **26 January 2024**, to comment on the FCA's proposed guidance with respect to the AGR, which is then intended to apply from **31 May 2024**. The labelling regime will take effect from **31 July 2024**. And the naming and marketing rules will apply from **2 December 2024**. Looking further ahead, firms will have until **2 December 2025** to comply with the product disclosure requirements and until **2 December 2026** to comply with the entity level disclosure requirements.

# Anti-greenwashing rule

As previously advertised, the SDR includes an AGR. The AGR will require all FCA-authorized firms to ensure that all and any references to the ESG characteristics of products and services accurately reflect the ESG characteristics of the product or service. The references also have to be fair, clear and not misleading (meaning proportionate, not exaggerated and capable of being supported by evidence).

This rule is intended to apply to both the environmental and social aspects of the products and services. Any references should be meaningful to facilitate comparisons with other products and services, and presented clearly and in a manner that's easily understood.

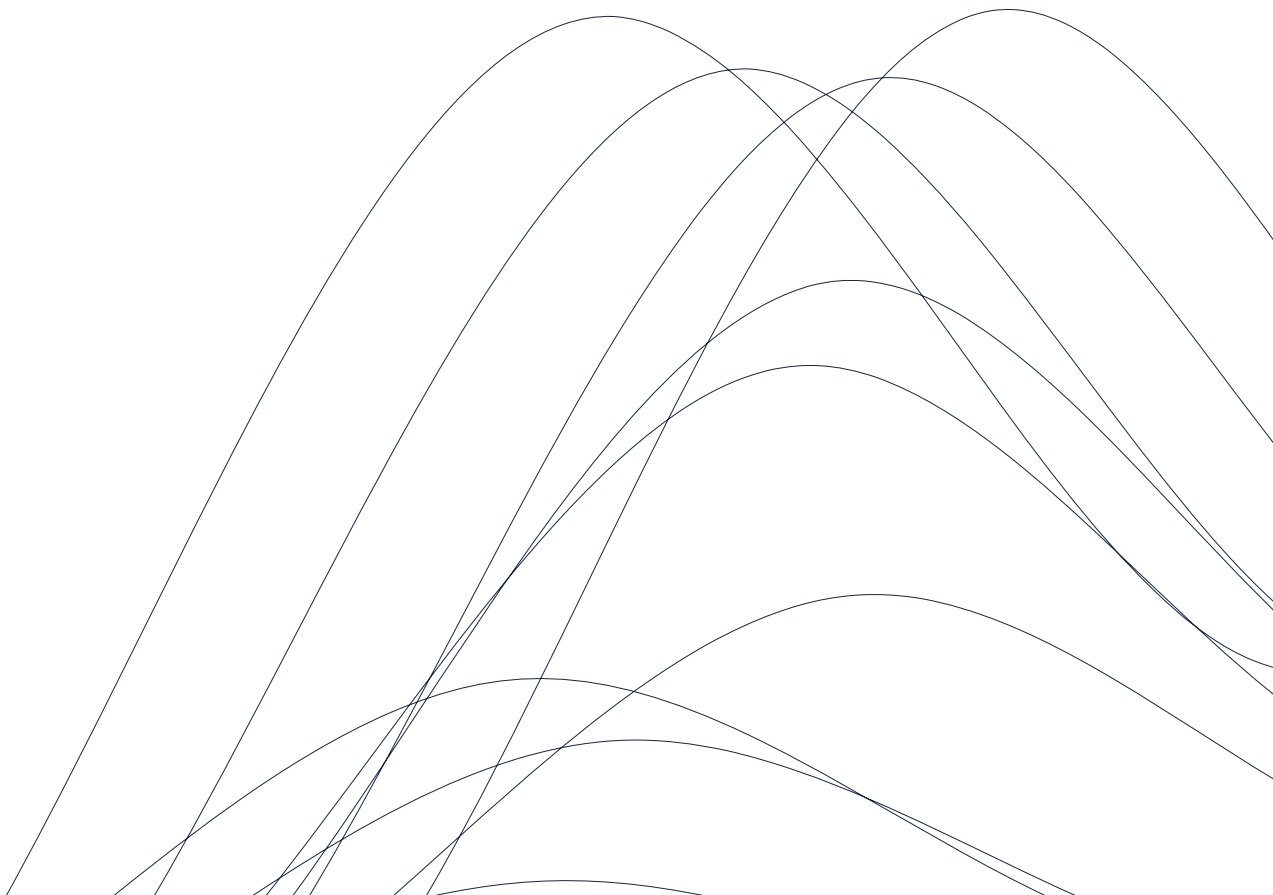
When assessing the ESG characteristics of the product or service, firms must ensure they consider the full life cycle and should not try to obscure important information. Firms will be required to have policies, procedures, and controls in place to prove and support the use of the ESG terms and statements about the products' or services' ESG features and characteristics.

To help firms understand and interpret the anti-greenwashing rule, the FCA has published [draft guidance](#), which includes some useful examples of good and bad conduct. Firms will have until 26 January 2024 to comment on the guidance.

