

**MEMO# 34346**

November 10, 2022

# **UK FCA Proposes Sustainability Disclosure Requirements (SDR) and investment labels for funds**

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TO: ICI Members

ICI Global Members

ESG Advisory Group

ESG Task Force

Global Regulated Funds Committee SUBJECTS: Disclosure

ESG

International/Global RE: UK FCA Proposes Sustainability Disclosure Requirements (SDR) and investment labels for funds

On 25 October, the UK Financial Conduct Authority (FCA) issued a [Consultation Paper on Sustainability Disclosure Requirements \(SDR\) and Investment Labels.\[1\]](#) Comments on the proposal are due on 25 January 2023. The proposal notes that the FCA intends to issue final rules by the end of the first half of 2023.

WHAT

WHY

WHO

WHEN

Sustainable investment labels

To help consumers navigate the investment product landscape and enhance consumer trust

Labels are voluntary, designed for retail products but may be used for institutional

12 months after publication of the Policy Statement (provisionally, from 30 June 2024)

Consumer facing disclosures

To help consumers understand the key sustainability-related features of a product

Mandatory for all products marketed to retail investors, regardless of sustainability characteristics or label

12 months after publication of the Policy Statement (provisionally, from 30 June 2024)

Detailed disclosures:

Pre-contractual disclosures

To standardize disclosures of sustainability-related features of investment products, in the fund prospectus

Mandatory for retail products using labels, and those without labels that have sustainability-related strategies (incl. ESG integration)

12 months after publication of the Policy Statement (provisionally, from 30 June 2024)

Detailed disclosures:

Sustainability product-level report

To require sustainability related performance information including KPIs and metrics

Mandatory for retail products using labels

Must be published 24 months after publication of the Policy Statement (provisionally, from 30 June 2025)

Detailed disclosures:

Sustainability entity report

To standardize disclosures on how firms are managing sustainability-related risks and opportunities

Mandatory for all in-scope firms (fund managers) with more than £5 billion AUM, regardless of use of labels

Staggered implementation, largest firms producing first reports 24 months after publication of the Policy Statement (provisionally, from 30 June 2025)

General 'anti greenwashing' rule

To reiterate existing rules to clarify that sustainability-related claims must be clear, fair and not misleading

Applies to all FCA-regulated firms

Effective immediately on the publication of the Policy Statement (provisionally, from 30 June 2023)

Naming and marketing rules

To restrict the use of certain sustainability-related terms in product names and marketing materials unless the product uses a sustainable investment label

Applies to all products; use of labels determines whether terms restricted

12 months after publication of the Policy Statement (provisionally, from 30 June 2024)

Requirements for distributors

To ensure that product-level information (including the labels) is made available to consumers

Applies to distributors of in-scope investment products to retail investors in UK

12 months after publication of the Policy Statement (provisionally, from 30 June 2024)

## **1. Background: Overall UK Sustainability Disclosure Framework**

With this proposal, the FCA is taking another step toward fulfilling the broader UK government plan for economy-wide Sustainability Disclosure Requirements (SDR), first announced in October 2021.<sup>[2]</sup> In December 2021, the FCA finalized the first components of this plan - TCFD reporting for issuers,<sup>[3]</sup> asset managers, life insurers, and FCA-regulated pension providers.<sup>[4]</sup> Those TCFD-aligned entity- and product-level disclosure requirements for asset managers provide a foundation for the additional layer of consumer-oriented disclosure included in this proposal, as well as the proposed product labels.

## **2. Sustainable Investment Labels**

In its proposal, the FCA has elected to create sustainability categories only for those products that have what it considers to be "intentionality," meaning those that "can plausibly contribute to positive sustainability outcomes."<sup>[5]</sup> Products without a sustainability objective<sup>[6]</sup> will not qualify for a sustainability label, even if the product has a sustainability-related strategy.<sup>[7]</sup>

The use of the mutually exclusive labels is voluntary, but to use these labels, funds must meet:

- Five overarching principles, or general criteria, covering (1) sustainability objective; (2) investment policy and strategy; (3) KPIs; (4) resources and governance; and (5) investor stewardship;<sup>[8]</sup>
- Several cross-cutting criteria;<sup>[9]</sup> and
- Category-specific criteria relevant to the particular label.<sup>[10]</sup>

The labels are meant to be used for investment products offered to retail investors, but the proposal indicates that the labels may also be used for products offered to institutional investors. Products without these labels must still meet the naming and marketing rules (see Section 4 below).

