

THE  
INVESTMENT  
ASSOCIATION

In association with

EVERSHEDS  
SUTHERLAND

# IMPLEMENTATION GUIDANCE v1.0

THE FCA'S SUSTAINABILITY DISCLOSURE  
REQUIREMENTS (SDR)

May 2024



## ABOUT THE INVESTMENT ASSOCIATION (IA):

The Investment Association champions UK investment management, supporting British savers, investors and businesses. Our 250 members manage £8.8 trillion of assets and the investment management industry supports 126,400 jobs across the UK.

Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital.

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks and shares ISAs.

The UK is the second largest investment management centre in the world, after the US and manages 37% of all assets managed in Europe.

The Investment Association (the "**Association**") has made available to its members the Implementation Guidance V 1.0 in relation to the FCA's Sustainability Disclosure Requirements ("**SDR**") (the "**Guidance**") in collaboration with Eversheds Sutherland (the "**Collaborator**"). The Guidance has been made available for information purposes only and to assist member firms which are considering implementation of the SDR regime by addressing various questions that have emerged across its different aspects. It is important to note that the Guidance does not address all questions raised, and it is not intended to be exhaustive.

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# PURPOSE OF THIS DOCUMENT

In November 2023, the Financial Conduct Authority (FCA) published its Policy Statement (PS23/16) on Sustainability Disclosure Requirements (SDR) and investment labels. The Policy Statement sets out the final rules on anti-greenwashing, a new labelling regime, naming and marketing rules and product and entity level disclosures, as well as distributor obligations. At the same time, the FCA published a consultation paper on draft guidance on the scope of its anti-greenwashing rule (GC23/3). The final guidance was published on 23 April 2024.

As firms have begun to implement the FCA's rules, the IA has collected questions from firms and worked closely with Eversheds Sutherland to produce this Question-and-Answer-style guidance document (the "Guidance").

This document does not present an exhaustive list of all the questions raised since the Policy Statement was published and, as the picture evolves, for example with the FCA's expansion of the regime to portfolio management and other products, we will keep the Guidance under review. It may evolve further following ongoing implementation of SDR and further communications with the regulator.

There will be separate cross-trade body guidance on the consumer-facing disclosure requirements: many elements of these requirements will be addressed in that document as opposed to within this Guidance.

As with similar documents issued by the IA, the Guidance is not mandatory but sets out ways in which members can address industry-wide issues on the basis of a common framework.

# BACKGROUND

## WHAT IS REQUIRED?

The FCA has introduced the SDR and investment labels as part of its efforts to promote sustainable investing in financial products and services but also to combat potentially misleading marketing practices related to the sustainability characteristics of financial products and services.

The regime's measures, to varying degrees, require firms to be more transparent about their products' sustainability characteristics and to ensure that the claims made are proportionate and justified. This transparency aims to empower investors to make more informed choices aligned with their sustainability goals. In many ways, the mantra from regulators has been "say what you do, then do what you say".

However, for retail investment funds in the UK, the new rules go further than disclosure obligations and effectively reshape how firms describe their offering. SDR also sets baseline standards for products to be able to use certain language in their name or in marketing materials.

There are also substantive entry criteria for each of the FCA's opt-in labels, and firms which want to make sustainability claims about their products that are available to retail clients will have to make substantial disclosures about those sustainability characteristics. All FCA-authorised firms will also have to ensure that they comply with the anti-greenwashing rule in relation to the statements they make regarding the sustainability characteristics of their products and services.

This means that SDR requires significantly more substance than other regimes, including (at least for the time being) the EU's Sustainable Finance Disclosure Regulation (SFDR) which reflects the different starting points of both regimes.





Finally, it is also worth noting that SDR should not be considered in isolation. PS23/16 makes clear that the SDR rules are consistent with the Consumer Duty and the FCA expects firms to apply the rules and guidance keeping the aim of the Duty in mind. In addition, the FCA's Guiding Principles, as set out in its [\*Dear Chair letter\*](#) (19 July 2021) cannot be forgotten (including the [\*FCA's review\*](#) in November 2023).

The FCA also published a [\*new webpage\*](#) in February 2024 providing clarification to firms on common SDR queries (we refer to this as the "Landing Page" in this document). The FCA has indicated that they will update this regularly. However, the FCA has emphasised that they have taken the regime up a level in response to industry feedback to their consultation, and therefore there are limits to the level of further information or guidance that they can give.



## WHEN DO YOU NEED TO HAVE IMPLEMENTED YOUR CHANGES?

Implementation of SDR is staggered and in the case of the labelling regime, optional. The key milestones are as follows:

	Timing	Scope
Anti-greenwashing 	<b>Comply by</b> <b>2024</b> 31 May	All firms
Product labelling 	<b>Available from</b> <b>2024</b> 31 Jul <small>* (for any retail fund using a protected word in its name)</small> <b>Adopt by*</b> <b>2024</b> 2 Dec	<b>Professional only funds</b> Opt-in <b>Funds available to retail</b> Opt-in
Naming and marketing 	<b>Comply by</b> <b>2024</b> 2 Dec	<b>Professional only funds</b> Out of scope <b>Funds available to retail</b> Those with sustainability characteristics in scope
Product Disclosure 	<b>Consumer-facing disclosure</b> <b>Starts from</b> <b>2024</b> 31 Jul <small>Required from 2 December 2024 where required under marketing rules or earlier (from 31 July 2024) if using a label earlier</small> <b>Needed by*</b> <b>2024</b> 2 Dec <b>Pre-contractual disclosure</b> <b>Starts from</b> <b>2024</b> 31 Jul <small>Required from 2 December 2024 where required under marketing rules or earlier (from 31 July 2024) if using a label earlier</small> <b>Needed by*</b> <b>2024</b> 2 Dec <b>Public periodic disclosure</b> <b>Starts from</b> <b>2025</b> 31 Jul <small>Required each anniversary of label being used or characteristics promoted</small> <b>On-demand ongoing disclosure</b> <b>Starts from</b> <b>2025</b> 2 Dec	<b>Professional only funds</b> Not applicable <b>Funds available to retail</b> Consumer-facing disclosure mandatory for labelled funds and products promoting sustainability characteristics <b>Professional only funds</b> Sustainability disclosure mandatory for labelled funds <b>Funds available to retail</b> (detailed) pre-contractual disclosure mandatory for labelled funds and products promoting sustainability characteristics <b>Professional only funds</b> Not applicable <b>Funds available to retail</b> In-scope <b>Unlisted, unauthorised AIFs</b> In-scope <b>Funds available to retail + Listed unauthorised AIFs</b> Not applicable
Entity Disclosure	<b>AUM &gt; £50bn</b> <b>Rules apply</b> <b>2025</b> 2 Dec <b>AUM &gt; £5bn</b> <b>Rules apply</b> <b>2026</b> 2 Dec	Subject to AUM

## WHAT ELSE IS EXPECTED IN RELATION TO SDR?

The FCA has been clear that PS23/16 is just the beginning of the journey and there have been and will be further developments in this area.

- On 23 April, the FCA published a consultation ([CP24/8](#)) on the application of SDR to portfolio management.
- Also on 23 April, the FCA published its expected finalised non-handbook guidance on the application of the anti-greenwashing rule ([FG24/3](#)).
- The FCA has highlighted that they are likely to extend the requirements to pensions and insurance-based investment products in the future.
- We are also expecting a consultation to be published by HM Treasury relating to the application of SDR to overseas funds being marketed into the UK under the Overseas Funds Regime.
- The FCA has signalled in CP24/8 that they will undertake a post-implementation review of SDR after 3 years.



