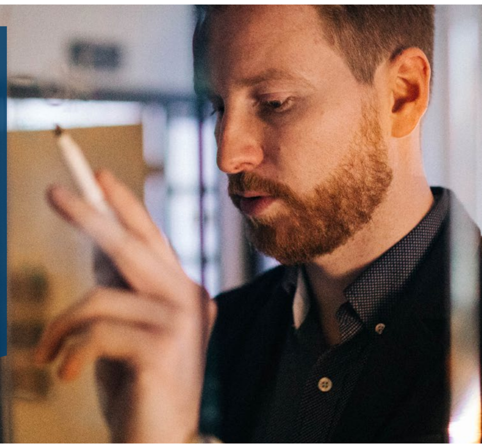
COLUMBIA THREADNEEDLE INVESTMENTS

Adviser Edge: Digging deeper

Sustainability Disclosure Requirements (SDR) and investment labels



On 28th November 2023, the FCA published its Policy Statement on Sustainability Disclosure Requirements (SDR) and investment labels (PS23/16). The Policy Statement introduces a package of measures, including a sustainable investment product labelling regime in the UK, which are relevant to all FCA regulated firms, but apply principally to UK authorised asset managers. This follows on from, and builds on, the Consultation Paper (CP22/20) of the same name published October 2022.

The Policy Statement sets out the FCA's 'final rules and guidance to improve trust and transparency to the market for sustainable investment products,' aimed at reducing greenwashing and other associated harms. This includes:

- **Four sustainability labels** – to help consumers navigate the product landscape and enhance trust
- **An anti-greenwashing rule** – to ensure claims are fair, clear, and not misleading
- **Naming and marketing rules** – to ensure the use of sustainability-related terms is accurate
- **Consumer-facing information** – to make it easy to understand sustainability product features
- **Detailed information** – to support all investors seeking more detail
- **Requirements for distributors** (including Financial Advisers) – to ensure product information is available to consumers

The final rules apply to UK UCITS managers and UK AIFMs, with the exception of the anti-greenwashing rule which applies to all FCA authorised firms and the requirements for distributors set out below.

Requirements for Distributors (Financial Advisers)

The Policy Statement cross refers to the FCA's Consumer Duty and indicates that Financial Advisers (referred to as Distributors) play a key role in communicating sustainability information to retail investors.

The key requirement for Financial Advisers is to communicate the SDR label and ensure that the consumer-facing disclosures are made available (both for labelled and unlabelled funds) to retail investors.

This may be done by displaying the label prominently on the relevant digital medium (e.g., product webpage), and by providing access to the consumer-facing disclosures, or otherwise communicating them via their own usual channels of communication (letters of recommendation).

The Financial Adviser must also ensure the labels and disclosures are kept up to date in accordance with any changes to the fund and also notify retail investors that overseas products are not subject to the UK labelling and disclosure requirements.

In addition, the FCA has stated that it will continue to explore how to clarify its expectations for Financial Advisers around taking sustainability matters into account in investment advice and product suitability. They have set up an industry working group to discuss the issue in 2024.

Sacha Sadan, the FCA's Director of Environment, Social and Governance, on SDR.

"We're putting in place a simple, easy to understand regime so investors can judge whether funds meet their investment needs – this is a crucial step for consumer protection as sustainable investment grows in popularity."

"By improving trust in the sustainable investment market, the UK will be able to maintain its position at the forefront of sustainable finance and capture the benefits of being a leading international centre of investment."

Sustainability investment labels – Fund labelling regime

The FCA has introduced a consumer-focussed labelling regime that will give retail investors the confidence to choose the right products for them, together with supporting disclosure requirements.

The labelling regime distinguishes between 4 types of sustainable investment funds:

- **'Sustainability Impact'** – funds with an objective to achieve a pre-defined positive measurable impact for an environmental and/or social outcome and invest at least 70% of their assets in accordance with that aim.
- **'Sustainability Focus'** – funds with an objective to invest at least 70% in environmentally and/or socially sustainable assets.
- **'Sustainability Improvers'** – funds with an objective to invest at least 70% in assets with the potential to improve environmental and/or social sustainability over time (even if they are not sustainable now).
- **'Sustainability Mixed Goals'** – funds with an objective to invest at least 70% in accordance with a combination of the sustainability objectives of the other labels, with the requirements for each relevant label being met.

The use of the labels is voluntary and funds with sustainable characteristics that meet the qualifying criteria for a label do not need to opt for a label, but still need to produce the same sustainability disclosures as labelled funds.

The 4 labels are not hierarchical, with the Policy Statement setting out the general criteria that is required for a fund to qualify for a label, together with specific label qualifying criteria requirements.

Naming and marketing rules

The naming and marketing rules in the Policy Statement regulate the use of sustainability-related terms used in the names or marketing of retail funds only.

The FCA has made a significant amendment to the initial proposals in CP22/20, allowing asset managers to promote non-labelled funds with sustainability characteristics subject to certain restrictions. The amendment allows non-labelled funds to use terms such as "green", "net-zero", "climate", "responsible", amongst others, when marketing the fund, however these funds will still be subject to the anti-greenwashing rule and the same disclosure requirements as labelled funds. The consumer-facing disclosures must clearly state how the fund is invested and why it does not use a label.