**Sustainable focus:** The primary channel used to achieve the sustainability outcome is influencing asset prices. These products have an objective to maintain a high standard of sustainability in the profile of assets by investing to (i) meet a credible standard of environmental and/or social sustainability; or (ii) align with a specified environmental and/or social sustainability theme. Using the market-led channel of influencing asset prices will

reduce the relative cost of capital of sustainable economic activities/projects. They may also pursue improvements in sustainability performance of assets through stewardship activities as a secondary channel. At least 70% of the product's assets must meet a credible standard of environmental and/or social sustainability. The FCA is not setting a strict definition of what constitutes sustainability; however, the proposal stipulates that a credible standard is one that is robust, independently assessed, evidence-based, and transparent.

**Sustainable improvers:** The primary channel used to achieve the sustainability outcome is stewardship and engagement. These products have an objective to deliver measurable improvements in the sustainability profile of assets over time. They are invested in assets that, while not currently environmentally or socially sustainable, are selected for their potential to become more environmentally and/or socially sustainable over time, including in response to the stewardship influence of the firm. The primary channel of these products would be stewardship, with a secondary channel being asset selection and influencing cost of capital.

**Sustainable impact:** The primary channel used to achieve the sustainability outcome is directing capital to solutions to environmental and social problems. These products have an explicit objective to achieve a positive, measurable contribution to sustainable outcomes. This category of product would pursue its sustainability goals by directing typically new capital to projects and activities that offer solutions to environmental or social problems, often in underserved markets, or to address observed market failures. They would be expected to have a stated theory of change, and to pursue a highly selective asset selection strategy aligned with that theory of change. Stewardship would be a secondary channel for these products.

The FCA will monitor use of the sustainable investment labels by firms to assess whether they are meeting the criteria, and assess the usefulness of labels through consumer outreach.

### **3. Disclosures**

#### **A. Consumer Facing Disclosures**

The FCA is proposing a new, standalone document that it believes will ensure consumers have sufficient information on the sustainability-related feature of investment products to assess whether the products meet their needs and preferences. All in-scope firms must produce the document for all in-scope products, though the FCA acknowledges that if a product does not have a sustainability-related strategy, the disclosures will be limited.

The document must be made available in a prominent place on the relevant digital medium (e.g., the main product webpage or page on a mobile application). For products that qualify for a sustainability label, the consumer-facing disclosure should be no more than 'one mouse click away' from where the label is presented (e.g., a hyperlink next to or underneath the label).

What about the KID? Where sustainability-related features are integral to an investment product, the FCA expects that firms are already making these relevant disclosures in the Packaged retail investment and insurance-based products (PRIIPs) Key Information Document (KID). For this reason, the FCA is not proposing any changes or additional disclosures to be made in the KID. However, the FCA is proposing that the new consumer-facing disclosures be made alongside documents that present other key investor

information, like the KID.

Content of the consumer-facing disclosures document:

- Basic information;
- Product label;
- Sustainability goal;
- Sustainability approach;
- Unexpected investments;
- Sustainability metrics, and
- Signposting to other disclosures.

There is no template for the document at this time. In its proposal, the FCA encourages the development a market-led template.

#### B. Detailed disclosures: Pre-contractual disclosures ('Part A')

Two types of products would need to make the proposed pre-contractual disclosures: (i) all products using a sustainable investment label; and (ii) products that do not qualify for a label but which have sustainability-related features that are integral to their investment policy and strategy. At this stage, the only pre-contractual materials in scope of the FCA proposals are the 'fund prospectus' and prior disclosure document required under FUND 3.2 for full scope UK AIFMs.