# ANTI-GREENWASHING RULE

## BACKGROUND

The anti-greenwashing rule (AGR) underpins SDR. It is the main warning shot from the FCA on greenwashing and addressing this is a regulatory priority.

The AGR was part of the original rules consulted on in 2022. The key difference in the final rules compared to what was consulted on in 2022 is that the rule did not take immediate effect when PS23/16 was published in November, as per the proposal in the consultation. Instead, firms will be required to comply with the AGR from 31 May 2024.

This rule doesn't just apply to retail fund manufacturers and distributors – it applies to all FCA authorised firms that communicate with clients in the UK in relation to a product or service or communicate or approve financial promotions to a person in the UK. "Client" is used as a defined term in the AGR. The definition of client differs dependent on the activity being carried out, but in relation to the ESG Sourcebook includes a unitholder or a potential unitholder in a scheme (including an AIF) as well as a person to whom a firm intends to provide or has provided a service in the course of carrying out a regulated activity (or in the case of MiFID business, an ancillary service). Therefore, products marketed to institutional clients would be covered as well as those sold to retail.

The AGR requires statements about sustainability characteristics to be consistent with the reality of those characteristics and that these statements should be fair, clear and not misleading. Whilst firms already need to ensure the statements they make to investors are fair, clear and not misleading, the AGR clarifies the approach with specific regard to sustainability claims and provides the FCA with a rule through which to enforce these requirements.

Alongside PS23/16, on 23 April 2024, the FCA published general non-handbook guidance on the application of the anti-greenwashing rule (*FG24/3*) ("AGR Guidance"). In particular, the FCA has set out its expectations for any FCA authorised firm that makes claims about the sustainability of a product or service. The FCA makes clear that sustainability references should follow the four Cs:

- **correct** and capable of being substantiated
- **clear** and represented in a way that can be understood

- **complete** – they should not omit or hide important information and should consider the full life cycle of the product or service
- fair and meaningful in relation to any **comparisons** to other products or services.

Firms should consider this final guidance as it provides further clarity on some of the key questions firms had raised during the guidance consultation phase.

The FCA has been keen to highlight that for most firms the AGR does not introduce any new requirements as there are existing rules which require firms to ensure that their communications are clear, fair and not misleading. The steer from the FCA in the AGR Guidance is that the AGR sits alongside and works with these existing rules and does not substitute or override them.

## SCOPE

### WHAT PUBLICATIONS ARE IN SCOPE OF THE AGR?

The rule in the ESG Sourcebook (ESG 4.3.1R) refers to situations where firms "communicate" with clients in relation to a financial promotion. The term is used as a defined term as it is italicised<sup>1</sup> and relates to communications of financial promotions made in any way. It appears from the guidance that this goes wider than financial promotions and covers all communications about financial products and services if they refer to environmental and/or social characteristics and covers (but is not limited to) "...statements, assertions, strategies, targets, policies, information and images." For example, for a fund, in addition to the prospectus, Key Investor Information Document (KIID), constituting document, and the new consumer-facing disclosure, it is possible that firmwide screening policies, pitch books, report and accounts, brochures, claims on social media and thought leadership, could all be in scope. We are also of the view that the AGR will apply to documents which are publicly available even if they were drafted and published prior to 31 May 2024.

Our assumption was that the italicisation of the word "communication" is an error which we raised with the FCA as part of our feedback. The FCA has now addressed this in CP 24/8 by removing the italicisation.

<sup>1</sup> Expressions used in the Handbook which are defined in the Glossary appear in the text in italic type (GEN 2.2. 7 R (1) (Use of defined expressions)). An expression which is not shown in the text in italics has its natural meaning unless the context otherwise requires (GEN 2.2. 9 G).



## DOES THE ANTI-GREENWASHING RULE APPLY AT ENTITY LEVEL?

The FCA's anti-greenwashing rule applies to 'products and services' (as stated in 4.3.1(2) of the ESG Sourcebook). However, the draft guidance seemed to go further than the rule by making reference in paragraph 28 to disclosures and claims made at entity level – *'Information about the firm itself may be considered part of the 'representative picture' in a decision-making process so it is important that these claims are also fair, clear and not misleading'*. In addition, paragraph 2.4 within the summary of the draft guidance referred to 'corporate social responsibility' (CSR) claims, but it is unclear whether this was only in respect of underlying companies in investments related to product or services or whether it extends to the CSR processes of regulated entities.

The FCA has sought to clarify this in the final AGR Guidance by stating that firms are subject to other rules about claims they make about themselves. They emphasise that any misleading claims at an entity level can already be captured by powers exercised by the Advertising Standards Agency and the Competition and Markets Authority. The FCA has also removed references to corporate social responsibility.

They do go on to state however that firms need to be aware that statements they make about themselves form part of a "representative picture" when a client is making a decision. The suggestion therefore is that firms do at least need to have regard for what they are saying at entity level and how that may, together with statements made about a product or service, influence the decision to buy a product or service.

## TIMELINES

### WHEN DO WE NEED TO COMPLY WITH THE AGR AND IS THERE ANY "TRANSITIONAL PERIOD" IN LIGHT OF THE FACT THAT THE NAMING AND MARKETING RULES DON'T APPLY UNTIL DECEMBER 2024?

The FCA has been clear that firms currently have to comply with the clear, fair and not misleading rule in relation to communications with clients generally and that many firms are subject to Consumer Duty which has relevant requirements in relation to customer understanding and outcomes. In addition, until PS23/16 was published, the FCA proposed that the AGR would come into effect at the same time as that policy statement, meaning firms should already have been considering the requirements of the new rule.

The FCA's expectation is then that firms will not have a lot to do to comply and should be ready to do so by 31 May 2024 when the rule becomes effective. The FCA has clarified in FG24/3 that the AGR is consistent with and complements existing rules in the FCA Handbook to ensure that communications are clear, fair and not misleading. However, in practice firms may want to review their processes and both entity and product level disclosures in light of the guidance and the incoming AGR. Any material on a firm's website that informs an investment decision should be in scope of any review.

There is also a legitimate question about the position between 31 May and 2 December 2024 for firms who, for example, use the term "sustainable" in the name of their fund and in marketing without meeting the requirements for a sustainability label, and whether or not this will be a breach of the AGR. Our understanding is that the FCA is aware of this "gap" and would not see this as an automatic breach, provided the use of the term does not constitute greenwashing for other reasons. The FCA states on its Landing Page that firms subject to the naming and marketing rules for asset managers are not required to meet those additional requirements until 2 December 2024.

## COMPLIANCE

### HOW CAN WE DEMONSTRATE COMPLIANCE WITH THE AGR?

Depending on the extent to which a firm's publications make environmental and sustainability claims, compliance with the AGR could entail a wholesale review of all such publications to ensure there is no infringement of the requirements and to substantiate every claim and record such evidence.





Firms may have to prioritise active review of the most visible and long-term literature. However, it remains the case that the FCA's expectation will be that there is no 'safe' level of greenwashing.

Although initial steps are required to ensure that existing publications are compliant with the AGR, this will of course be an ongoing process and firms will need to integrate the AGR into BAU practices. For example, firms should consider:

- whether product launch/change frameworks are updated to incorporate consideration of the AGR, and,
- how the AGR is enforced across their business – for example, it is common for different teams to have ownership of different publications and so firms will need to ensure that any disclosures which cut across these different documents are consistent and reviewed regularly.