## Commentary

The AGR permeates everything that firms say about sustainability going forward. The AGR (and draft guidance) supports the direction of travel of the UK Advertising Standards Agency rulings – with a focus on “completeness” (in addition to being: correct, capable of substantiation, clear, fair and meaningfully comparable). A key element of completeness is that any aspects of a product that could have a negative impact on sustainability must be just as prominent as positive sustainability characteristics.

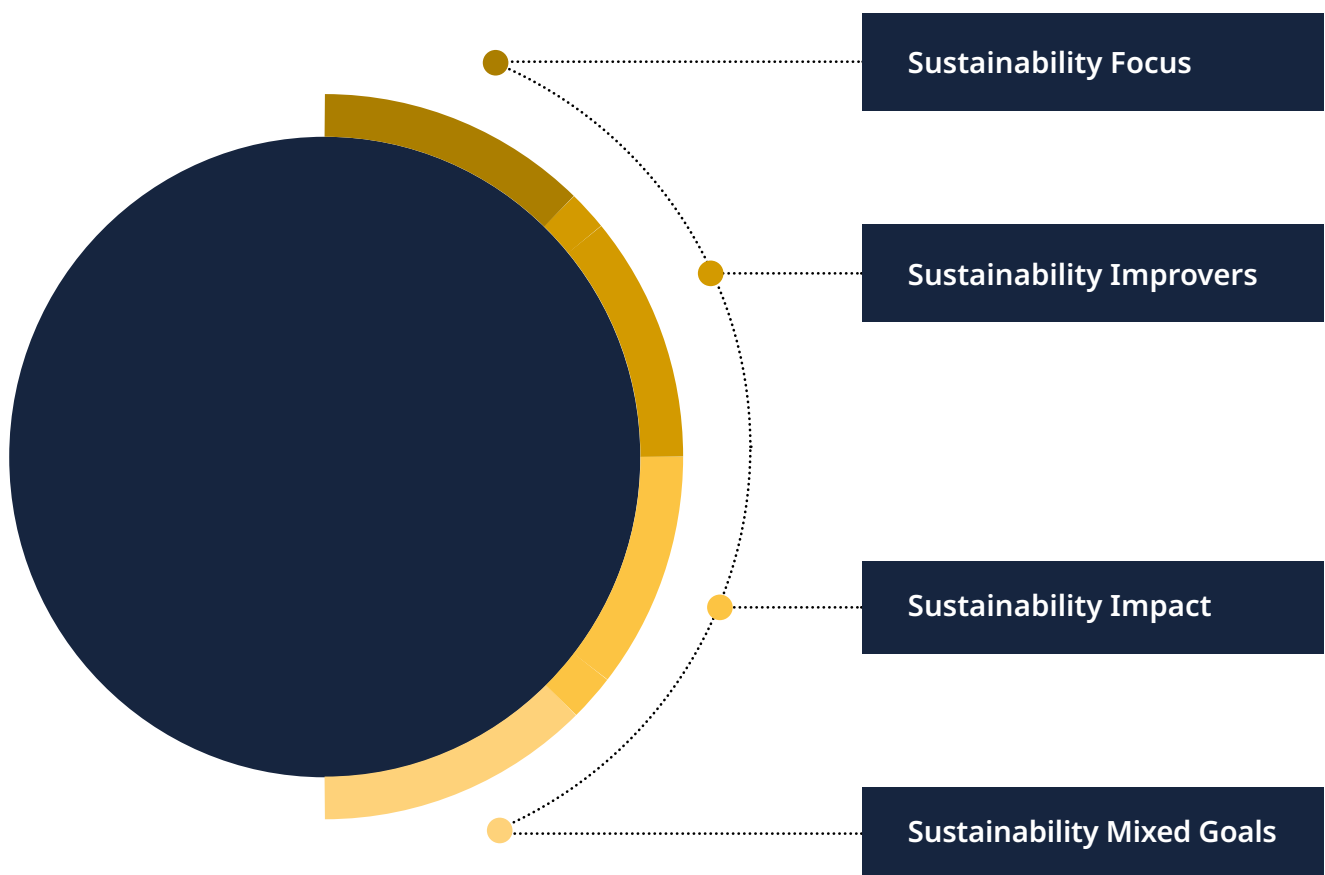
Firms should review all external communications that refer to the ESG characteristics of products and services to ensure they're fair, clear and not misleading and supported by documented evidence. This will likely require firms to make enhancements to their existing policies, procedures and controls, including establishing clear guidelines on the use of ESG terminology and the data and evidence needed to support the statements. Employees will need to be trained on the rule and any changes made to internal procedures.



# Product labels and criteria

The FCA indicated that its proposed labelling regime received broad support and it's taking forward those proposals with some clarifications and simplification.