Content of pre-contractual disclosures:

- Principle 1 - investment objective;
- Principle 2 - investment policy and strategy;
- Principle 5 - stewardship; and
- Category-specific criteria for products with 'Sustainable Improvers' and 'Sustainable Impact' labels.

#### C. Detailed disclosures: Sustainability product report ('Part B')

The sustainability product report will only be required for products that qualify for a sustainable investment label. The sustainability product report would build from the existing TCFD product report, enabling consumers to assess the ongoing performance and progress of these products towards meeting their stated objectives. Like the TCFD product report, the sustainability product report would need to be published in a prominent place on the firm's main website.

Content of sustainability product report disclosures:

- Principle 2 - investment policy and strategy;
- Principle 3 - KPIs;
- Principle 5 - stewardship (if stewardship plays a significant role in the product's investment policy and strategy);
- Category-specific criteria for all three sustainability labels; and
- Any other metrics a consumer might find useful, among other contextual information.

The FCA does not propose a baseline of sustainability-related metrics, but notes that in time these will be added to the required contents of the sustainability product report.

Firms that decide to use a label for products for which public disclosures are not

appropriate must make the sustainability product reports available upon client request, once per year.<sup>[11]</sup>

#### D. Detailed disclosures: Sustainability entity report

The FCA notes that information on how firms are managing sustainability risks and opportunities can enable clients and consumers to take sustainability matters into account when granting mandates or selecting firms. The FCA also believes producing these reports will benefit the disclosing firms by encouraging more structured dialogue on, and analysis of, sustainability-related matters across the organization.

All 'in-scope firms'<sup>[12]</sup> would be required to produce sustainability entity reports. The sustainability entity report would build on the existing TCFD entity-level disclosure requirements, similar to how the sustainability product report would build upon the existing TCFD product report. The sustainability entity report would be published in a prominent place on the firm's main website, and either incorporate disclosures required under the TCFD rules or include a hyperlink to the TCFD entity report. The FCA proposes to retain the flexible approach taken to the TCFD entity report, whereby firms are able to cross-refer to sustainability-related disclosures made in a group, affiliate or third-party (e.g., a delegated asset manager's) sustainability report.

Content of sustainability entity report:

- Extends disclosure requirements of the TCFD report's four pillars on climate-related disclosures - governance, strategy, risk management and metrics and targets - to sustainability-related risks and opportunities; and
- Principle 4 - governance and resources (for firms with products using sustainable investing labels).

## 4. Naming and Marketing

The FCA is concerned that products that do not qualify for a sustainable investing label will continue to name or market themselves in a way that may suggest they are sustainable, thus confusing consumers and compromising the effectiveness of the labels.

#### A. General anti-greenwashing rule

To address this concern, the FCA proposes an anti-greenwashing rule, which would require all regulated firms to ensure that the naming and marketing of financial products and services in the UK are clear, fair and not misleading, and consistent with the sustainability profile of the product or service (i.e., proportionate and not exaggerated). The rule applies to all FCA-regulated firms and will be in effect upon publication of the final Policy Statement (expected by end of first half of 2023).

#### B. Product names and marketing materials

The FCA proposes prohibiting firms providing in-scope products to retail investors that do not qualify for and use one of the sustainable labels from using sustainability-related terms including (but not limited to) 'ESG' (or 'environmental', 'social' or 'governance'), 'climate', 'impact', 'sustainable' or 'sustainability', 'responsible', 'green', 'SDG' (sustainable development goals), 'Paris-aligned' or 'net zero' in their product names and marketing. Additionally, products using 'Sustainable Focus' or 'Sustainable Improvers' labels would be prohibited from using the term 'impact' in the naming and marketing of these products.

The naming and marketing rules would only apply to products that are made available to retail investors in the UK. Products offered to institutional investors are not in scope, though the proposal may raise questions about what the FCA would view as 'greenwashing' in marketing materials for institutional clients.

