

KIRKLAND & ELLIS

Kirkland Alert

UK's Financial Conduct Authority Publishes Final Sustainability Disclosure Requirements

07 December 2023

On November 28, 2023, the UK's Financial Conduct Authority ("FCA") published the [Sustainability Labelling and Disclosure of Sustainability-Related Financial Information Instrument 2023](#) (the "SDR"). The SDR formalizes an anti-greenwashing rule and introduces the UK's sustainability labelling and disclosure regime for UK financial products, following a November 2021 [Discussion Paper](#) and October 2022 [Consultation Paper](#).

The anti-greenwashing rule is broad and applies to all firms authorized by the FCA when communicating with clients (including existing and prospective investors) in the UK in relation to a product, service or financial promotion. The [Policy Statement](#) accompanying the SDR underscores that this rule will apply to the more than 45,000 firms authorized in the UK, which includes UK subsidiaries of non-UK managers.

The sustainability labelling and disclosure requirements apply more narrowly and are limited, at least for the time being, to managers of UK domiciled funds (or an "alternative investment fund" or "AIF" as defined in the AIFMD) and UK UCITS in relation to FCA-authorized funds and certain unauthorized funds.

In this *Alert*, we summarize the key features of the SDR and highlight some potential future developments.

Overview of SDR

The SDR introduces four key elements:

1. The anti-greenwashing rule;

2. Four “sustainability labels” – “sustainability focus”, “sustainability improvers”, “sustainability impact” and “sustainability mixed goals”;
3. Product-level disclosures and reports, including a “consumer-facing disclosure”, a “pre-contractual disclosure”, a “public product-level sustainability report” (including an annual report) and a requirement to make available certain “on-demand sustainability information”; and
4. An entity-level report, in the form of an annual “sustainability entity report”.

The anti-greenwashing rule comes into force on May 31, 2024. The labels are available for first use from July 31, 2024, but are not required to be applied until the underlying restrictions on naming and marketing take effect on December 2, 2024.

The first product-level annual reports, as well as annual entity-level reports for managers with assets under management of £50 billion or more (calculated as a three-year rolling average), are due no later than December 2, 2025. The annual entity-level reporting requirements extend to managers with assets under management of £5 billion or more (also a three-year rolling average) in the following year, with reports due no later December 2, 2026.

Scope of Application

With the exception of the anti-greenwashing rule, the scope of application of the SDR is relatively limited, particularly for non-UK managers. In particular, the labelling and disclosure requirements of the SDR are narrower than proposed in the Consultation Paper, and narrower than the TCFD-related requirements of the ESG Sourcebook (as covered in our previous *Alert*, [EU and UK Regulatory Update for Fund Sponsors](#)).

Materially, the labelling and disclosure requirements do not apply to non-UK funds or any portfolio management activities. For non-UK managers, including those with UK subsidiaries providing portfolio management on a delegated basis, the labelling and disclosure requirements of the SDR are of no immediate application.

These limitations are intentional. The Policy Statement notes that the FCA has excluded both overseas funds and portfolio management from the requirements for the time being in response to stakeholder feedback.

More generally, the FCA [is consulting on](#) its approach to overseas funds and may consider extending some or all the SDR requirements to “all types” of portfolio managers.

The Anti-Greenwashing Rule

The anti-greenwashing rule builds on existing requirements that communications are “fair, clear and not misleading”. The rule requires that any communications by an FCA-authorized firm with an investor or other client in the UK, in relation to the environmental or social characteristics of a product or service, must be:

1. Consistent with those environmental or social characteristics; and
2. Fair, clear and not misleading.

The SDR was accompanied by the announcement of a consultation in relation to [Guidance on the Anti-Greenwashing Rule](#) (“Proposed Anti-Greenwashing Guidance”), which articulates the FCA’s reasoning for introducing the anti-greenwashing rule and its expectations of firms under the rule, namely, that communications that make sustainability-related claims are:

1. Correct and capable of being substantiated;
2. Clear and presented in a way that can be understood;
3. Complete, including by not omitting important information and by considering the full life cycle of the product or service; and
4. Fair and meaningful in relation to any comparisons to other products or services.

The Proposed Anti-Greenwashing Guidance expands on each of the above categories, including illustrative examples of products making misleading or inaccurate claims or overstating the role of, or extent of integration of, environmental or social characteristics into the investment decision-making process. The Proposed Anti-Greenwashing Guidance specifically warns, among other things, against:

1. Making claims without robust, relevant and credible evidence;
2. Using very technical or, alternatively, very vague language to articulate claims;
3. Misleading imagery, logos and colors;
4. Highlighting only positive impacts while “disguising” negative impacts;
5. “Cherry-picking” information that relates only to part of a product’s life cycle; or
6. Claiming environmental or social characteristics where only meeting a “minimum standard of compliance with existing legal requirements”.

The Proposed Anti-Greenwashing Guidance is open for consultation until January 26, 2024, and proposed to take effect from May 31, 2024 (the date on which the anti-

greenwashing rule takes effect).

Use of Sustainability Labels

Provided that they meet certain criteria, products may be labelled with one of the following “sustainability labels”:

- Sustainability focus;
- Sustainability improvers;
- Sustainability impact; or
- Sustainability mixed goals.

These labels are accompanied by a set of general criteria applicable to the use of all of these labels and a set of specific criteria applicable to each label.