Investment labels can be applied to products seeking positive sustainability outcomes. The FCA has added a new investment label following the consultation. So there are now four labels available for products seeking to achieve positive sustainability outcomes:



There are general criteria that apply for all labels. And there are specific criteria that must be met for each individual label. The FCA has again stressed that the labels are not designed to be hierarchical.

## General criteria

- **Sustainability objective** – products must have a sustainability objective aimed at directly or indirectly improving or pursuing positive environmental and/or social outcomes. There are no requirements regarding the number of sustainability objectives or how they're measured.
- **Investment policy and strategy** – 70% of the gross value of the product's assets must be invested in line with the sustainability objective; the 70% minimum threshold now applies to all labels. At least 70% of the product's assets must meet the required standard of sustainability (see below).
- **Standard of sustainability** – firms will need to determine a robust, evidence-based standard that's an absolute measure of sustainability and aligns with the sustainability objective. The standard must be assessed using an internal or third-party independent assessment.
- **KPIs** – firms must determine robust, evidence-based KPIs to measure performance towards the sustainability objective; they can measure the performance of the product as a whole or the individual assets.
- **Governance and stewardship** – firms must ensure they maintain resources, governance and organisational arrangements commensurate with the product achieving its sustainability objective. Firms must also identify and apply an investor stewardship strategy required to help achieve the sustainability objective. Though the FCA has not prescribed the form or stewardship or whether the strategy is implemented at firm or product level. There will be no need for firms to demonstrate a causal link between stewardship activities and sustainability outcomes, which addresses concerns raised by market participants in their response to the consultation paper.
- **Escalation plan** – firms must identify an escalation plan enabling them to take action where assets do not demonstrate sufficient progress towards the sustainability objective and/or KPIs.

## Commentary

In our experience of EU SFDR, it's important to design the systems, controls, processes and standards that will underpin the sustainability attributes of a product at the outset. Defining a sustainability objective based on pre-existing systems is much easier than operationalising compliance with that objective after it's been disclosed. Firms have to set objectives that are achievable, consistent with the other (non-sustainability) objectives of the product and that can be clearly supported and backed up by credible data and other evidence. There's a commercial reality that funds must raise capital to succeed. But sustainability objectives of a fund as expressed in marketing material should not be overstated.

The FCA has confirmed that firms can use proprietary sustainability standards and KPIs, ie those developed in-house. Clearly there's a risk that in-house standards could be perceived as less robust than industry-recognised standards and firms should take care using proprietary standards and performance metrics. However, this approach also allows firms to create bespoke sustainability strategies with varying degrees of ambition – which is welcome.

## Specific criteria

### • Sustainability Focus

- For products investing *mainly* in assets that are environmentally and/or socially sustainable. The product may invest thematically, but it will not qualify for the Sustainability Focus label *solely* on the basis that 70% of its assets align with a sustainability theme.

### • Sustainability Improvers

- For products investing in assets that have the potential to improve environmental and/or social sustainability over time. Assets must be selected based on evidence that they have the potential to improve and meet a robust, evidence-based standard over time.

### • Sustainability Impact

- For products investing in solutions to problems affecting people or the planet and seeking to achieve a pre-defined, positive, measurable impact.
- Firms must specify a theory of change, in line with the sustainability objective, which can be applied either at product or asset level. The theory of change must set out how firms expect their investment activities and the product's assets to achieve a positive impact.
- Firms must be able to measure both the impact of the assets and the investor contribution. The method of measurement can be qualitative or quantitative if it's robust and details of the impact are clearly disclosed.

