

PS23/16 - FCA PUBLISHES FINAL RULES ON SUSTAINABILITY DISCLOSURE REQUIREMENTS AND INVESTMENT LABELLING

Following its consultation [CP22/20](#) issued in October 2022 (see [our briefing](#) here), the FCA has finally published its [Policy Statement \(PS 23/16\)](#) setting out its final rules and guidance on sustainability disclosure requirements (SDR) and investment labelling for sustainable investment products. Feedback was extensive (more than 240 responses were received), with many respondents highlighting a myriad of practical challenges as well as lack of clarity with some of the initial proposals, resulting in a delay in publication of the final policy statement until now.

Under this regime, the FCA is introducing a comprehensive package of consumer-centric measures that encompass a general anti-greenwashing rule, a labelling regime for sustainable investment products and rules relating to consumer-facing, product and entity-level disclosures. All the elements of the package as proposed in the consultation have survived, albeit with some changes following feedback.

Scope and timeline

As proposed, the general anti-greenwashing rule (see below) will apply to all UK FCA-authorized firms.

The scope of the other measures broadly follows that which was set out in the consultation. However, one significant change is the removal of firms undertaking portfolio management from the scope of the regime for the moment. The consultation included criteria for discretionary strategies wishing to use a label but the difficulties arising from the fact that most portfolios are diversified and unlikely to invest only in UK funds with labels meant this was considered unworkable in practice.

In addition, the FCA is allowing feeder funds to use a label where the predominant purpose of the feeder fund is to reflect the sustainability objective of their in-scope master fund. The FCA also confirmed that listed investment trusts are in scope of the naming and marketing rules to the extent it is marketing its sustainability characteristics to retail clients.

Overseas funds and firms are outside the regime. Accordingly, funds marketed in the UK on a cross-border basis, for example, AIFs marketed by a non-UK AIFM

under the UK National Private Placement Regime, or EU funds marketed in the UK under the temporary marketing permissions regime, are *not* in scope. It also means that a non-UK fund market by a UK firm is not in scope, although entity-level disclosure requirements will still apply to that UK firm. As many asset managers operate global funds, the application of the regime to overseas funds is of much concern. It is not within the FCA's remit to extend the application of the rules to overseas funds. Nonetheless, recognising the importance of ensuring a level playing field between UK and overseas funds, the FCA is actively engaging with HM Treasury to consider the options to extend the scope of the regime.

Different elements of the regime will come into force in stages as set out in [Appendix 1: Timeline for implementation](#).

Anti-greenwashing rule and naming and marketing

Putting to one side the detailed final rules and qualifying criteria relating to the new investment labelling regime for sustainable investment products, a couple of measures will have the most immediate impact on regulated firms.

Anti-greenwashing rule: The FCA will be introducing the general anti-greenwashing rule (new ESG 4.3.1R) as proposed in the initial consultation requiring all FCA-authorized firms to ensure that all sustainability-related claims made about their financial products or services are fair, clear and not misleading and consistent with the sustainability profile of the product or service. As previously noted, existing rules already provide a 'fair, clear, and not misleading' standard and it is debatable whether the additional limb adds anything - although an explicit link between the rules and the sustainability profile of any product or service is probably helpful in providing FCA with a clear regulatory hook to establish liability for greenwashing. The general anti-greenwashing rule will form the foundation for the more specific naming and marketing rules.

Guidance

In response to feedback, the FCA is publishing draft [guidance \(GC23/3\)](#) setting out its expectations on this rule, which will be open for consultation until 26

January 2024. Any sustainability-related claim is expected to be “correct”, “capable of being substantiated”, “clear” and “complete”. Any comparisons to other products or services should be “fair and meaningful”. None of this is particularly surprising and the examples given in the guidance provide a useful steer on the FCA’s expectations - for example, what may be considered misleading (such as misleading use of images associated with green credentials) or how the FCA would require comparisons (such as a claim that a product is “UK’s greenest”) to be substantiated. All indication points to the FCA taking a robust approach in applying this rule to promotional material with sustainability claims.

The rule will come into force on **31 May 2024** to give some time for firms to address operational issues rather than immediately on publication of the policy statement as originally proposed.