The proposal may also raise questions about a firm's use of ESG- or sustainability-related terms in mandatory disclosure documents. The proposal notes that where firms adopt sustainability-related investment policies and strategies that are integral to their investment policy and strategy, firms should describe these factually and in a proportionate way in their pre-contractual disclosures. So, the proposal explains, prohibition on including sustainability-related terminology would not apply for the purposes of disclosing factual information in the pre-contractual disclosures, the summary of information in consumer-facing disclosures, and any other disclosure requirements a firm may be subject to.

## **5. Rules for Distributors**

Where in-scope products are offered to retail investors and have a sustainable investment label, the FCA proposes that distributors must display the label prominently on a relevant digital medium (e.g., product webpage, page on a mobile application or other medium) and provide access to the accompanying consumer-facing disclosures. Distributors must also use labels consistent with the labels assigned by the fund manager, and keep website and marketing materials updated with any changes a firm may make to labels and disclosures. For products that do not use a label, distributors would be required to provide retail investors with access to the consumer-facing disclosure.

The FCA intends to follow with a separate consultation in the future on how the rules for distributors would apply to overseas products offered in the UK. To address the gap this may leave in the meantime for overseas products, the FCA proposes a temporary approach. Where prohibited sustainability-related terms (see Section 4(B), above) are used in relation to the naming and marketing of overseas products (e.g., recognized ETFs), distributors of those products to retail investors must place a notice on that product, alerting retail investors that: "This product is based overseas and is not subject to FCA sustainable investment labelling and disclosure requirements".

## **6. International Coherence**

Annex 1 to the proposal provides a comparison of the FCA's proposed classification and labelling regime to product classifications in the EU SFDR and the US SEC's proposals. The FCA acknowledges that while they believe they have proposed a regime that is "compatible" with the EU and US, the FCA rules are based on a distinct policy rationale - to help consumers identify sustainable products. The EU and US rules, however, are based on a rationale of classification for the purpose of determining disclosure requirements. The EU and US regulators have yet to make the type of judgement calls that the FCA is doing in this proposal (re: which products are 'sustainable').

Notably, the FCA does not propose requirements that mirror the SFDR's 'Do No Significant Harm' approach, i.e., disclosures on how a sustainable investment does not significantly harm the sustainability objective, as the FCA considers this approach to be too restrictive at this stage.

## **7. Consultation Questions**

Q1: Do you agree with the proposed scope of firms, products and distributors under our regime? If not, what alternative scope would you prefer, and why?

Q2: Do you agree with the proposed implementation timeline? If not, what alternative timeline would you prefer, and why?

Q3: Do you agree with the proposed cost-benefit analysis set out in Annex 2. If not, we welcome feedback in relation to the one-off and ongoing costs you expect to incur and the potential benefits you envisage.

Q4: Do you agree with our characterisation of what constitutes a sustainable investment, and our description of the channels by which positive sustainability outcomes may be pursued? If not, what alternatives do you suggest and why?

Q5: Do you agree with the proposed approach to the labelling and classification of sustainable investment products, in particular the emphasis on intentionality? If not, what alternatives do you suggest and why?

Q6: Do you agree with the proposed distinguishing features, and likely product profiles and strategies, for each category? If not, what alternatives do you suggest and why? In particular, we welcome your views on:

- a) Sustainable Focus: whether at least 70% of a 'sustainable focus' product's assets must meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme?
- b) Sustainable Improvers: the extent to which investor stewardship should be a key feature; and whether you consider the distinction between Sustainable Improvers and Sustainable Impact to be sufficiently clear?
- c) Sustainable Impact: whether 'impact' is the right term for this category or whether should we consider others such as 'solutions'; and the extent to which financial additionality should be a key feature?

Q7: Do you agree with our proposal to only introduce labels for sustainable investment products (i.e., to not require a label for 'non-sustainable' investment products)? If not, what alternative do you suggest and why?