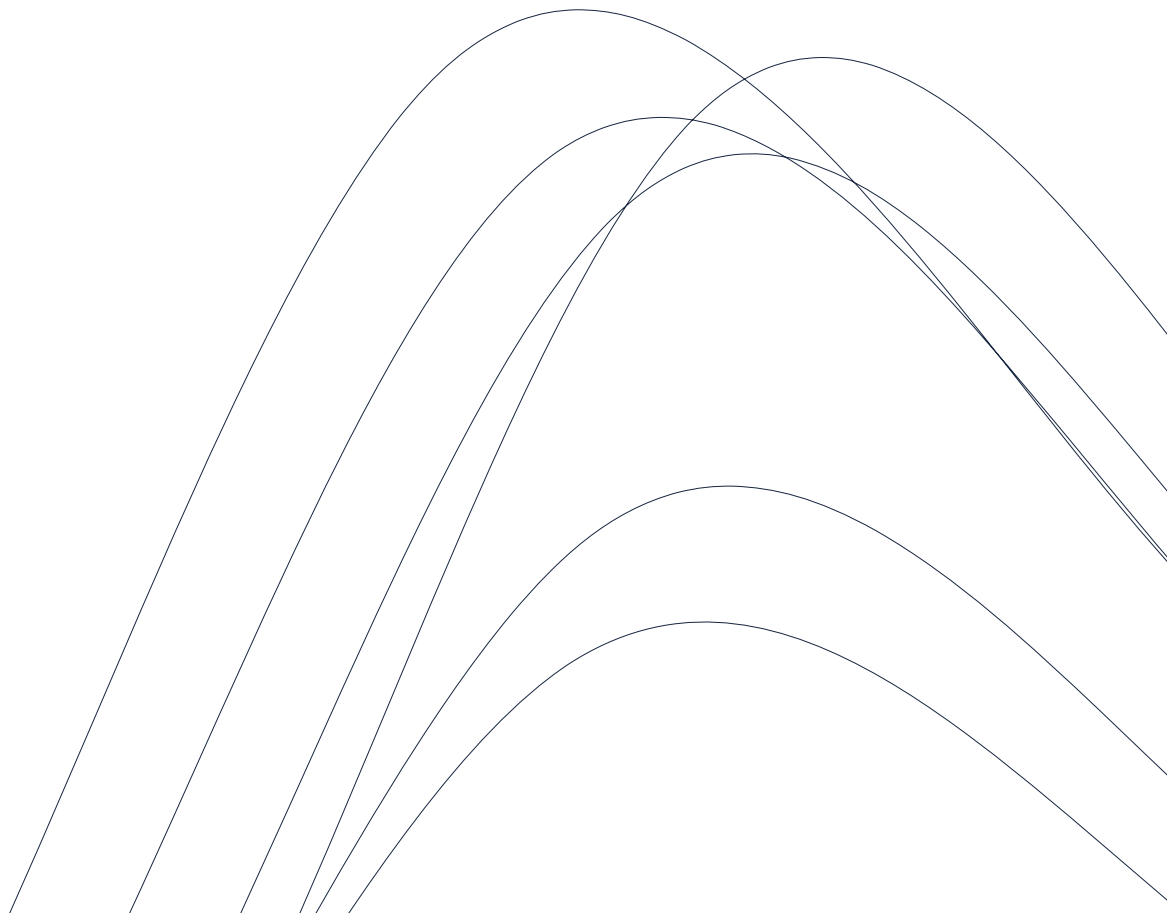
### • Sustainability Mixed Goals

- For products investing in assets meeting two or more of the Focus, Improvers and/or Impact criteria. Firms must identify the proportion of assets meeting the criteria for each of the labels.

## Commentary

The labels are not intended to be hierarchical. And they're primarily designed with consumers in mind and as a means to encourage capital to gravitate towards assets and investments that support or encourage sustainability objectives. However, in our experience of EU SFDR, the market is likely to ascribe a hierarchy of sorts to the labels (which will also include unlabelled products at the bottom of the sustainability hierarchy). The FCA acknowledges that some stakeholders might perceive a hierarchy of: Improvers to Focus to Impact. In theory, that analysis ought to put Mixed Goals above Improvers.

Though the labels are targeted to consumers, in our view, the labels will be used by investment professionals and institutions just as much as they'll be used by consumers. Market data providers will inevitably report on trends in fund performance with reference to labelling, perpetuating a hierarchy. While products should be judged on their detailed disclosures in full, labels provide a very convenient way for investors to group and filter products.



## Naming and Marketing

The FCA has listened to feedback from market participants and has amended the proposed rules so UK asset managers can use sustainability-related terms in their product names and marketing material. This applies even where a product label is not used if certain conditions are satisfied (eg consumer facing disclosures – see below).

The SDR rules and guidance have clarified that to use a sustainability-related term in the product name, the sustainability characteristics of the product should be material to that product. This includes a requirement that at least 70% of its assets have sustainability characteristics.