# THE LABELLING REGIME FOR FUND MANAGERS

SDR introduces a voluntary labelling regime for funds. There are four labels: Sustainability Focus, Sustainability Improvers, Sustainability Impact, and Sustainability Mixed Goals, with no hierarchy between them. Managers who decide to adopt a label will need to comply with a number of general requirements which are essentially the same across the labels as well as with label specific criteria. Labels can be adopted at any time after 31 July 2024.

1.  **Sustainability Impact™**
2.  **Sustainability Focus™**
3.  **Sustainability Mixed Goals™**
4.  **Sustainability Improvers™**

## GENERAL

### WHERE SHOULD THE LABELS APPEAR?

The SDR final rules require that the relevant label icon must be published on the relevant digital medium for the business of the firm. The icon must be in a “prominent” place on the specific webpage or page on the mobile application where the fund is offered for sale. In addition, a firm may, but is not required to, give further information about the label by including a hyperlink to the relevant page on the FCA’s website. Again, if used, the link needs to appear in a prominent place. The FCA has given some guidance on what it considers ‘prominent’ and that this would include a consideration of the content, size and orientation of the information on the sustainability characteristics.

Where the product is sold through a distributor, that distributor also has an obligation to display the label on the relevant digital medium or mobile application for the product in a prominent place.

The icon will also need to appear in:

- the consumer-facing disclosure document;
- the document containing the pre-contractual disclosures – most likely the prospectus; and
- the public product-level sustainability report (Part B).

The FCA has stated that the label should not appear on the KIID.

### WHICH PRODUCTS ARE ABLE TO USE A LABEL?

The sustainability labels are broadly available for opt-in by UK UCITS and UK AIFs. Other types of products (unit-linked life policies, pensions, overseas funds) are not eligible to opt-into the labelling regime even if they satisfy the relevant criteria. At the time of publication of this guidance, the FCA is consulting on bringing portfolio management services into the scope of SDR.

### WHAT ADDITIONAL PRE-CONTRACTUAL DISCLOSURES ARE REQUIRED FOR A FUND WITH A LABEL AND WHERE SHOULD THEY GO?

Where a fund has a label (or indeed uses sustainability-related terms without a label), there will be a number of additional disclosures that need to be included within the pre-contractual disclosure (e.g. details of KPIs, details for monitoring performance, details of action the manager will take in accordance with the escalation plan). The rules do not stipulate where these disclosures need to be provided, other than they need to be in the pre-contractual disclosures for the fund (e.g. the fund prospectus or FUND 3.2.2. disclosures) and the FCA has confirmed that they do not need to be in a separate section of this document provided they are clearly identifiable. Where disclosures are included may depend on a fund’s characteristics – although some will be included within the investment objective and policy section (e.g. detail of the investment manager’s investment policy and strategy), some will be better suited to an additional information section

directly below the fund details (e.g. details of the manager's policies and procedures to monitor the performance of the sustainability product in achieving its sustainability objective).

Firms will also need to produce a consumer-facing disclosure document (CFD). *See further information on the CFD and other disclosure requirements under 'Sustainability Disclosures.'*

## INDEX FUNDS

### CAN A PASSIVE FUND HAVE A LABEL?

The FCA has been clear in its feedback that there is no reason from a regulatory perspective why a passively managed fund cannot adopt a label if it is able to meet the relevant criteria. Box 3 in Annex 2 of the Policy Statement sets out some of the FCA's thinking in this regard, including that:

- the chosen index must meet the criteria for a label;
- the index must align with the sustainability objective;
- KPIs need to be appropriate to track the product against the sustainability objective which may require an understanding of the index methodology;
- the index will need to be monitored on an ongoing basis to ensure it continues to meet the relevant requirements and any rebalancing of the index constituents does not mean that the index is no longer appropriate;
- there is a requirement for a stewardship strategy in relation to index products;
- simply tracking a Paris-aligned benchmark alone will not meet the requirements if this does not align with a fund's sustainability objective and meet the rest of the label's qualifying criteria;
- firms will need to disclose how the index methodology aligns with the sustainability objective.

In practice, it is not clear how an index fund can meet the relevant requirements. The IA is liaising with a smaller group of member firms regarding how index funds could meet the relevant requirements in practice and will discuss the approach with the FCA. Furthermore, the FCA has stated it will continue to update its webpage with any further clarifications as needed.

## KPIs

### SHOULD THE KPIs BE AT ASSET OR FUND LEVEL?

The KPIs can be at either asset or fund level.

### DO THE KPIs NEED TO BE IN THE INVESTMENT POLICY?

The rules do not stipulate where the KPIs need to be disclosed, other than the need to be in the pre-contractual disclosures for the fund (i.e. the fund prospectus or FUND 3.2.2 disclosures).

## SUSTAINABILITY OBJECTIVES

### ARE THE SUSTAINABLE DEVELOPMENT GOALS (SDGs) ON THEIR OWN SUFFICIENT TO FORM A SUSTAINABILITY OBJECTIVE?

The sustainability objective is a core part of a labelled product. The objective must be clear, specific, and measurable and must go beyond broad statements that the product aims to have broad outcomes. The FCA has stated that the SDGs are unlikely to be sufficient on their own – they constitute a broad statement and are essentially a series of high-level goals.

### CAN THERE BE MULTIPLE SUSTAINABILITY OBJECTIVES?

There can be multiple sustainability objectives and therefore there can be multiple KPIs. However, it must be clear to the consumer what the product is trying to achieve and how that will be measured. Funds will also have a financial objective and it will be important to articulate the relationship between the two.

*See further information on fund objectives under 'Sustainability Disclosures.'*

## 70% OF ASSETS

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### WHAT ARE THE FCA'S EXPECTATIONS REGARDING THE 70% AND 30%?

The FCA has emphasised that the 70% threshold of assets that must be invested in accordance with the sustainability objective should be seen as a minimum and not a target.

For assets in the remaining 30%, the FCA has clarified that *"they can still be included in the product provided that the firm discloses the type of asset held and why"* but these assets **must not conflict** with the sustainability objective of the fund.

### HOW SHOULD ASSETS SUCH AS CASH, DERIVATIVES AND BONDS BE CATEGORISED?

The FCA has clarified on its Landing Page that they have not been prescriptive in how certain assets should be treated, and so it is possible for assets such as derivatives and bonds to meet the robust standard if the manager determines this is the case: *"[i]f firms determine that sovereign bonds, derivatives, or other assets, meet or have the potential to meet a robust, evidence-based standard of sustainability they can be in the part of the product that pursues the sustainability objective."*

### ARE THERE EXCEPTIONS TO MEETING THE 70% THRESHOLD?

There is an exemption in the rules for where products are operating in their 'ramp-up' phase. This exception is only for funds specifically designed to build their portfolio over time, e.g. an LTAF.

There is also an exemption for firms carrying out an escalation plan or taking actions to meet the criteria on an ongoing basis.

## ROBUST, EVIDENCE-BASED STANDARD THAT IS AN ABSOLUTE MEASURE OF ENVIRONMENTAL AND/OR SOCIAL SUSTAINABILITY

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### WHAT IS A 'ROBUST STANDARD EVIDENCE-BASED STANDARD THAT IS AN ABSOLUTE MEASURE'?