Naming and marketing: In [CP22/20](#), the FCA proposed rules prohibiting asset management firms from using sustainability-related terms (such as “ESG”, “environmental”, “social”, “climate”, “green”, “impact”, “responsible”, or “sustainable”) in the naming and marketing of in-scope products made available to retail investors (products offered to institutional investors are not caught) if those products do not qualify for and use one of the proposed sustainable labels.

This was an area that received substantial feedback with concerns raised by many stakeholders that the proposals were too restrictive, limited consumer choice in products that do not qualify for a label, could stifle firms’ ability to adopt sustainability-related investment approaches and lead to “greenhushing”. The FCA is taking the rule forward but, in acknowledgement of the strength of the feedback, with amendments so that firms can continue to use sustainability-related terms in product names and in marketing provided certain conditions are met.

The FCA clearly attaches great importance to the name of a product and any continued use of sustainability-related terms in a product name comes with it additional obligations to produce further disclosures and a prominent statement that the product does not use a label and reasons why. Products using sustainability-related terms in their names must have sustainability characteristics - which should be “material” (i.e. constitute at least 70% of the product’s portfolio or assets). The words “sustainable”, “sustainability” and “impact” can only be used for products that qualify for a label. Despite industry pushback stating that passive funds need to be able to use the index provider’s product name (which may include a relevant sustainability-related term), the FCA is giving little quarter. Fund managers of index trackers will need to consider whether they should name their product after the index it tracks as they will still need to satisfy themselves that the index name meets the relevant requirements.

Additional disclosure requirements (requiring similar disclosures as where sustainability-related terms are used in product names, including a statement that the product does not use a label and reasons why) also apply where sustainability-related terms are used in marketing. The FCA has clarified that the rules only apply when referring to sustainability characteristics of a product and not in other contexts, nor do they apply when firms are making “short, factual, non-promotional” statements about a product.

Similar measures and guidelines relating to the naming and marketing of funds are being proposed both in the UK and the EU so there is undoubtedly a clear trajectory towards tightening the naming and marketing of funds that claim to have “sustainable” characteristics.

Notwithstanding that existing rules already require “fair, clear and not misleading” communications to clients and consumers, the introduction of a general anti-greenwashing rule brings into sharper focus the need for “green” claims to be properly vetted and substantiated; there is no room for marketing puff. Although the FCA has relaxed the naming and marketing rules from that in the initial proposal, they are still likely to pose a challenge for firms to implement. Even if the universe of funds that use sustainability-related terms in their names is limited, many firms potentially use or refer to these terms in their fund materials in order to fully describe how the fund operates. A fund that does not qualify for a label may nonetheless involve consideration of ESG matters in its investment approach or strategy which the asset manager may want to communicate to consumers. While the FCA is no longer proposing a complete prohibition on the use of sustainability-related terms, *any* use of such terms in marketing comes with it a whole set of additional disclosure obligations.

Labelling regime

The labelling regime is the centrepiece of the package. Four labels for sustainable investment products will be introduced under the new rules - **Sustainability Impact**, **Sustainability Focus**, **Sustainability Improvers** and **Sustainability Mixed Goals**.

Aimed squarely at the retail investor, products can only qualify for and use a label if they meet both **general** and **specific** criteria for each label. The general criteria applies to all products that intend to use a label and covers five themes: sustainability objective, investment policy and strategy, KPIs, resources and governance, and stewardship. It should be noted that for all products that intend to use a label, at least 70% of value of the product’s assets must be invested in line with the sustainability objective.

Label	Sustainable objective	Key features
Sustainability Focus	Invest in assets that are environmentally and/or socially sustainable determined using a robust evidence-based standard	The standard is required to be an absolute (not relative) measure of environmental and/or social sustainability.
Sustainability Improvers	Invest in assets that have the potential to <u>improve</u> environmental and/or social sustainability over time, determined by the potential of those assets to meet a robust, evidence-based standard (as above, this is required to be an absolute measure)	<p>Firms must:</p> <ul style="list-style-type: none"> obtain robust evidence that selected assets have the potential to improve environmental and/or social sustainability over time, determined by their potential to meet the relevant standard. 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. <p>Stewardship is key in this category. Firms' investor stewardship strategy should support delivery of the objective and help to accelerate improvements in sustainability over time.</p>
Sustainability Impact	Achieve a pre-defined, positive, measurable impact in relation to an environmental and/or social outcome	<p>Firms must specify:</p> <ul style="list-style-type: none"> a theory of change setting out how they expect their investment activities and the product's assets to achieve a positive impact. a robust method for measuring and demonstrating the positive impact of both the assets the product invests in and the firms' investment activities.
Sustainability Mixed Goals	Invest in 2 or more of the sustainability objectives (set out above)	Requirements for each of the other labels must be met. The proportion of assets invested in accordance with each of the other relevant labels must be identified and disclosed.