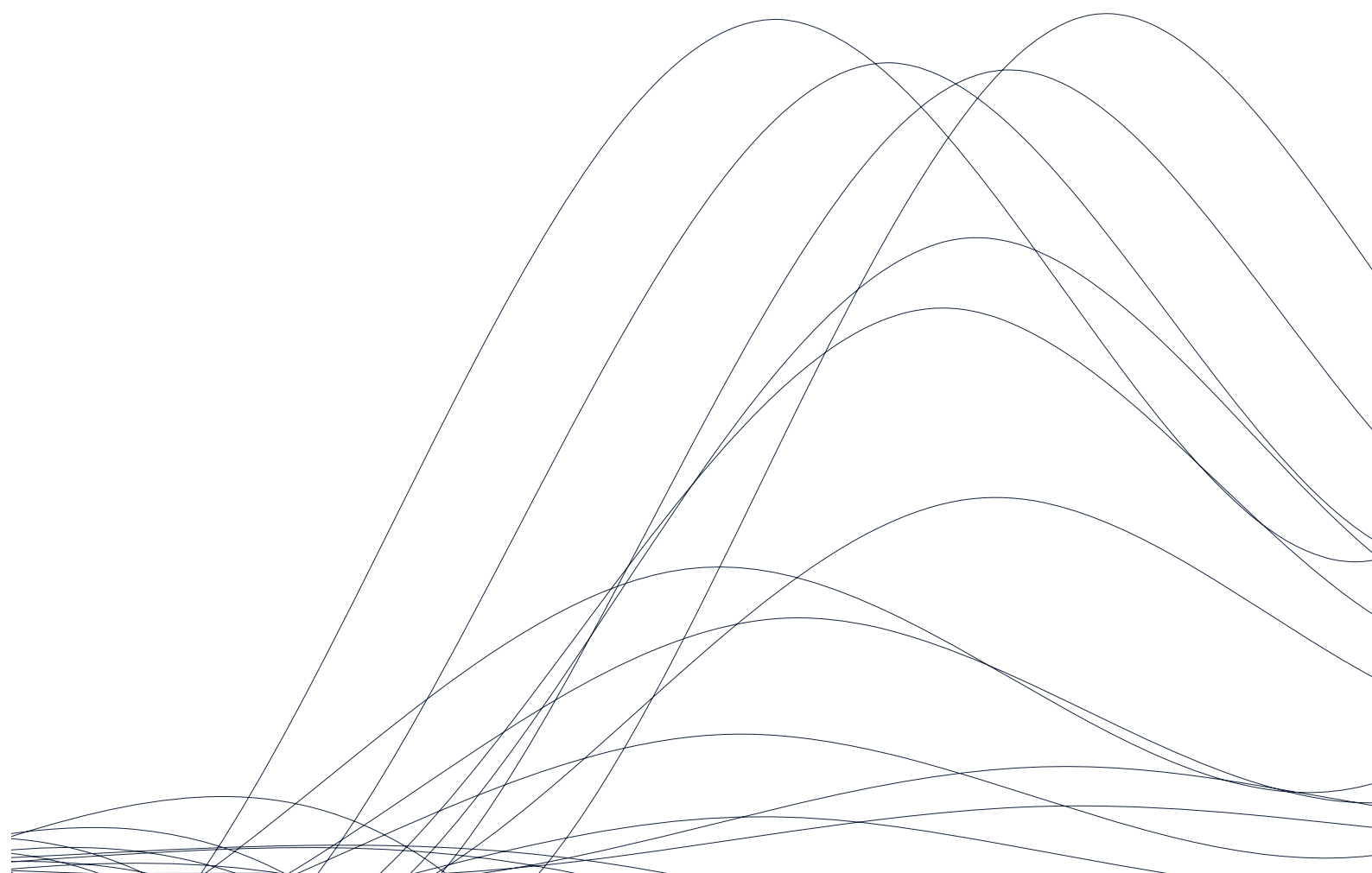
The guidance encourages UK asset managers to consider whether using a sustainability-related term needs to be qualified to accurately reflect a product's sustainability characteristics, for example, using the term "low-carbon tilt" rather than "low carbon."

The FCA has clarified that the restrictions will not apply to:

- short factual statements that are not financial promotions; or
- where terms are used in statements outside of a sustainability context eg use of the term "impact" when using a heading such as "financial impact."

SDR labelled funds and products will be prohibited from using the term "impact" in their product name unless the product uses the Sustainability Impact label.

UK asset managers should review their fund and product names, marketing materials, client communications and customer disclosures to ensure compliance with the SDR rules. It will be important for managers to embed the new requirements in their product strategy development process, marketing material sign off procedures, and record retention. These rules will apply from 2 December 2024.



# Disclosure rules

The final rules reflect a tiered approach to disclosures, which is summarised in the table below. Unlike in the EU, there's no plan to introduce a standardised disclosure template at present. But the FCA has provided guidance on the scope, format, content, location, and frequency for each disclosure type. Firms should assess the merit of creating an industry disclosure template, adaptable to different sectors and asset classes.

Disclosure type			
<b>Consumer facing</b> – summaries of key information			
Scope	Location	Form	Review/frequency
<ul style="list-style-type: none"> <li>For all products with a label</li> <li>For products without a label but that use sustainability-related terms in their name or marketing (financial promotions)</li> </ul>	<ul style="list-style-type: none"> <li>Standalone document in prominent place on product webpage or app alongside other key investor information (eg investor portal)</li> </ul>	<ul style="list-style-type: none"> <li>No template</li> <li>Must be clear, concise and can be easily read and understood by consumers</li> <li>It must not exceed two A4 pages in length</li> </ul>	<ul style="list-style-type: none"> <li>Review and update at least annually</li> </ul>
<b>Pre-contractual</b> – more detailed information on the product			
Scope	Location	Form	Review/frequency
<ul style="list-style-type: none"> <li>For all products with a label</li> <li>For products without a label but that use sustainability-related terms in their name or marketing (financial promotions)</li> </ul>	<ul style="list-style-type: none"> <li>With other pre-contractual materials eg prospectus</li> <li>Must be in a prominent place</li> </ul>	<ul style="list-style-type: none"> <li>No template</li> <li>More detailed information than consumer facing disclosure</li> <li>Information should be clearly identifiable in pre-contractual disclosures eg in a dedicated section</li> </ul>	<ul style="list-style-type: none"> <li>Review before any change to a product and make updates to ensure disclosure accurately reflects the product</li> </ul>
<b>Ongoing product-level disclosure</b> – information on the progress of the product			
Scope	Location	Form	Review/frequency
<ul style="list-style-type: none"> <li>For all products with a label</li> <li>For products without a label but that use sustainability-related terms in their name or marketing (financial promotions)</li> </ul>	<ul style="list-style-type: none"> <li>In a prominent place on the manager's website</li> <li>Link to be included in communication that most closely follows annual reporting deadline</li> </ul>	<ul style="list-style-type: none"> <li>No template</li> <li>Can cross-refer to entity-level report or reports published under the UK Stewardship Code 2020</li> </ul>	<ul style="list-style-type: none"> <li>Report to be produced annually</li> </ul>
<b>Entity-level disclosures</b> – manager reporting in line with the TCFD pillars			
Scope	Location	Form	Review/frequency
<ul style="list-style-type: none"> <li>Asset managers with AUM above GBP5 billion</li> <li>Smaller firms encouraged to produce voluntary reports</li> </ul>	<ul style="list-style-type: none"> <li>Sustainability entity report</li> <li>In a prominent place on the manager's website</li> </ul>	<ul style="list-style-type: none"> <li>No template</li> </ul>	<ul style="list-style-type: none"> <li>Report to be produced annually</li> </ul>