SDR requires firms adopting a Sustainability Focus, Sustainability Improvers or Sustainability Mixed Goals label to ensure that the assets of the fund are environmentally and/or socially sustainable (Sustainability Focus) or have the potential to improve their environmental and/or social sustainability over time (Sustainability Improvers). Sustainability must be measured against a "robust, evidence-based standard which is an absolute measure of sustainability". We have considered each of these elements in turn:

#### "standard"

The FCA has said that firms should select assets using "a methodology or approach in a systematic way". The standard should be "used for both determining the environmental and/or social sustainability characteristics of the product's assets and the ability of those assets to contribute to positive environmental or social outcomes."

#### "robust"

This must be capable of standing up to scrutiny. Relevant questions may include whether the methodology is complete and comprehensive and whether the weighting of different factors reflect the relative importance of those factors.

#### "absolute measure"

The FCA requires the standard to be "an absolute measure of environmental and/or social sustainability". They state that this must be an absolute "as opposed to a 'relative'" measure of sustainability. It follows that standards which rely on a company's position in an index ('best in class' / 'leaders') will not meet this requirement.

It seems unlikely that a standard that includes only some absolute elements will suffice. Equally we would have concerns where elements are merely 'to be considered' or are overridable or capable of being set off against each other.

However, the FCA has stated that there is nothing to stop firms selecting assets using a methodology or approach that may be a relative measure, such as best in class for a particular sector, provided that the underlying reference is an absolute measure.

#### **“evidence-based”**

The sustainability standard must be evidence-based. The FCA says this means the standard should be “derived from or informed by” an “objective and relevant body of data or other evidence”. In our view, this requirement for evidence attaches to the standard itself and not the selection of the asset. While the data used to justify the selection is clearly important, this requirement is for the standard to be evidence-based. Firms relying on proprietary frameworks should therefore be able to justify the thresholds they have set against a body of evidence. Again, it will be important here to avoid relative considerations like industry averages.

This does not mean that a robust standard needs to apply the same requirements or thresholds to each asset: it may have different thresholds based on asset class, sector or geography, in the same way that taxonomies are tailored to specific economic activities.

## **IS IT POSSIBLE TO HAVE MULTIPLE ROBUST STANDARDS FOR ONE FUND?**

For a fund with one sustainability objective, we do not believe that the FCA would consider multiple robust standards to be appropriate, given that the purpose of the standard is to provide clarity on the fund’s definition of sustainability.

However, a fund may have multiple sustainability objectives (for instance in the case of a multi-manager fund or mixed goals labelled fund) which each have a separate robust standard. In addition, there may be multiple considerations which form part of the robust standard, as long as the requirements for the robust standard are met.

## **WHAT DOES INTERNAL INDEPENDENT VERIFICATION LOOK LIKE?**

Firms’ robust standards must be independently assessed. The FCA says independent means independent of a firm’s investment process. The assessment may be carried out internally or externally.

Firms planning internal assessment will need to demonstrate that the team carrying out the assessment has the necessary skills and independence. The FCA has not given any commentary on what they would consider to be appropriate skills. It is likely that most firms do not have teams of ESG professionals to carry out this work. The FCA has certainly not suggested that this should be the case (and for example, recruitment of ESG expertise is not covered in the FCA’s cost benefit analysis which accompanies the Policy Statement – although this would not be conclusive) and there could be questions about how independent ESG teams are given that they have likely fed into the investment process/built scorecards/methodologies etc.

The following might be things that could be considered to be pointing to adequate experience:

- a baseline understanding of SDR and its policy intention;
- knowledge of the specific requirements of the robust standard and the (limited) examples the FCA has provided;
- objectivity, that is they are removed from the SDR implementation from an investment perspective and can bring an unbiased mindset to the considerations. In addition, that the individual(s) won’t be constrained in their view as a consequence of their reporting line;
- proven analytical skills;
- skills around interpretation of data;
- the skills need not reside in a single person and a team or function can carry out the assessment so expertise could be considered in the round;
- it is possible that the relevant individuals may need to undergo some upskilling to be able to claim they have the expertise.

Firms will need to disclose the basis on which a standard is deemed appropriate and the function or third party which carries out the assessment.



## IS IT POSSIBLE TO HAVE A SUSTAINABLE INVESTMENT COMMITTEE OR PANEL WHICH FORMS PART OF THE INVESTMENT DECISION-MAKING PROCESS?

While it is possible to integrate a committee into the asset selection process, care needs to be taken to ensure that the robust standard is not being overridden or undermined. For example, a committee may have discretion to vote against a potential investment that meets the robust standard on the basis of non-ESG considerations, such as commerciality or volatility. It may also have influence over the assets which form part of the up to 30% of assets that do not need to meet the robust standard. However, for the 70% or more of assets invested in line with a label, a committee with the power to allow investment into assets that would not otherwise meet the applicable robust standard requirements would likely not be in line with SDR.

## FUNDS OF FUNDS

### HOW SHOULD A FUND OF FUNDS APPROACH UNDERLYING FUNDS? DO WE NEED TO 'LOOK-THROUGH' TO UNDERLYING HOLDINGS, OR CAN WE RELY ON THE OTHER FUND HAVING A LABEL?

The FCA has not set out any specific requirements for a Fund of Funds, but has clarified in the Landing Page that where a fund invests in other funds, those funds will be treated as 'assets', in the same way as its other investments. This means that the manager is responsible for ensuring the labelling criteria for the fund are met, and must be able to demonstrate that the funds it invests in meet the necessary requirements. This may mean that the fund only invests in labelled funds with a compatible robust standard, or uses a 'look through' approach to ensure that the funds' underlying assets are compatible with the fund's sustainability objective and the other relevant criteria.

Where the underlying funds are labelled funds, the Fund of Funds will not necessarily automatically qualify for a label on that basis and will need to be assessed on its own merits under the SDR requirements.

Please see Annex 1 of this document for further views on this point.

### HOW DO UNDERLYING FUNDS CONTRIBUTE TO INVESTEE'S FUNDS' 70% THRESHOLD?

For the purposes of calculating the threshold for Funds of Funds, managers should approach each asset class on its own merits. A manager's process should address whether to look through to the holdings of each underlying fund on a case-by-case basis.

### HOW CAN THE SUSTAINABILITY OF REAL ESTATE, AS AN ASSET CLASS, BE EVIDENCED?

The FCA has clarified on its [Landing Page](#) that if assets have the potential to meet a robust, evidence-based standard of sustainability they can be in the part of the product that pursues the sustainability objective.

A working group of ESG experts, from members of real estate associations including the Association of Real Estate Funds (AREF), have produced a paper '[ESG Metrics for Real Estate](#)'. This sets out best practice principles and informs the development of real estate-specific metrics. The aim of these is to enable consistent, transparent, and comparable reporting and disclosure for real estate portfolios and to facilitate consistency of disclosures across the UK as well as internationally. While developing the principles and metrics they were shared on an ongoing basis with the FCA, ISSB and TPT. As sustainability policy and real estate metrics evolve, it is planned to update the paper accordingly.

# THE NAMING AND MARKETING RULES FOR FUND MANAGERS

The new naming and marketing rules are designed to allow firms which don't adopt labels for their products to still refer to the sustainability features of their funds. Firms that wish to do so and use certain words in so doing (for example ESG, climate, net-zero etc.) must still make relevant disclosures both in a consumer-facing document, in pre-contractual materials, a product-level report and an entity-level report if the entity exceeds £5 billion in AUM.

Only funds taking a label can use the terms sustainable, sustainability or impact (or any variation of these) in their name. In particular, impact can only be used in the name of a fund with a Sustainability Impact label.