A few points on the rules:

- The labels can only be used by products that seek to achieve a positive sustainability outcome (what the FCA calls "intentionality"). In other words, just because ESG considerations are taken into account as part of a product's investment strategy is not sufficient for that product to qualify for a label.
- Firms are responsible for the classification of a product if they choose to use a label. While the FCA may review and challenge the labels that managers have applied as part of its fund authorisation process and will generally monitor and supervise the use of labels, it will not formally approve or endorse use of a particular label.
- The FCA has introduced a fourth label ("Sustainability Mixed Goals") to allow "blended" strategies following concerns that multi-asset products or products that have a combination of the attributes of the three other labels would not qualify for those labels.

- As noted in the consultation, there is no intended hierarchy between the labels - they simply represent different investment objectives and approaches. While concerns were raised that consumers may perceive a hierarchy (for example, that a "Focus" label is somehow 'better' than an "Improvers" label) the FCA has maintained that their research has shown consumers are likely to place their own hierarchies depending on their needs and preferences, rather than perceive a hierarchy based on the labels.
- The FCA has clarified that aspects of its description of the features of each label which seem to suggest a prescriptive approach to a firm's investment approaches and strategies are not intended as such. For example:
 - The FCA has clarified that the 'primary' and 'secondary' channels for investor contribution with respect to each label identified in the consultation are not prescribed rules.
 - The FCA's discussion on stewardship activities in its consultation appear to prescribe the form of stewardship and require firms to demonstrate a

causal link between their stewardship activities and outcomes. While the requirement that firms identify and apply their stewardship strategy remains, the FCA has removed terms that imply particular approaches and clarified its expectations on demonstrating any causal link.

- Similarly, the FCA is not prescribing any KPIs although it will require firms to specify a measurable objective and determine appropriate KPIs accordingly.

A simple and standardised labelling system coupled with a robust qualifying criteria ought to bring with it significant benefits in minimising greenwashing and building trust in the market for sustainable investment products. That should facilitate the development and growth of this market. Nonetheless, it will be interesting to see how the level of awareness and understanding of the different labels among consumers develops over time and whether that translates into increased demand for labelled products. That of course will inform firms' decisions on whether they offer such products given the increased compliance burden involved.

Disclosures

Consumer-facing disclosures

The FCA remains committed to having firms produce a standalone consumer-facing disclosure document despite some pushback. However, although initially proposed for all (i.e. both labelled and non-labelled) in-scope products, these are now required only for labelled products and for products that use sustainability-related terms in their naming and marketing. The standalone consumer-facing disclosures will need to be reviewed and updated every 12 months with progress towards the sustainability objective, where relevant.

The content requirements of such disclosures cover a number of categories. The FCA has done away with requiring an "unexpected investment" category, but the rules now require firms to disclose "any material negative environmental and/or social impacts" that may arise (or have arisen) in pursuing the sustainability objective of the relevant product (new ESG 5.2.2(5)(c)). This is the broad equivalent of the "principal adverse impacts" disclosure under the SFDR regime - although, unlike the SFDR, the rules do not provide any technical indicators that prescribe what such negative impacts may be. It will be left to firms to decide how to disclose against this requirement.

Other disclosures - detailed product and entity-level disclosures

With respect to other disclosure requirements, including the need for more detailed pre-contractual disclosures and sustainability product reports for labelled products and entity-level sustainability entity reports for all in-

scope asset managers, the requirements will be adopted broadly as proposed, subject to a few amendments. It should be noted that products that do not use a label but which have sustainability characteristics that are integral to their investment policy and strategy must also include disclosures of those features in their pre-contractual documents.

Some notable changes from the initial proposals include:

- **Pre-contractual disclosures:** In a change from the initial proposal, disclosures relating to investment policy and strategy need not be in a separate section. Pre-contractual documents in respect of labelled products also do not need to be updated annually although they must be updated as soon as reasonably practicable when revising or ceasing to use a label.
- **Entity-level disclosures:** For entity-level sustainability-related reports, although not a mandatory requirement, the FCA has added a provision stating that firms "should consider" disclosing their impact on the environment and/or society - which introduces an element of double materiality reporting.