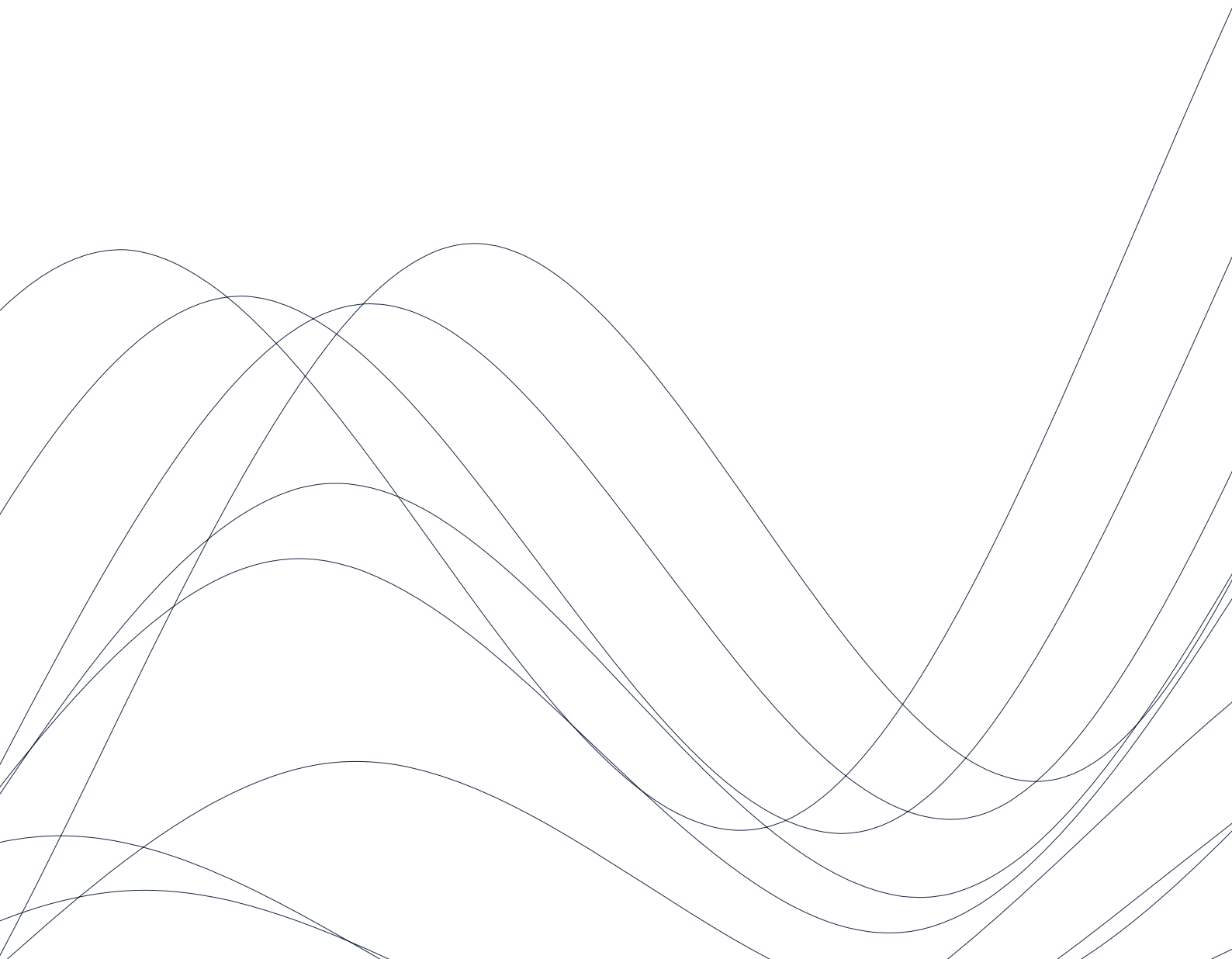
## Commentary

UK SDR has a heavy consumer focus that reflects the FCA's statutory objectives. If firms want to use a label, or include sustainability-related terms in their name or marketing materials, the consumer disclosure element is a requirement whether or not there's any prospect of actual distribution to consumers. Though this may feel burdensome, we think investment institutions and professionals will make use of the consumer disclosures in certain situations. Fulsome product-level disclosures can be lengthy and don't lend themselves to comparability between products. So, while this requirement increases the overall burden, we think (even where fund products will never be distributed to consumers) there's a place for both summary and detailed product information.