Funds without a label that are caught under the naming and marketing rules will have to clarify that the fund does not use a label and why.

## WHAT ARE THE BOUNDARIES OF THE NAMING AND MARKETING RULES?

It is relatively easy to trigger the naming and marketing rules by using the "trigger" terms in a fund's name or marketing materials. There are, however, a few safe harbours:

- if a firm makes a short factual statement which is not a financial promotion. The FCA has given a few examples of what they consider to fall within this definition. For example "we provide our sustainability reports annually" would be acceptable. It is a short statement which reflects a fact and is not promotional in nature. "Our sustainability report sets out our market leading sustainability investing approach" might not fall on the right side of the line.
- a reference to a firmwide policy as opposed to a fund specific feature. For example the FCA has stated that a reference to ESG integration where this forms part of a firm's standard risk management process would be acceptable as would an entity level screening policy where there is no active promotion of that policy taking place. In each case the anti-greenwashing rule would need to be complied with for those documents.

There is a question about what short means and whether it is a relative concept. For example is a short paragraph in a 200 page prospectus short? We think there is an argument that a statement can be assessed on a case-by-case basis relative to the length of the overall document – provided it is not promotional in nature.

## DO THE NAMING AND MARKETING RULES APPLY TO PRODUCTS SOLD TO PROFESSIONAL CLIENTS?

The FCA has confirmed that the naming and marketing rules only apply to products made available to retail clients. Therefore, certain AIFs marketed to professional clients only will not need to comply, but firms will need to make sure that their product is not marketed to retail clients. All fund managers will still need to make sure that the claims they are making in relation to the sustainability characteristics of their products do not breach the AGR.

## DO WE NEED TO MAKE A FCA APPLICATION IF WE ARE CHANGING A FUND TO COMPLY WITH THE NAMING AND MARKETING RULES?

This will very much depend on the nature of the changes that are required. For example, if an authorised fund needs to change its name to remove a "restricted" term, such as sustainable or impact, then this will need a FCA application and pre-notification to investors. Equally most changes to investment objectives and policies will require FCA approval, although the extent of the changes will dictate whether or not such changes are treated as significant or notifiable from an investor's perspective. *Please see our separate guidance on timing considerations for SDR implementation for authorised funds for further information.*

# FUND AUTHORISATIONS AND NOTIFICATION

## DO WE NEED TO MAKE A FCA APPLICATION WHEN CHANGING A FUND TO ADOPT A LABEL?

Although the FCA does not approve the adoption of a label, in reality we expect that authorised funds looking to take a label will need to make a number of FCA-approvable changes to comply with the general SDR requirements and the label specific criteria. This will include, for example, introducing a non-financial objective, building out the investment policy and possibly also changing the fund's name. These changes will often be classified under COLL 4.3 (or equivalent rules for Qualified Investor Schemes (QIS) and Long-term Asset Fund (LTAF) if relevant) as significant changes requiring 60 days' prior notice to investors, unless they fundamentally change the purpose, nature or risk profile of the fund, or fail any of the other tests in COLL 4.3.4R (or equivalent rules for QIS and LTAF if relevant).

In reality this means that the FCA's Authorisations Team will be reviewing, commenting on and approving the necessary enhancements and changes that a fund needs to make to get it to the right standard before a label is then added on. They may therefore have questions about whether the fund qualifies for the relevant label, but the purpose of the FCA application will not be to approve the label itself. The same goes for any subsequent changes to or removal of a label.

## SHOULD WE NOTIFY THE FCA IF WE ARE PLANNING TO USE A LABEL FOR OUR FUNDS?

Yes, firms must notify the FCA via their online notification and applications system if they are planning to use a label. Ideally, firms should let the FCA know that they plan to make a submission before going through the formal notification process.

## CAN WE DISCUSS DRAFT PROSPECTIVE CHANGES TO OUR FUNDS WITH THE FCA BEFORE MAKING AN OFFICIAL SUBMISSION?

The FCA team has stated that they will review best-efforts drafts and policies ahead of submission and has invited firms, particularly those adding labels to a number of funds, to contact them prior to submission.

You can contact the FCA team to discuss your draft changes at the following email address: UKCIS@fca.org.uk. This is the main mailbox used for UK authorised funds and where fund applications are submitted.

## WHAT ARE THE FCA'S EXPECTATIONS REGARDING THE LEVEL OF DETAIL OF THESE SUBMISSIONS?

SDR will require clear disclosure of pertinent information in the objective, policy and strategy. The FCA expects submissions to contain details of portfolio holdings and commentary examples within this to demonstrate that what members do in their sustainable process links to the actual assets selected. The emphasis should be on the spirit of SDR and ensuring there is information that a retail investor could understand.

If firms are including information on SDR that sits outside of the objective and policy, it is very likely that this will still need to be submitted to the FCA.

Furthermore, details of the independent assessment are required in the pre-contractual disclosures under ESG 5.3.3R(3)(b)(i) and (ii).

On submission, the consumer-facing disclosure is not required. However, firms could be asked about this as part of the FCA review.



## WILL UPDATES TO FUND DOCUMENTS REQUIRE FCA APPROVAL?

The FCA has repeatedly said that it will not be approving the labels. It is likely, however, that funds will need to introduce changes to their investment objectives and policy (including a sustainability objective for example) and potentially other changes and these are likely to require FCA approval in the usual way. This will, however, depend on the nature of the update and each update will need to be considered on a case-by-case basis. Our operating assumption is that any fund making enhanced disclosures to qualify for a label will require FCA approval. Where funds are making enhanced disclosures to comply with the naming and marketing rules, the position may be slightly more flexible. We have set out further details on these points later on in our guidance.

Changes to a fund's name, investment objective and/or investment policy (including strategy) will trigger a requirement for approval in the usual way. However, even disclosures outside of these sections may need approval. The FCA has, for example, suggested

that firms check with them before introducing KPIs, stewardship disclosures and any disclosure that implies changes to the management approach or what investors can expect.

## WILL UPDATES TO FUND DOCUMENTS REQUIRE INVESTOR ENGAGEMENT?

Ultimately the usual change event tests in COLL 4.3 (or equivalent rules for QIS and LTAF if relevant) will apply. If further clarification on an existing process is being included, then this could be something investors receive notice of post-event. However, if the process has not previously been disclosed or it is being removed/changed as a result of the review then it is likely that investors will require prior notice. Changes to fund names and investment objectives should be considered in the usual way.

Firms should also liaise with their depositaries and allow sufficient time for the depositary's review.



# OVERSEAS FUNDS

## CORE REQUIREMENTS IN RELATION TO SDR FOR OVERSEAS FUNDS MARKETING IN THE UK

### ARE OVERSEAS FUNDS IN THE SCOPE OF AGR?

The AGR Guidance has clarified that the AGR does apply to overseas funds and services in certain circumstances – essentially where a UK authorised firm makes such a fund (or service) available in the UK. This includes a situation where a firm makes or approves a financial promotion for unauthorised persons “...including for overseas products and services where the promotion is approved in the UK.”

This aligns with the interpretation most firms are taking but it is helpful to have this confirmed by the FCA.

The FCA has noted that it will continue to engage with HM Treasury on the application of SDR to overseas funds and this is something we will continue to monitor to reach a position which firms can work to. HM Treasury is expected to publish a consultation on the application of SDR to overseas funds marketed in the UK in the near future.

