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ESG – FCA publishes final rules for UK's landmark Sustainability Disclosure Requirements (SDRs)

Client news alert

28 November 2023

In a significant and long-awaited development for the UK's ESG regulatory landscape, the FCA published on 28 November 2023 its Policy Statement PS 23/16. This sets out the final rules for the FCA's new Sustainability Disclosure Requirements (SDRs) and investment labels.

The policy statement charts the course for important forthcoming changes to the UK ESG rules. These rules will be phased-in across the next 3 years, and will affect all UK firms.

Simmons & Simmons stands ready to help the financial services industry digest this critical development:

- **This initial client alert sets out the key Day 1 talking points.**
- **We will be hosting a "flash call" webinar at 1.30pm (UK time) on Thursday 30 November. Please join us then for our hot takes. Please register here.**
- **Our more detailed "Top 10 Things" note will be published in December, setting out a comprehensive summary of what you need to know.**
- **More broadly, please do take a look at the findings of our review: A sustainability state of mind: unlocking growth and opportunity.**

Background

The policy statement follows-up on October 2022's Consultation Paper CP 22/20, which in turn built upon an earlier November 2021 Discussion Paper DP 21/4. (For further details on the previous consultation work, please see our detailed client briefing note from 2022, and our response to the FCA consultation). It also follows hot on the heels of the FCA's multi-firm review in relation to the implementation of its Guiding Principles for authorised funds – see our client note from earlier this month.

The FCA had initially proposed that the first tranche of the final rules would come into force by June 2023. However, the FCA received an unexpectedly large and detailed range of feedback from the industry, which caused delays to the publication of the policy statement until Q4 2023.

The consultation paper included proposed new rules for:

1) a new opt-in labelling regime for sustainable investment products
2) a requirement to prepare consumer-facing product-level disclosures

3) additional requirements on pre-contractual disclosures for products using an investment label or where sustainability features are otherwise integral

4) ongoing sustainability reporting for firms using investment labels

5) management entity disclosures

6) new naming and marketing rules, restricting the use of sustainability-related terminology

7) an anti-greenwashing rule

8) requirements for distributors.

All of these areas remain covered by the policy statement, although in each case the FCA has materially evolved the proposal in response to feedback.

We set out below a summary of the firms and products in scope of the SDRs, along with the phased timing for the rules to come into force. Following that, we set out the eight key areas covered by the new rules.

Scope

- UK firms:

  In the consultation paper, the FCA had proposed that the SDRs would apply to UK authorised fund managers and UK portfolio managers. In the policy statement, the FCA has introduced an important change, such that **portfolio managers** are – for the moment – **out of scope**. (The FCA will consult in early 2024 on whether and how to apply the SDRs to portfolio managers).

  Consequently, the SDRs will generally now apply **only to UK fund managers**. This includes UCITS management companies, full-scope AIFMs, and small authorised AIFMs.

  The exception is the **anti-greenwashing rule**, which applies to all UK FCA authorised firms.

- UK funds:

  The products in-scope of SDRs include **authorised UK funds** (including feeder funds), and **unauthorised UK funds**.

  The FCA has clarified a previous point of uncertainty from the consultation paper. It is now clear that the SDRs will not generally apply to **non-UK AIFs** which are managed by a UK AIFM.

- Non-UK firms and overseas funds:

  Non-UK firms are not caught by any aspect of the SDRs, even if marketing funds in the UK.

  Non-UK funds which are marketed in the UK on a cross-border basis (for example, non-UK AIFs marketed under the AIFMD private placement rules, or EU funds which have a temporary marketing permission) are similarly not directly caught by any aspect of the regime (although UK firms distributing overseas recognised funds can be caught).

  The FCA states in the policy statement that HM Treasury will separately consult as part of its work on the Overseas Funds Regime (OFR) on whether and how non-UK funds are subject to SDR.