# Distributor rules

Distributors (including financial advisors and platforms) have to ensure labels and consumer-facing disclosures are made available to retail investors. They also have to include a notice on overseas products to clarify that they're not subject to the SDR.

The FCA is continuing to explore how to clarify its expectations of advisors. It's acknowledged that not all advisors feel comfortable talking to clients about sustainability. So it plans to establish a working group for the advice industry.



# Differences to the EU SFDR

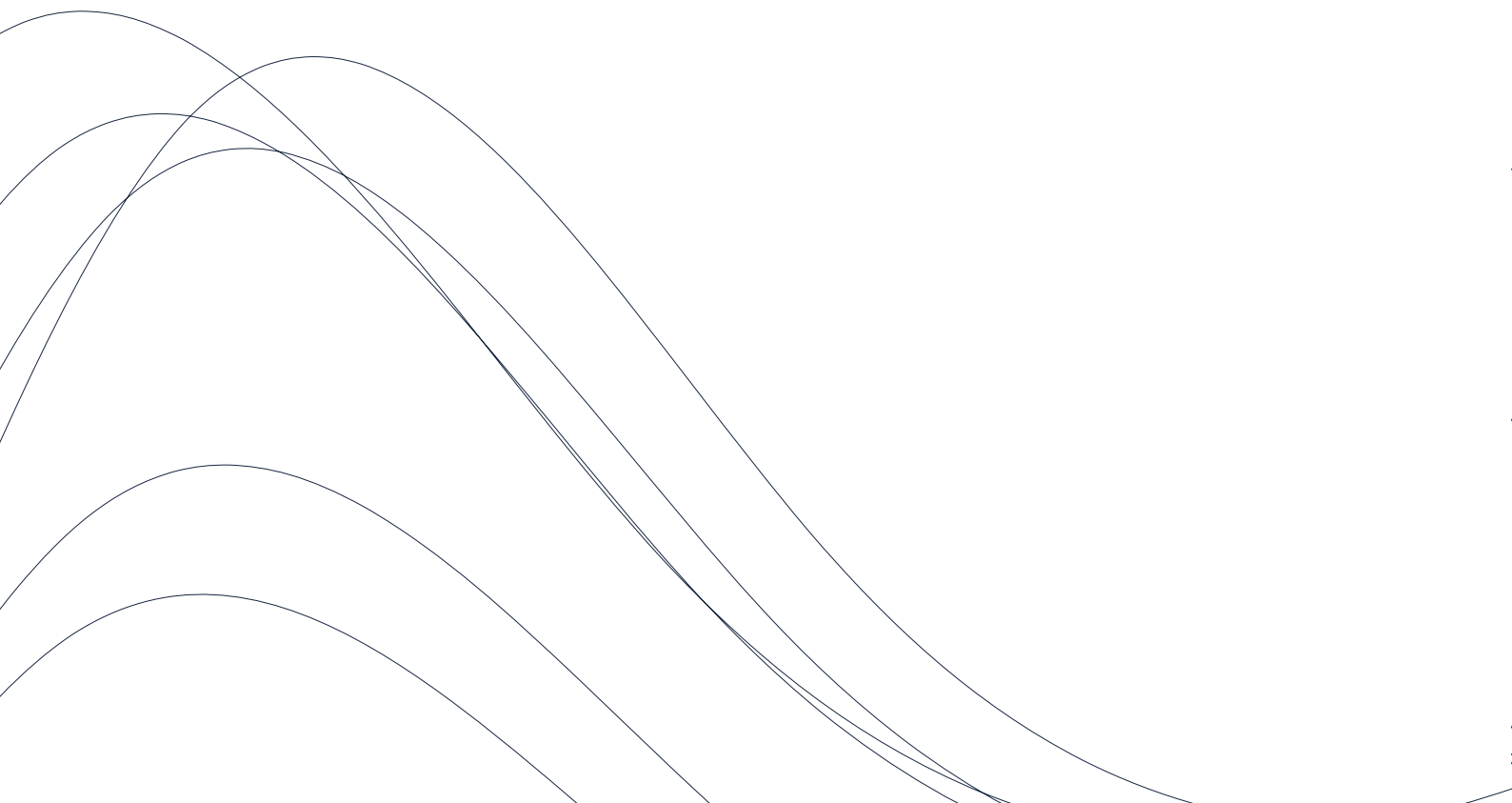
The FCA has stated that the SDR aims to be interoperable with international regimes and provides a mapping against the current EU SFDR. But the two regimes have significant differences and clearly reflect another area where the UK has diverged from the EU post-Brexit. That said, the EU SFDR is currently under consultation and it's possible the regime will evolve to be more similar to the UK regime (particularly due to the proposed introduction of investment labels and consumer-friendly disclosures).