### CAN OVERSEAS FUNDS CHOOSE TO VOLUNTARILY APPLY A LABEL?

Overseas funds being marketed in the UK cannot voluntarily put a label on the product. The SDR and labels regime only applies in respect of UK firms and products. UK distributors have a requirement to add a notice on overseas funds to inform consumers that overseas funds, regardless of the sustainable objectives or characteristics of the fund, are not subject to the regime.

### WHAT SHOULD WE CONSIDER WHEN COMMUNICATING TO INVESTORS THAT OUR OVERSEAS FUNDS CAN'T GET A LABEL BUT ARE STILL LEGITIMATE SUSTAINABLE INVESTMENTS?

The FCA's only requirement currently is the addition of the prescribed notice as referenced in the previous question. There is nothing to stop a firm from providing an explanation of why it does not have a UK label (i.e. because it cannot from a regulatory perspective) and from stating its compliance with SFDR etc. Firms should be mindful of not exaggerating their ESG credentials in doing so.



## IS SFDR EQUIVALENT TO SDR?

At the date of writing SFDR does not have direct equivalence to SDR. It is not therefore possible to automatically align funds which are categorised as Article 6, 8 or 9 within the EU's SFDR regime with any particular label under SDR. The FCA has said, however, that the regimes are "compatible" and so it may in certain circumstances be possible for SFDR funds to meet requirements of a label if they are able to demonstrate the relevant characteristics for the particular label.

## DO ARTICLE 9 FUNDS AND STRATEGIES AUTOMATICALLY QUALIFY FOR A LABEL?

Article 9 funds established overseas are not in scope of the regime but would in any case not automatically qualify for a label under SDR.

Under SFDR, Article 9 funds have a sustainable investment as their objective and are expected to invest almost exclusively in sustainable investments. In the FCA's consultation paper, CP22/20, published in October 2022, the FCA set out in detail how Article 9 funds map to the SDR labels. This approach has remained effectively unchanged in PS23/16, with the addition of the FCA setting out a summary of its qualifying criteria and relevant information under SFDR that firms may leverage to meet the SDR requirements.

In considering how to treat a product categorised under SFDR or a mirror product established in the UK under the same mandate, Article 9 funds would need to satisfy both of the following elements to be eligible for a label: (i) does it meet the FCA's general qualifying criteria under SDR (i.e. (1) sustainability objective, (2) investment policy and strategy, (3) KPIs, (4) resources and governance and (5) investor stewardship); and (ii) does it meet category specific criteria for the particular label?

The FCA has reassured firms that the regimes are compatible and that many of the processes already adopted by firms to classify products under SFDR overlap with the qualifying criteria and disclosure requirements under the UK framework. However, there is a difference between compatibility and equivalence. Here, compatibility means that the product/strategy can be capable of meeting both regimes' requirements. It does not, however, mean that by meeting one, a product will automatically meet the other.

Article 9 funds that do not meet the above qualifying criteria under SDR will not be able to use any of the sustainable investment labels if they become available for overseas funds, meaning that firms will need to take these factors into consideration when determining how a product categorised under Article 9 of SFDR would be treated under the UK framework.



# SUSTAINABILITY DISCLOSURES FOR FUND MANAGERS

A key component of SDR is the disclosure regime and there are four main layers to the disclosure requirements:

- consumer-facing disclosures – aimed solely at retail investors;
- pre-contractual disclosures – aimed at all potential investors;
- ongoing product-level disclosures; and
- entity-level disclosures – building on current TCFD entity-level reporting.

The disclosure requirements apply to both labelled funds and funds with sustainability characteristics that are captured under the naming and marketing rules. Funds which use sustainability-related terms in their naming and marketing but which do not use a label will need to explain why they do not have a label as well as the nature of sustainability characteristics of the fund.

The foundation of the classification and labelling regime woven into each of the above disclosure requirements for labelled products is the need to have a 'sustainability objective' that is clear, specific and measurable and part of the product's investment objective. The FCA has also mandated four other general key areas for firms looking to use a label: investment policy, KPIs, resources and governance and stewardship.

## HOW SHOULD THE OBJECTIVES BE FRAMED?

The FCA was clear in the Policy Statement that labelled products must have a sustainability objective "as part of their investment objectives" which suggests that the FCA expect this to be combined in the investment objective section of the prospectus rather than as part of the investment policy or strategy. So, for example, where a fund currently has no stated sustainability objective but there is a sustainable investment policy that sets out the firm's approach, firms will need to include a sustainability objective to use a label. Early interactions with the FCA have reemphasised the need for sustainability objectives to be 'clear, specific, and measurable'. In response we are finding that sustainability objectives, and therefore investment objectives, are trending towards becoming quite lengthy.

Firms may instinctively wish to rely on other aspects of their disclosures (e.g. investment policy, KPIs) in order to reduce the information front-loading in the sustainability objective and may, on a case-by-case basis, be able to justify this. However, we understand that the FCA expects to see more than bare statements that merely reflect the language of the rules (for example, it would not be acceptable to state "We seek a capital return greater than [index] each year by investing in a portfolio that meets a robust standard of sustainability" and then rely on subsequent detail).



## HOW SHOULD THE OBJECTIVES BE DISCLOSED?

As noted above, firms that adopt a label will need to have a sustainability objective as well as a financial objective. In terms of how these are disclosed, the FCA has not prescribed how this must be done. The examples the FCA gives in the Policy Statement include a fund which has a combined financial and sustainability objective and also a fund with separate financial and sustainability objectives. We therefore think that firms can adopt either approach, as long as the sustainability objective meets the requirements of being explicit, clear, specific and measurable. We would expect both objectives to be included in the investment objective section of the Prospectus, as this will usually be the place where the pre-contractual disclosures required by ESG 5.3 would be set out (as well as the COLL 4.2.5 prospectus checklist (or COLL 8 or COLL 15, as applicable) requiring such disclosure) but also the KIID, as the KIID should reflect the key disclosures made in the prospectus in relation to the investment objective.

*The rules in relation to the consumer-facing disclosure do not specify whether the financial objective must be included in the sustainability goal section. Please refer to the cross-industry Guidance on SDR Consumer-Facing Disclosure for further detail.*

### Product-level disclosures: consumer-facing disclosure

The first disclosure requirement is product level disclosure and this is simplified disclosure aimed at retail investors. This document is also being referred to by some as the 'consumer factsheet'.

This level of disclosure is only required if the product has a label or if the product uses one of the sustainability-related terms.

The consumer-facing disclosure document will be a short summary of the key sustainability related features of the product. The disclosures are much less detailed for non-labelled products than for the products with a label. The document needs to be maximum 2 pages of A4 but the FCA, whilst prescribing categories for the content, has not provided a template for firms to use. The FCA was keen to reference Consumer Duty in looking at these disclosures and ensuring that they are provided in a clear and comprehensible way for retail investors.

The document needs to be provided in a prominent place on the website, alongside other key investor information documents.

The consumer-facing disclosure document will need to be available from the point a label is used or from 2 December 2024 if sustainability related terms are used. We understand that the FCA will not require this document as part of a FCA application. It will need to be reviewed each year.

*As above, please refer to the cross-industry Guidance on SDR Consumer-Facing Disclosure for further detail.*

### Product-level disclosures: pre-contractual disclosures and ongoing disclosures within the sustainability report

The second level of disclosure is aimed at institutional investors or retail investors who want to have more detail than is provided by the consumer factsheet. The disclosures come in two parts – pre-contractual disclosures (otherwise known as “Part A” disclosures) and ongoing product disclosures (otherwise known as “Part B” disclosures) which need to be provided in a sustainability report. These disclosures will need to be provided if the product is using a label or uses sustainability-related terms in its name or marketing.