Interaction with Consumer Duty

The FCA is quick to highlight that the rules under the regime is consistent with the Consumer Duty. Although not all firms are within scope of the Duty, firms are generally reminded to keep the aims of the Duty in mind. Where the Duty applies, there may be overlapping requirements - for example, with respect to disclosures for a sustainable investment product, firms will also need to ensure that the *consumer understanding outcome* under the Duty, requiring that disclosures equip retail investors with the information needed to make effective, timely and properly informed decisions, is met.

Distributors

Some industry commentators have noted that regulatory failings often happen at point of distribution. The new regime introduces various obligations on UK distributors, requiring them to ensure that any labels and consumer-facing disclosures relating to products that use a label or fall within the naming and marketing rules are made available to retail investors as soon as reasonably practicable after the asset manager produces them. Communication can be via 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 need alert investors to the fact that an overseas 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.

International Inter-operability

An issue of focus for many asset management firms will be the interoperability of the regime with other regimes, most notably the EU SFDR regime. The FCA has taken the effort to try to map the requirements of the UK SDR to EU SFDR to address respondents' concerns, given that many have made significant investment to ensure compliance with SFDR. In its consultation, the FCA had also tried to set out how Article 6, 8 and 9 funds under SFDR could map to the proposed labels. However, with the UK having decided to establish a labelling regime whilst the SFDR was conceived as a disclosure regime, there is no straightforward mapping of requirements. Interestingly, the European Commission has launched a [review](#) of the SFDR regime which may result in the establishment of product categories that are conceptually closer to the UK's labelling regime.

In relation to entity-level reporting, the final rules now expressly reference ISSB (S1), SASB and GRI standards as documents to consider when firms are considering the content of their disclosures. The disclosure requirements relating to firms' management of sustainability-related risks and opportunities follow the by now familiar TCFD (and ISSB's) 'four pillars' framework. It should be noted that while it is expected that the FCA will be consulting on the general application of ISSB standards to listed companies, those relate to corporate reporting (and will apply to an asset management firm insofar as it is a listed entity subject to the Listing Rules) and is separate from the SDR entity-level reporting requirements under this regime (aimed at clients and consumers) as they apply to FCA-authorized asset managers under the ESG Sourcebook.

As the Investment Association noted in its [response](#) to the consultation, issues of interoperability have significant real-world consequences for firms. Divergence of rules may result in fragmentation of funds with firms forced to establish separate funds for different jurisdictions, leading to higher costs for investors. Compliance costs associated with having to comply with multiple sets of rules and different systems and processes to capture overlapping but different sets of data requirements will also proliferate where the regimes are divergent.

Next steps

Consultation on guidance on the anti-greenwashing rule closes on 26 January 2024, after which we should expect final guidance to be published before the anti-greenwashing rule comes into effect on 31 May 2024. The FCA is also clear that it intends to expand and evolve the regime:

- **Overseas funds:** As noted, the FCA is engaging with HMT to consider the options for extending the regime to overseas funds, including those marketing under the Overseas Funds regime.

- **Portfolio management:** Although portfolio management is outside scope for the moment, the FCA will consult on proposals for portfolio management with a focus on portfolio management undertaken for UK retail clients in early 2024.
- **Pension products:** The FCA is considering extending the regime to pension products in the medium term.
- **Financial advisers:** Recognising the role that financial advisers play in supporting consumers, the FCA is proposing to set up an independent working group for financial advisers to build their sustainable finance capabilities.

More generally, the FCA will also be updating its disclosure requirements over time to take into account UK and international developments, including the TPT Disclosure Framework, the UK Green Taxonomy once in use, and any future ISSB standards.

Comment

The practical challenges arising from these new rules - in particular the naming and marketing rules as well as all the additional disclosure obligations - should not be underestimated. The regime will inevitably involve a more detailed and closer review of all product and services literature. Although the FCA has rowed back in some areas, there are many areas where the requirements remain highly prescriptive.

While regulatory intervention is much needed given the proliferation of products making "green" claims and the corresponding risk of exaggerated or overstated claims, the FCA has to walk a fine line between building trust in the market and not stifling innovation in product design and delivery and in ensuring the pendulum does not swing from greenwashing to greenhushing.