Timing

The SDRs will be phased in over a three year timeframe. In summary:

Rule	Timing
Anti-greenwashing rule and guidance *(see section 7 below)*	**31 May 2024**
Opt-in labelling regime for sustainable investment products *(see section 1 below)*	**31 July 2024**
Consumer-facing product-level disclosures *(see section 2 below)*	**31 July 2024**
Pre-contractual disclosures for products using an investment label or where sustainability features are otherwise integral *(see section 3 below)*	**31 July 2024**
Requirements for distributors *(see section 8 below)*	**31 July 2024**
New naming and marketing rules, restricting the use of sustainability-related terminology and accompanying disclosures *(see section 6 below)*	**2 December 2024**
Ongoing sustainability reporting for firms using investment labels *(see section 4 below)*	**2 December 2025**
Management entity disclosures (firms with AUM > £50bn) *(see section 5 below)*	**2 December 2025**
Entity-level reporting: firms with AUM > £5bn *(see section 5 below)*	**2 December 2026**

The FCA will consult on application of the SDRs to UK portfolio managers in early 2024.

Areas covered by the SDRs

1) Opt-in labelling regime for sustainable investment products

In the consultation paper, the FCA proposed a new opt-in labelling regime for sustainable investment products. These were framed around three labels: Sustainable Focus, Sustainable Improvers and Sustainable Impact. Each label would be underpinned by overarching principles, cross-cutting requirements, and category-specific considerations.

Policy statement
The FCA has maintained the three optional labels (although these have now been renamed Sustainability Focus, Sustainability Improvers and Sustainability Impact). In addition, the FCA has newly added a fourth label Sustainability Mixed Goals in response to feedback that products with a combination of the attributes of the other labels would not have qualified for a label under the original proposals. Products using the "Sustainability Mixed Goals" label would need to meet the requirements under the specific criteria for each of the other labels the product is invested across. The FCA has retained the overarching principles around which the label criteria are structured (Sustainability Objective; Investment Policy and Strategy; KPIs; Resources and Governance and Investor Stewardship) but has clarified and restructured some of the rules, including: • Any product using a label needs to have a sustainability objective forming part of its investment objective.

- The **70% asset threshold** that applied to the Focus label now applies to **all labels** – i.e., if a product uses any label, 70% of its assets must be invested in line with the sustainability objective.
- A product should not include any assets which are in **conflict** with its sustainability objective.
- Although there is no equivalent to the SFDR "do no significant harm" regime, the FCA has introduced a new requirement that firms disclose whether pursuing the positive outcome could result in **negative outcomes**.
- The FCA has maintained its focus on a firm's **stewardship** strategy as part of the way in which a product would achieve its sustainability outcome. However the FCA has clarified that it does not expect firms to demonstrate a causal link between stewardship activities and the outcomes.

Timing: The labels will be available to use from **31 July 2024**.

2) Consumer-facing product-level disclosures

In the consultation paper, the FCA proposed new consumer-facing disclosures, for all products marketed to retail clients (whether or not the product has a sustainability-related objective).

Policy statement
The FCA has scaled back the scope of the requirements such that only products using a sustainability label, or using sustainability-related terms in their naming and marketing, will be required to prepare consumer-facing disclosures.

Timing: The requirement to have in place consumer-facing disclosures will apply from the date a label is first used (which would be **31 July 2024 at the earliest**) or from **2 December 2024** for products without a label and must be reviewed and updated at least annually.

3) Additional requirements on pre-contractual disclosures for products using an investment label or where sustainability features are otherwise integral

In the consultation paper, the FCA proposed additional disclosure requirements for products which either (i) use an investment label, or (ii) sustainability-related features are integral to the investment policy or strategy.

Policy statement
The pre-contractual reporting requirement will apply to all products that either use a sustainability label or use one or more sustainability-related terms in relation to a product. To reduce the disclosure burden, the final rules do permit disclosures to cross-refer to information in on-going product disclosures (e.g. Stewardship Code reporting) and disclosures relating to investment policy and strategy are no longer required to be in a separate section of the pre-contractual documents

Timing: In-scope products will be required to include sustainability information in pre-contractual disclosures from the date a label is first used (which would be **31 July 2024 at the earliest**) or from **2 December 2024** for products without a label.

4) Ongoing sustainability reporting for firms using investment labels

In the consultation paper, the FCA proposed that firms using investment labels would need to include sustainability-related information in the annual product report. . For certain in-scope products (e.g. portfolio management clients and AIFMs managing unauthorised AIFs), the FCA proposed an on-demand reporting regime.

Policy statement
The requirement to product a sustainability report will apply to all products that either use a sustainability label or use one or more sustainability-related terms in relation to a product. The FCA has retained the proposal for an on-demand reporting regime for certain products and, in line with requirements under the existing TCFR rules, firms can either provide information as at an agreed calculation date or select the most recent calculation date for which up-to-date information will be available..