The Part A pre-contractual disclosures have to be included in the prospectus or the FUND 3.2.2 disclosures or, if neither of these are provided, in a separate part of the sustainability report. The FCA no longer requires this disclosure to be included in a standalone section of the prospectus so firms can decide how best to provide this but the information must be identifiable as the required disclosure.

The Part B disclosures are more granular and will cover data, metrics, stewardship and the newly required escalation plan detail.

This report needs to be provided annually from the first anniversary of the label being used, or from 2 December 2025 if sustainability terms are used. Each report must cover a 12-month period.

## CAN WE USE OUR EXISTING REPORTING (INCLUDING TCFD REPORTING) TO COMPLY WITH SDR?

### Product-level disclosures

The rules are clear that the FCA expects a separate product-level report to be produced and the TCFD report cannot be used in place of the product-level report. It is possible to hyperlink to a manager's TCFD report to deal with some of the information requirements. However, as the Part B disclosures are quite specific and the rules require a separate report, it won't be sufficient to simply link to the TCFD report without more detail being provided. The FCA is also clear that the product-level report can "build from" the TCFD report. ESG 5.4.4 also requires firms which are required to prepare a public TCFD report to include the contents of that TCFD report or a hyperlink in the Part B element of product-level reporting.

### Entity-level disclosures

The final level of disclosure is the entity-level report. This will apply to all asset managers, regardless of whether they use a label or sustainability related terms, if they have more than £5 billion in AUM. Asset managers with more than £50 billion in AUM will be required to report at entity-level from December 2025 and then all other managers above £5 billion in AUM are required to report from December 2026.

## CAN WE RELY ON GROUP-LEVEL DISCLOSURES?

The FCA has said that firms that are members of a group can cross refer to group-level disclosures when producing the SDR entity-level report, but only if group-level disclosures are relevant to the firm and cover the assets managed by the firm as part of its in-scope sustainability business. If group-level disclosures are used, they will need to be linked along with the rationale for using them, and an explanation that the report relies on group-level disclosures. Material deviations from the group approach will need to be disclosed. This does not mean that group reporting can be used to satisfy this requirement.

At entity-level, the reporting obligation only applies to the authorised fund manager, alternative investment fund manager and not other entities in the group – see rule ESG 5.6. It will not therefore be possible to rely on other group information alone to produce this report as it will need to be entity specific. Equally, if the TCFD and entity-level reporting dates align it will not be possible to produce a single report to cover both requirements given the difference in reporting entities and the content of the Part B reporting.



## CAN A FIRM SET ITS OWN TIMELINE FOR REPORTING UNDER SDR SO IT TIES IN WITH OTHER REPORTING CYCLES?

The SDR rules set out specific timelines for reporting as set out below:

	Frequency of reporting	Period to be covered	Initial disclosure/report	Ongoing disclosure/reporting
<b>Consumer Facing Disclosure</b>	Must be reviewed annually	CFD does not relate to a particular period	From point of using a label or 2 December 2024	Review annually
<b>Part B Product Report</b>	Annual	12 months	Must produce and publish the report within 12 months of first using a label or using one of the trigger terms under the naming and marketing rules. So if a firm uses a label from 1 August 2024 it will need to provide and publish a report by 1 August 2025 in relation to the previous 12 month period	A firm can change the dates for subsequent reports provided there is no period which is not covered by a report and if so must issue an interim report
<b>Entity-level</b>	Annual	12 months	AUM over £50 billion – the report needs to be produced and published by 2 December 2025. AUM over £5 billion – the report needs to be produced and published by 2 December 2026	A firm can change the dates for subsequent reports provided there is no period which is not covered by a report and if so must issue an interim report
<b>On-demand reporting</b> (For entities who need data to satisfy their own sustainability related disclosure requirements)	On-demand – one request in respect of each sustainability product in each of manager's 12 month reporting periods	In relation to a calculation date agreed with the person requesting the detail or in line with the calculation date for the Part B product-level reporting	Not before 2 December 2025 in relation to a calculation date agreed with the person requesting the detail or in line with the calculation date for the Part B product-level reporting	No on-going reporting obligation other than to comply with the one request per 12 months obligation

## WHAT ABOUT FIRMS WITH LESS THAN £5 BILLION IN AUM?

For the time being smaller firms are being encouraged to report on a voluntary basis, but this may become a requirement in the future.



# STEWARDSHIP REQUIREMENTS FOR FUND MANAGERS

## WHAT ARE THE STEWARDSHIP REQUIREMENTS FOR ALL LABELLED FUNDS?

There are general qualifying requirements for all labels relating to Stewardship:

**1) Stewardship strategy:** Firms must identify and apply the stewardship strategy needed to deliver the sustainability objective of the product, including the expected activities and outcomes, and ensure appropriate resources are applied. The strategy should support assets in remaining sustainable, accelerating improvements, or delivering positive impact, depending on the label used.

- The FCA has not been prescriptive as to the form which stewardship would take, acknowledging that stewardship may take place in different forms for different asset classes and strategies, may include collaborative engagement, and is likely to be executed at firm level.
- There is no expectation to demonstrate causality between activities and outcomes but demonstration of correlation between stewardship outcomes the firm would like to achieve and stewardship activities is expected.
- Outcomes may not be achieved on an annual basis so disclosures should provide sufficient contextual information to help consumers understand that outcomes may not be achieved in the short term.
- Where stewardship plays a significant role in the sustainability product's investment policy and strategy, firms may consider disclosing KPIs related to the outcomes achieved or that measure progress towards the product's sustainability objective.

**2) Stewardship Escalation Plan:** Firms must disclose their stewardship strategy and outcomes and have an escalation plan setting out the actions they will take if the assets do not demonstrate sufficient performance towards achieving the sustainability objective or KPIs. The plan should set out the anticipated timescales for addressing any matters that may result in insufficient performance against the sustainability objective. Assets subject to such action remain within the 70% threshold.

**3) Stewardship disclosures:** The disclosure should include the following information:

- consumer-facing disclosure: A summary of the manager's approach to investor stewardship in supporting the achievement of the sustainability objective.
- pre-contractual disclosure: Details of the investor stewardship strategy and resources to support achievement of the sustainability objective, including how that strategy will be applied and, where relevant, whether the firm is a signatory to the UK Stewardship Code. The disclosure also incorporates an Escalation Plan, detailing the firm's course of action in line with its escalation procedures.
- ongoing product-level disclosure: Details as to how investor stewardship has been applied, including activities undertaken and outcomes achieved (or expected to be achieved). These may include cross-references to Stewardship Code reporting, provided that information relevant to the product is clearly signposted.

The FCA note the attributes of stewardship to each of the labels as:

- Sustainability Focus – To support assets in remaining sustainable/ delivering long-term value
- Sustainability Improvers – To support and accelerate improvements over time
- Sustainability Impact – To support assets in delivering positive impact
- Sustainability Mixed Goals – To support assets in remaining sustainable/ accelerate improvements over time/ delivering positive impact



## WHAT ARE THE SPECIFIC STEWARDSHIP REQUIREMENTS FOR THE SUSTAINABILITY IMPROVERS LABEL?

PS23/16 considered the extent to which investor stewardship should be a key feature of the Sustainability Improvers Label. It clarified that the FCA has removed the stewardship-related specific requirements from this label. Instead, these apply as part of the general qualifying criteria (see above). However, the FCA have stated that stewardship plays a key role in this category. Firms' investor stewardship strategy should support delivery of the objective and therefore help to accelerate improvements in environmental and/or sustainability.