At this time, key differences between the UK and EU regimes are:

- **Principal adverse impacts** – arguably the most challenging aspect of EU SFDR is the principal adverse impacts (PAI) regime. PAIs are the negative effects that both firms and their products have on sustainability. EU SFDR requires consideration and disclosure of PAIs in a prescriptive manner, resulting in an intensive data collection exercise. In the UK, the obligation appears to be more flexible and firms must determine (and disclose) whether any material negative environmental and/or social outcomes may arise in pursuing the sustainability objective.
- **Responsible business** – a baseline requirement for Article 8 and 9 EU SFDR products is that the investee companies follow good governance practices. In addition, “sustainable investments” have to show alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles of Business

and Human Rights. In our experience, this requirement has resulted in market participants implementing robust policies and due diligence procedures to ensure that investments are screened from a “responsible business” perspective. The UK SDR does not employ an analogous framework relating to the governance practices of investee companies.

- **Do no significant harm** – a key feature of the EU SFDR is the principle of “do no significant harm”. This effectively means that investments must be assessed to ensure that while trying to achieve a particular sustainability objective, they don't significantly harm any other sustainability objectives. The UK SDR contains an obligation to disclose any material negative sustainability outcomes (as above), but it doesn't include a requirement to not invest, or divest, if the investment has a material negative sustainability outcome. Again, this is arguably more flexible than the EU SFDR.
- **Taxonomy** – an additional feature of the EU SFDR is that it sits alongside the EU Taxonomy. The EU Taxonomy adds another layer of robustness and sets criteria for “environmentally sustainable economic activities”. Though the UK doesn't currently have its own taxonomy, development of the UK Taxonomy is under way, and the FCA notes that the UK SDR will likely need to be amended in the future to ensure that disclosures can reflect UK Taxonomy alignment, where appropriate.



# Conclusion

The publication of these rules is an important milestone for the UK and the asset management sector in particular. Clearly, the next six months are going to be crucial for UK asset managers in terms of preparing for the introduction of the new regime.

UK asset managers should start considering:

- which products are in-scope;
- which labels may be suitable (if any);
- what disclosures are required at the relevant product and entity level;
- what information (and information rights from counterparties) will be required to support and evidence the use of the labels and disclosures; and
- what changes have to be made to internal policies, procedures and controls.

All UK regulated firms will need to review their sustainability and marketing communications to ensure they don't fall foul of the AGR. Firms should expect FCA supervision and enforcement action in this space after the rules are implemented to send a clear message to the market.

Overseas sponsors or managers are not currently in scope, but it would be prudent for them to continue to monitor developments in the UK as it's likely at

least some elements of the UK regime will apply to overseas products marketed in the UK in the future. There may also be pressure from UK investors and other stakeholders to use the labels and comply with the broader disclosure requirements.

The FCA considers that asset managers using a label will have a one-off compliance cost of GBP351,000 on average and GBP217,000 every year after that. In our experience, putting in place a robust framework for compliance and operationalising that framework throughout an institution is a material cost and task. But this could be seen as modest when compared with the benefits associated with a robust and trusted regulatory regime for sustainability-oriented products and the costs and risks of non-compliance and greenwashing.

The FCA estimates that there's approximately GBP11 trillion AUM in the UK's asset management industry. UK SDR is a huge step towards a robust system allowing the market to scrutinise the deployment of that capital towards sustainability objectives. The ultimate success of the regime will be measured in part by uptake compared against EU SFDR where, according to Morningstar, around EUR5 trillion of assets now sit in Article 8 or Article 9 funds after just 30 months.

# Contacts



**Stuart Murdoch**  
**Partner**  
International lead – ESG for  
Investment Management & Funds  
Edinburgh  
+44 131 345 5199  
stuart.murdoch@dlapiper.com



**Karen Butler**  
**Partner**  
London  
+44 (0)207 796 6797  
karen.butler@dlapiper.com



**Katie O'Hara**  
**Senior Associate**  
London  
+44 (0)207 796 6103  
katie.ohara@dlapiper.com



**Erin Sculthorpe**  
**Associate**  
London  
+44 747 1113 835  
erin.sculthorpe@dlapiper.com



**Rory Milkova**  
**Associate**  
Edinburgh  
+44 131 345 51 80  
rory.milkova@dlapiper.com



**Alessio Marchetti**  
**Associate**  
London  
+44 (0)207 796 6239  
alessio.marchetti@dlapiper.com