In addition, it continues to be the case that a fund is not permitted to use the term "Sustainable", "Sustainability" (or any variation of those terms) or "Impact" in its name if it does not use a label but may use other sustainability-related terms if at least 70% of the fund's assets have sustainability characteristics that accurately reflect the name.

The FCA stated that, "investment strategies such as exclusion or negative screens, ESG integration or basic ESG tilts alone would not be enough to qualify for a label".

Anti-Greenwashing rule

The FCA has introduced an anti-greenwashing rule (ESG 4.3.1R) which is applicable to all FCA regulated firms that make sustainability-related claims about financial products and services to UK investors. This reinforces that sustainability-related claims must be "fair, clear, and not misleading" and consistent with the sustainability characteristics of the product or service.

The new rule is also supported by GC23/3: Guidance on the anti-greenwashing rule, with a consultation period on the guidance ending 26th January 2024 and rules coming into force on 31st May 2024.

Index-tracking products

The Policy Statement confirms that the labels were designed to accommodate both active and passive strategies. When constructing a passive product with the intention of using a sustainability label, asset managers should ensure that the chosen index aligns with the sustainability objective for their product and that it meets the qualifying criteria.

Within the pre-contractual disclosures, it must be confirmed how the index providers' methodology aligns with the product's sustainability objective.

Out of scope products

The initial consultation included discretionary portfolios within the definition of a "sustainability product" and included distinct criteria for discretionary strategies wishing to use a label. However, the FCA has taken the decision to delay introducing rules in respect of 'portfolio management' and instead will consult on this in 'early 2024'.

Overseas recognised schemes are also currently out of scope, with the FCA indicating that it is working with HM Treasury in exploring ways to extend the regime to cover these schemes.

The FCA has indicated that work is continuing on proposals for other investment products, including pensions and insurance-based products, with the Department for Work and Pension and The Pensions Regulator, but these are not expected imminently.

Product Level Disclosures

The Policy Statement confirmed that disclosure requirements are to be designed to ensure that accessible information is provided to retail investors, for funds with a label or funds without a label which use sustainability-related terms.

Consumer-facing disclosure
The consumer-facing disclosure will be required to summarise a fund's key sustainability-related features to support the retail investor understanding and assist comparisons between products.

Having been in scope under previous proposals, products not using sustainability- related terms are now excluded from this requirement.

The aim of this disclosure is to provide key, standardised sustainability information for retail investors to make investment decisions. The disclosure should be contained in a standalone document, that is concise, easily read and no more than 2 pages of A4, if printed.

As with all aspects of SDR, the disclosure document should be compliant with Consumer Duty, particularly the Consumer Understanding outcome.

Pre contractual disclosures
These disclosures aim to provide more detailed sustainability information (e.g. in a fund prospectus) than that contained in the consumer-facing disclosure. These are intended for retail investors who want more information, or (if relevant) for institutional investors.

Ongoing product-level disclosures
These disclosures must be published 12 months after a label is first used or from when the sustainability-related terms are first used (for products without a label), and annually thereafter. These disclosures will provide investors with detailed information relating to the fund's investment policy and strategy and any relevant metrics.

Entity-Level disclosures
A sustainability entity report will be required setting out how the firm is managing sustainability related risks and opportunities at an entity level. From 2nd December 2025 these annual disclosures are mandatory for all asset managers with assets under management (AUM) of over £50bn and mandatory for all asset managers with assets over £5bn AUM from 2nd December 2026.

"The FCA want firms to deliver good outcomes for their customers, making sure that people get the right information, at the right time in a way that they can understand so they can make effective decisions."

Compliance with SDR

The FCA has confirmed that it will apply its usual supervisory and enforcement approaches to the regime, which will include responding to any compliance issues and acting on intelligence indicating non-compliance. In cases of serious misconduct, the FCA has indicated that it may take enforcement action.

Timetable

- 31st May 2024 – Anti-greenwashing rule and guidance comes into force.
- 31st July 2024 – Firms can begin to use labels, with accompanying disclosures.
- 2nd December 2024 – Naming and marketing rules come into force, with accompanying disclosures for non-labelled products with sustainability-related terms used in naming or marketing.
- 2nd December 2025 – Ongoing product-level disclosures, and entity-level disclosures for firms with assets under management of over £50bn.
- 2nd December 2026 – Entity-level disclosure rules extended to firms with assets under management of over £5bn.

For More information and further reading:

- Policy Statement – Sustainability Disclosure Requirements (SDR) and investment labels (PS23/16)
- Consultation Paper – Sustainability Disclosure Requirements (SDR) and investment labels (CP22/20)
- Guidance Consultation on Anti-Greenwashing – GC23/3: Guidance on the anti-greenwashing rule | FCA
- Policy Statement – New Consumer Duty (PS22/9)
- Identifying sustainable investments – Identifying sustainable investments | FCA

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