There are also specific requirements for the Sustainability Improvers label where firms will need to 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. The FCA has not been prescriptive in specifying the timing of these targets. The responsibility falls on the firms to decide these targets, provided they align with the investment horizon of the product. They must also obtain robust evidence to satisfy themselves that the assets have the potential to meet the standard (see section "what is a robust standard?" for more details). If a firm expects its stewardship strategy to be a mechanism used to achieve the improvements, it will have to set these targets in the context of their ability to achieve change through its stewardship approach.



# ANNEX 1

## FROM A DUE DILIGENCE PERSPECTIVE, HOW SHOULD LABELLED FUNDS OF FUNDS LOOK THROUGH TO UNDERLYING FUNDS?

The FCA states in PS23/16 (Page 66) that its “rules do not set out any specific requirements for a ‘fund of funds’. Where a fund in scope of the regime invests in other funds, those funds will be treated as ‘assets’. The rules apply as usual to the authorised fund, so the firm can apply the labelling criteria and must make the associated disclosures, or comply with the naming and marketing requirements.”

This position is also repeated on the Landing Page with the addition of a statement that the labelling criteria must be met for the fund of funds (i.e. the investing fund). Domestic and overseas funds (whether in the Temporary Permissions Regime or not) seem to be treated equally. There is also nothing in the rules that suggests labelled funds are automatically eligible investments for other labelled funds. Indeed there could be scenarios where they may not be eligible. For example:

- **incompatible objectives:** a labelled fund of funds with an environmental sustainability objective may find that a labelled fund with a social objective does not align with its objective;
- **incompatible labels:** a Sustainability Impact fund of funds may struggle to fit a Sustainability Improvers fund within its theory of change;
- **misalignment in standards:** a Sustainability Focus fund of funds whose sustainability objective refers to taxonomy alignment may well conclude that an underlying fund whose robust standard is based solely on greenhouse gas emissions is not eligible.

However, a labelled fund should have lots of the attributes that a fund of funds is looking for and may well be aligned with the investing fund in all material respects. Presently the FCA has not been prescriptive about how a firm can satisfy itself regarding eligibility of an underlying fund. If a fund of funds wishes to look through and consider the individual exposures in the underlying fund, almost as though those exposures were direct holdings, that seems to be a maximum compliance approach. The frequency at which the look through would be undertaken needs further exploration.

However, it is noteworthy that the FCA has not explicitly required fund of funds, either in rules or guidance, to look through to their underlying holdings. This therefore suggests firms may use different approaches to the degree of due diligence they perform on target funds. Ultimately, due diligence for SDR purposes should sensibly be centred on the underlying product rather than solely on the manager. Firms could conclude that their priority should be to investigate the key attributes of the underlying fund and ensure that these align with the investing fund’s approach, such as the underlying funds’:

- sustainability objectives;
- asset selection criteria and degree of alignment;
- potential to hold assets incompatible with the investing fund’s objective;
- definition of sustainability; and
- then, depending on the label, the manager’s credentials may become more prominent as a consideration.

If the above analysis is undertaken thoroughly, with some sort of check that the underlying fund is indeed managed to its stated objectives, this approach could be compatible with the FCA’s statement that the underlying fund is to be viewed as an ‘asset’ to be held in compliance with the rules.

As is generally the case in SDR, the nature of the due diligence required is a decision for managers. It will also need to be confirmed whether any regime that the fund is currently being managed under (e.g. Art. 9 SFDR) would allow simplified due diligence to be performed.

# ANNEX 2

## RELATIONSHIP BETWEEN CONTENT OF THE CONSUMER FACING DISCLOSURE AND RELATED ASPECTS OF OTHER DISCLOSURE REQUIREMENTS

### Where a sustainability label is used

Consumer-facing disclosures	Related content in the pre-contractual disclosures, and The public product-level sustainability report (Part B)
Manager's name, product name, identifier (e.g. ISIN), date.	
Sustainability label and prescribed descriptor: For the mixed goals label, the proportion invested in accordance with each sustainable investment category.	
<b>Sustainability goal*</b> The sustainability objective, including a summary of: <ul style="list-style-type: none"> <li>any material effect (or expected effect) on the financial risk and return due to the investment strategy used to pursue the objective.</li> <li>progress towards achieving the objective.</li> <li>any material negative environmental and/or social outcomes due to pursuing the objective.</li> </ul>	<b>Sustainability objective</b> The sustainability objective, including details of: <ul style="list-style-type: none"> <li>any material effect (or expected effect) on the financial risk and return due to the investment strategy used to pursue the objective.</li> <li>progress towards achieving the objective.</li> <li>any material negative environmental and/or social outcomes due to pursuing the objective.</li> </ul>
<b>Sustainability approach</b> A summary of the investment strategy and policy in plain English, setting out: the key sustainability characteristics of the assets that the product will and will not invest in. <ul style="list-style-type: none"> <li>the types of assets held for reasons other than to pursue the sustainability objective and why.</li> <li>a summary of the investor stewardship approach in supporting the achievement of the objective.</li> </ul>	<b>Sustainability approach</b> Details of the investment policy and strategy, in particular: <ul style="list-style-type: none"> <li>how the assets are selected, including the criteria applied in determining the assets' sustainability characteristics, and the evidence-based standard used.</li> <li>the types of assets held for reasons other than to pursue the sustainability objective and why.</li> <li>the investor stewardship strategy and resources in relation to supporting the achievement of the objective.</li> </ul>
<b>Sustainability metrics</b> A summary of relevant metrics, setting out: <ul style="list-style-type: none"> <li>KPIs showing progress towards achieving the objective.</li> <li>other metrics useful for understanding the product's sustainability characteristics.</li> <li>contextual information about the metrics.</li> </ul>	<b>Sustainability metrics</b> Details of: <ul style="list-style-type: none"> <li>performance against the KPIs.</li> <li>other metrics useful for understanding the investment policy and strategy.</li> <li>contextual information about the metrics.</li> </ul>
Signposting (including hyperlinks) to other information.	

**Where a sustainability label is not used but one or more prescribed sustainability-related terms are used in communications with retail clients**

Consumer-facing disclosures	Related content in the pre-contractual disclosures, and <i>The public product-level sustainability report (Part B)</i>
Manager's name, product name, identifier (e.g. ISIN), date.	
The purpose of sustainability labels and why the product does not use one.*	
<b>Sustainability approach</b> A summary of the investment strategy and policy in plain English, setting out: <ul style="list-style-type: none"> <li>the key sustainability characteristics of the assets that the product will and will not invest in.</li> </ul>	<b>Sustainability approach</b> Details of the investment policy and strategy, in particular: <ul style="list-style-type: none"> <li>how the assets are selected, including the criteria applied in determining the assets' sustainability characteristics.</li> </ul>
<b>Sustainability metrics</b> A summary of relevant metrics, setting out: <ul style="list-style-type: none"> <li>other metrics useful for understanding the product's sustainability characteristics.</li> <li>contextual information about the metrics.</li> </ul>	<b>Sustainability metrics</b> Details of: <ul style="list-style-type: none"> <li>other metrics useful for understanding the investment policy and strategy.</li> <li>contextual information about the metrics.</li> </ul>
Signposting (including hyperlinks) to other information.	
Any further information in ESG 5.2.2R the manager considers appropriate.	

\*These items or sections are to be located prominently at the front of the CFD.





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