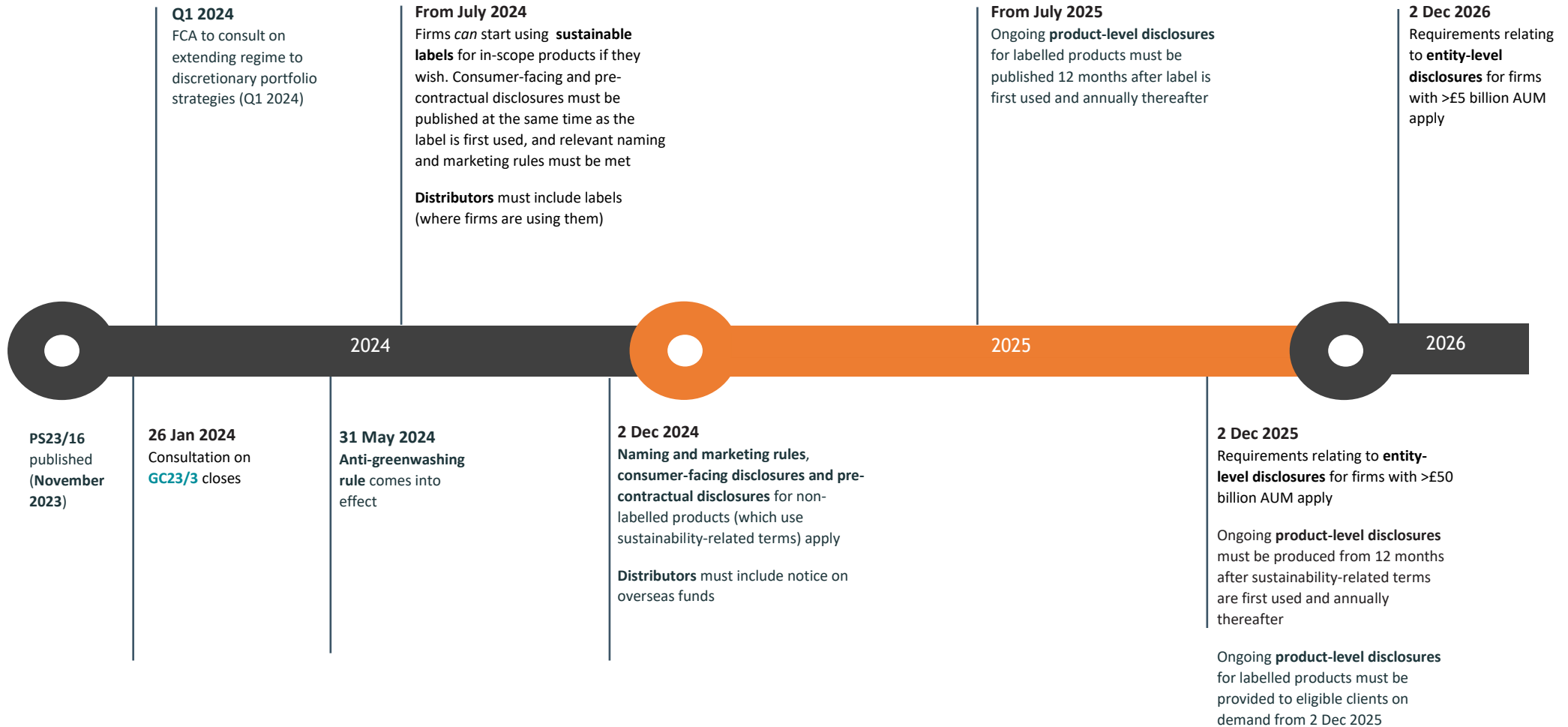
The FCA has conducted a more extensive cost-benefit analysis in the policy statement following mixed feedback on the initial analysis with many suggesting that the FCA has underestimated both the number of funds affected and size of costs. Overall, the FCA still maintains that their rules are "net beneficial" with the expected benefits arising from better consumer protection, standardised information, and better informed capital allocation likely to exceed the compliance costs over the "medium and long term". We will see whether that is borne out in practice when the FCA carries out its post-implementation review in three years' time.

// Our aim [with this regime] ... is simple - financial products that are marketed as sustainable should do as they claim and have the evidence to back it up. //

Foreword to PS23/16

APPENDIX 1

TIMELINE FOR IMPLEMENTATION



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