Q8: Do you agree with our proposed qualifying criteria? If not, what alternatives do you suggest and why? In your response, please consider:

- whether the criteria strike the right balance between principles and prescription • the different components to the criteria (including the implementing guidance in Appendix 2
- whether they sufficiently delineate the different label categories, and;
- whether terms such as 'assets' are understood in this context?

Q9: Do you agree with the category-specific criteria for:

- The 'Sustainable focus' category, including the 70% threshold?
- The 'Sustainable improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?
- The 'Sustainable impact' category, including expectations around the measurement of the product's environmental or social impact? Please consider whether there any other important aspects that we should consider adding.



Q10: Does our approach to firm requirements around categorisation and displaying labels, including not requiring independent verification at this stage, seem appropriate? If not, what alternative do you suggest and why?

Q11: Do you agree with our proposed approach to disclosures, including the tiered structure and the division of information to be disclosed in the consumer-facing and detailed disclosures as set out in Figure 7?

Q12: Do you agree with our proposal to build from our TCFD-aligned disclosure rules in the first instance, evolving the disclosure requirements over time in line with the development of future ISSB standards?

Q13: Do you agree with our proposals for consumer-facing disclosures, including location, scope, content and frequency of disclosure and updates? If not, what alternatives do you suggest and why?

Q14: Do you agree with the proposal that we should not mandate use of a template at this stage, but that industry may develop one if useful? If not, what alternative do you suggest and why?

Q15: Do you agree with our proposals for pre-contractual disclosures? If not, what alternatives do you suggest and why. Please comment specifically on the scope, format, location, content and frequency of disclosure and updates.

Q16: Do you agree with our proposals for ongoing sustainability-related performance disclosures in the sustainability product report? If not, what alternative do you suggest and why? In your response, please comment on our proposed scope, location, format, content and frequency of disclosure updates.

Q17: Do you agree with our proposals for an 'on demand' regime, including the types of products that would be subject to this regime? If not, what alternative do you suggest and why?

Q18: Do you agree with our proposals for sustainability entity report disclosures? If not, what alternatives do you suggest and why? In your response, please comment on our proposed scope, location, format, content, frequency of disclosures and updates.

Q19: Do you agree with how our proposals reflect the ISSB's standards, including referencing UK-adopted IFRS S1 in our Handbook Guidance once finalised? If not, please explain why?

Q20: Do you agree with our proposed general 'anti-greenwashing' rule? If not, what alternative do you suggest and why?

Q21: Do you agree with our proposed product naming rule and prohibited terms we have identified? If not, what alternative do you suggest and why?

Q22: Do you agree with the proposed marketing rule? If not, what alternative do you suggest and why?

Q23: Are there additional approaches to marketing not covered by our proposals that could lead to greenwashing if unaddressed?

Q24: Do you agree with our proposals for distributors? If not, what alternatives do you suggest and why?

Q25: What are your views on how labels should be applied to pension products? What would be an appropriate threshold for the overarching product to qualify for a label and why? How should we treat changes in the composition of the product over time?

Q26: Do you consider the proposed naming and marketing rules set out in Chapter 6 to be appropriate for pension products (subject to a potentially lower threshold of constituent funds qualifying for a label). If not, why? What would be an appropriate threshold for the naming and marketing exemption to apply?

Q27: Are there challenges or practical considerations that we should take into account in developing a coherent regime for pension products, irrespective of whether they are offered by providers subject to our or DWP's requirements?

Q28: To what extent would the disclosures outlined in Chapter 5 be appropriate for pension providers ie do you foresee any challenges or concerns in making consumer-facing disclosures, pre-contractual disclosures and building from the TCFD product and entity-level reports?

Q29: Do you agree that the approach under our TCFD-aligned product-level disclosure rules should not apply to products qualifying for a sustainable investment label and accompanying disclosures? Would it be appropriate to introduce this approach for disclosure of a baseline of sustainability-related metrics for all products in time?

Q30: What other considerations or practical challenges should we take into account when expanding the labelling and disclosures regime to pension products?

Q31: Would the proposals set out in Chapters 4-7 of this CP be appropriate for other investment products marketed to retail investors such as IBIPs and ETPs. In your response, please include the type of product, challenges with the proposals, and suggest an alternative approach.