General Criteria Applicable to All Sustainability Labels

The general criteria notably include requirements for:

1. At least 70% of the gross value of the product’s assets to be invested in accordance with the product’s “sustainability objective”, which objective must align with one of the sustainability labels and be explicitly identified together with “robust and evidence-based KPIs”;
2. Assets to be selected with reference to a “robust, evidence-based standard that is an absolute measure of environmental and/or social sustainability”, the suitability of which standard is required to be the subject of third party or other independent assessment; and
3. An escalation plan setting out requirements that the manager will take if any of the assets do not demonstrate sufficient performance against the sustainability objective or the chosen KPIs.

Specific Criteria

The specific criteria require the sustainability objective of products applying the following labels to be consistent with the following aims:

1. "Sustainability focus" – investing in assets that "are environmentally and/or socially sustainable";
2. "Sustainability improvers" – investing in assets that "have the potential to improve environmental and/or social sustainability over time";
3. "Sustainability impact" – a "pre-defined, measurable impact in relation to an environmental and/or social outcome"; and
4. "Sustainability mixed goals" – a combination of two or more of the aims of the other labels.

Use of Sustainability-Related Terms

The labelling regime is accompanied by a prohibition on managers using any "sustainability-related terms" within product names or financial promotions to retail clients, except to make short factual statements that are not financial promotions or to make statements in a context not intended to refer to or describe environmental or social characteristics of a product.

The SDR identifies the following as "sustainability-related terms":

- ESG (or environmental, social and governance);
- Environment, environmental or environmentally;
- Social or socially;
- Climate;
- Sustainable or sustainability;
- Green;
- Transition;
- Net zero;
- Impact;
- Responsible;
- Sustainable development goals or SDG(s);
- Paris-aligned; and
- "any other term which implies that a [relevant financial product] has environmental or social characteristics."

This prohibition on "sustainability-related terms" applies:

1. In relation to product names, unless: (a) a sustainability label has been applied to the product or (b) the product has material environmental and/or social characteristics, the name of the product accurately reflects its characteristics and certain disclaimers are applied, and (c) relevant product-level disclosures are made; and
2. In relation to financial promotions to retail clients, unless relevant product-level disclosures are made and the promotion is consistent with those disclosures.

Product-Level Disclosure Requirements

Products marketed to retail clients with a sustainability label or with sustainability-related terms in their names must include:

1. A consumer-facing disclosure setting out key details of the product including, in relation to a product with a sustainability label, a specific description of the label;
2. A pre-contractual disclosure, either by including specified information in the prospectus or regulatory disclosure statement for the product or in a specified form; and
3. An annual product-level sustainability report.

Managers of unauthorized UK funds are separately required to make available certain “on-demand sustainability information”, including information equivalent to that included in pre-contractual disclosures and annual product-level sustainability reports, upon request and no more frequently than once every 12 months, and not before December 2, 2025.

Entity-Level Disclosure Requirements

Managers are also required to prepare an annual “sustainability entity report”, regardless of whether their products use a sustainability label or sustainability-related terms.

The sustainability entity report is required to include, among other things, information in relation to the manager’s:

1. Governance with respect to sustainability risks and opportunities;

2. Actual and potential impacts of sustainability-related risks and opportunities on the manager's businesses, strategy and financial planning;
3. Identification, assessment and management of sustainability-related risks; and
4. Metrics and targets used to assess and manage relevant material sustainability-related risks.

Potential Future Developments

As discussed above, the FCA intends to consider a possible future extension of the SDR to portfolio management and overseas funds. But even absent extension to overseas funds, the labels introduced by the SDR may prove to be globally influential. The Policy Statement accompanying the SDR includes a notional mapping to product categories proposed in the [consultation regarding the implementation of the EU's Sustainable Finance Disclosure Regulation \(SFDR\)](#), including by illustrating how "sustainability improvers", "sustainability impact" and "sustainability focus" might align with possible, future EU-wide labels for products with a transition focus, products offering "targeted and measurable solutions to sustainability-related problems that affect people and/or the planet" and products aiming to meet credible sustainability standards, respectively. It is also possible the SEC may take the development of the SDR into account as it considers finalization of its previously [proposed ESG disclosure rules for registered investment advisers and funds](#), particularly given that several commenters, including the [American Investment Council](#), asked the SEC to consider consistency with other regulatory regimes in crafting its final rule.

Authors

Rhys Davies

Partner / London

Daniel D'Ambrosio

Partner / London

Lisa Hsin

Of Counsel / London

Revathi Raghavan

Partner / London

James Roslington

Partner / London

Lisa Cawley

Partner / London

Julia Dixon

Partner / London

Prem Mohan

Partner / London

Alexandra N. Farmer, P.C.

Partner / Washington, D.C.

Jennie Morawetz

Partner / Washington, D.C.

Related Services

Practices

- ESG & Impact
- Investment Funds
- Regulatory Solutions

Suggested Reading

- 07 December 2023 Sponsored Event COP28: How the Law Can Unite and Act to Deliver the UN SDGs

- 06 December 2023 Press Release Kirkland Represents Snowhawk Partners on Strategic Investment from Nuveen
- 05 December 2023 Award North America Innovative Lawyers Awards 2023

This publication is distributed with the understanding that the author, publisher and distributor of this publication and/or any linked publication are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to applicable rules of professional conduct, portions of this publication may constitute Attorney Advertising.

© 2023 Kirkland & Ellis LLP.