Timing: In-scope products will be required to produce ongoing product-level disclosures **annually, after 12 months from the date on which a label is first used**, or 12 months from when sustainability-related terms are first used. The earliest reports would be required by **31 July 2025** (one year after the labels are first available).

5) Management entity disclosures

In the consultation paper, the FCA proposed that in-scope asset management firms would need to produce a public entity-level report, mirroring the four themes of the existing TCFD disclosure framework.

Policy statement
The FCA has potentially broadened the scope of entity-level reporting by including guidance that firms should consider disclosing their impact on the environment and/or society, having regard to the Global Reporting Initiative (GRI) Standards. The FCA has also recognised that firms may find it helpful to consider other reporting frameworks, such as TNFD, ISSB, SASB and GRI standards, when determining the content of their entity-level disclosures and the types of sustainability-related information that would be decision-useful to clients and consumers. Finally, the FCA has clarified that both firms using labels and those using sustainability-related terms in their product names and marketing must include information on resources, governance and organisational arrangements relating to their sustainability objective and/or investment policy and strategy, as relevant, in their entity-level report.

Timing: Entity-level reports must be produced and published:

- by **2 December 2025** for larger firms (asset managers with **£50 billion or more** in AUM), and then annually or
- by **2 December 2026** for smaller firms (asset managers with **£5 billion** or more in AUM), and then annually.

6) Naming and marketing rules

In the consultation paper, the FCA proposed that products which are marketed to retail clients, but which do not use a sustainability label, would be subject to new restrictions on the use of sustainability-related terms in product naming and in marketing materials.

Policy statement
The FCA has re-worked the original proposals and acknowledged that these were too restrictive. In the final rules, firms can continue to use sustainability-related terms in product names and marketing if either: (i) they use a label, or (ii) if they meet new product name, disclosure and statement conditions. These conditions include clarifying that the product does not use a label and why. The naming and marketing rules only apply when the sustainability-related terms are being used for products marketed to retail investors. They only apply when referring to sustainability characteristics and do not preclude firms from using the terms in other contexts. They also do not apply when firms are making short, factual, non-promotional statements about a product.

Timing: The new naming and marketing rules apply as from 2 December 2024.

7) Anti-greenwashing rule

In the consultation paper, the FCA proposed a new over-arching rule that any sustainability-related claims in any communication (not just with retail clients) must be fair, clear and not misleading, and consistent with the sustainability profile of the product or service. Firms are already required to ensure that information they communicate to clients is fair, clear and not misleading, however, the FCA considered it appropriate to add a specific rule to link this directly to sustainability claims.

Policy statement
The FCA has confirmed that it will introduce the rule as proposed. Additionally, the FCA has launched a separate Guidance Consultation GC23/3 on separate guidance as to its expectations under the anti-greenwashing rule. The draft guidance proposes four requirements that sustainability-related claims must meet, namely that they must be: (i) correct and capable of being substantiated; (ii) clear and presented in a way that can be understood; (iii) complete - they should not omit or hide important information and should consider the full life cycle of the product or service; and (iv) fair and meaningful in relation to any comparisons to other products and services. The guidance then gives examples as to how each of these four criteria could be met.

Timing: The anti-greenwashing rule will apply first out of all the rules in SDRs, from 31 May 2024. (Note this is different to the original proposal that the anti-greenwashing rule would apply immediately).

The anti-greenwashing rule applies to all FCA authorised firms (not just fund managers).

8) Requirements for distributors

In the consultation paper, the FCA proposed that firms which distribute products to retail investors (including platforms and advisers) must provide relevant sustainability disclosures to their underlying clients and display the relevant label via various digital media. In addition where a firm distributes an overseas "recognised" fund which use an ESG term in its name or marketing materials would have to include a specific notice to state that the FCA's SDR and investment labels do not apply.

Policy statement
The FCA has amended the rule to allow for the relevant label to be displayed via the channel they would usually communicate with their customers (i.e., it does not have to be via digital media). Otherwise the FCA has retained the requirements for providing the disclosures to clients and for a specific notice to be included on overseas funds.

Timing: The rules for distributors in respect of providing sustainability disclosures to clients will apply from 31 July 2024. The notice for overseas recognised funds will be required from 2 December 2024.

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