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## Notes

[1] The FCA Consultation Paper (CP22/20) is available at <https://www.fca.org.uk/publication/consultation/cp22-20.pdf>.

[2] See Greening Finance: A Roadmap to Sustainable Investing, October 2021, available at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1026224/CCS0821102722-006\\_Green\\_Finance\\_Paper\\_2021\\_v5\\_Bookmarked\\_48PP.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1026224/CCS0821102722-006_Green_Finance_Paper_2021_v5_Bookmarked_48PP.pdf). Also See ICI Global Memorandum [33892], dated 10 November 2021, available

at <https://www.ici.org/memo33892>.

[3] See Policy Statement PS21/23 Enhancing climate-related disclosures by standard listed companies, December 2021, available at <https://www.fca.org.uk/publication/policy/ps21-23.pdf>.

[4] See Policy Statement PS21/24 Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers, December 2021, available at <https://www.fca.org.uk/publication/policy/ps21-24.pdf> ("PS21/24"). For a summary of the requirements for asset managers and investment products, see ICI Global Memorandum [34052], available at <https://www.ici.org/memo34052>.

[5] "The outcomes that any investment can achieve for the environment and/or society will reflect both: the enterprise contribution of underlying assets - i.e., the outcomes contributed by the issuer of the asset, independently of actions by the investor; and the investor's contribution - i.e., the additional outcomes that can be attributed to the actions taken by the investor in respect of its assets. Both layers are critical. However, currently, relatively few firms attempt to describe a causal link between the firm's investment activities and the eventual positive real world sustainability outcomes of its products. More typically, firms emphasise the sustainability characteristics of the assets in which a product invests i.e., enterprise contribution." See FCA Consultation Paper (CP22/20), *supra* note 1, at 24-25.

[6] Regardless of the specific label a product is using, the FCA proposes that the sustainability objective must be expressed in specific and measurable terms, with a plausible, purposeful, and credible link to positive outcomes for the environment and/or society. Firms may refer to Sustainability Accounting Standards Board (SASB) standards to help determine topics that a retail investor would reasonably associate with environmental and social sustainability.

[7] The Consultation Paper specifically calls out ESG integration, exclusion/negative screening, and "basic" ESG tilts as strategies that do not plausibly contribute to positive sustainability outcomes, noting that the labels are needed to distinguish them from "genuinely sustainable investment products." *Id.*, at 31-32.

[8] The five principles are referred to in the draft regulatory text in Appendix 1 as "general criteria". See Consultation Paper, *supra* note 1, at Appendix 1 (beginning p.177), p.16 of 54.

[9] The cross-cutting criteria are broken down for each of the five Principles, and cover what firms must do (Chapter 4 of Consultation Paper, pp.41-46), and what firms must disclose (Chapter 5 of the Consultation Paper, pp.60-61 for pre-contractual disclosures, p.64 for Sustainability Product Report, and p.70 for Sustainability Entity Report). See Consultation Paper, *supra* note 1.

[10] Like the cross-cutting criteria, the category-specific criteria are broken down for each Principle, and cover what firms must do (Chapter 4 of Consultation Paper, pp.41-46), and what firms must disclose (Chapter 5 of the Consultation Paper, p.62 for pre-contractual disclosures, and p.65 for Sustainability Product Report). See Consultation Paper, *supra* note 1.

[11] The first client request could be made on 1 July 2025, specifying a calculation date no earlier than 30 June 2024 (12 months after the rules enter into force).

[\[12\]](#) 'In-scope firms' are defined as: Firms carrying out portfolio management; UK Undertakings for Collective Investment in Transferable Securities (UCITS) management company; Investment company with variable capital (ICVC) that is a UCITS scheme without a separate management company; Full-scope UK Alternative Investment Fund Manager (AIFM); and Small authorised UK AIFMs. See FCA Consultation Paper (CP22/20), *supra* note 1, at Table 1, p.20.

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