

The FCA's proposed anti-greenwashing rule and Sustainability Disclosure Requirements: what does “sustainable” mean?

At COP26 last year, the Chief Executive of the Financial Conduct Authority (**FCA**) warned the financial services industry that it was time to “walk the walk”, and emphasised that greenwashing would not be tolerated in the industry. In this context, the FCA published a consultation paper (**CP**) on Sustainability Disclosure Requirements (**SDR**) and investment labels on 25 October 2022, in line with the UK Government’s Roadmap to Sustainable Investing. This bulletin examines the main proposals under the CP.

Topics covered in this bulletin include:

Implications of the SDR for boards and management teams

A list of key points that boards and management teams should note from the FCA’s proposals. Also included is a set of recommendations for firms in-scope of these proposed rules.

Sustainable investment labels and coherence with international regimes

A detailed discussion of the FCA’s proposals to create a series of “sustainable investment labels”. We also tabulate the degree of divergence or otherwise coherence of these labels with other international regimes (in particular, the Sustainable Finance Disclosure Regulation (**SFDR**) and the EU Taxonomy Regulation).

Disclosure requirements

A discussion of the FCA’s proposals concerning a first tier of consumer-facing disclosures, and a second tier of detailed disclosures. The latter includes pre-contractual disclosures, ongoing sustainability-related performance information and sustainability entity reports.

Naming and marketing rules, including the anti-greenwashing rule

Restricting the use of sustainability-related terms unless products qualify for the FCA’s proposed labels, and a newly introduced general anti-greenwashing rule, applying to all regulated firms.

Requirements for distributors

An overview of the requirements proposed for market intermediaries, such as distributors, in communicating sustainability-related information along the investment chain.

Enforcement and litigation risks

A discussion of the litigation and enforcement risks that arise from the proposed SDR, other existing FCA rules and the FCA’s general direction of travel.

Background: how the CP fits within the UK's broader sustainable finance goals

At COP26 last year, the Chief Executive of the Financial Conduct Authority (FCA), Nikhil Rathi, warned the financial services industry that it was time to “walk the walk”, and emphasised that greenwashing would not be tolerated in the UK financial services industry.¹ In this context, the FCA published a consultation paper² (CP) on the Sustainability Disclosure Requirements (SDR) and investment labels on 25 October 2022. The Government’s Roadmap to Sustainable Investing (October 2021)³ specifically foreshadowed the development and publication of a sustainable investment labelling system.

The SDR CP demonstrates alignment with broader FCA principles and the UK’s wider sustainable finance goals. For example, the FCA’s proposals align with its forthcoming Consumer Duty and new Principle (Principle 12), which requires firms to “act to deliver good outcomes for retail customers”⁴ and build on existing requirements for firms in the FCA Guiding Principles on the design, delivery and disclosure of ESG and sustainable investment funds set out in the Dear Chair Letter (July 2021).⁵

Further, the FCA is proposing a general anti-greenwashing rule requiring **all regulated firms** (including those that approve financial promotions for unauthorised persons) to ensure that sustainability-related claims, naming and marketing are clear, fair and not misleading, and consistent with the sustainability profile of products. We expect this to be only the start of the FCA’s focus on greenwashing across the financial services industry, and suggest that all firms should be paying close attention

to developing regulatory expectations in this space, particularly as the Consumer Duty will soon be in force.

In line with this, the objectives of the SDR proposals are to:

- protect consumers and improve trust in the ESG and sustainable investment products market;
- enhance transparency for end consumers;
- meet the information needs of institutional investors; and
- help combat potential “greenwashing” by requiring firms to produce evidence for the ESG claims they make.

As secondary outcomes, the proposals aim to increase the provision of sustainable investment products and increase capital flows into sustainable activities.⁶

Scope: what the CP will cover

Disclosure, labelling and classification, and the naming and marketing rules, will apply to UK fund advisers initially. Financial advisers, private banks and platforms may also fall in scope in their capacity as distributors of product-level information. Further, the “anti-greenwashing” rule will apply to all regulated firms. In general, the FCA intends to build on the proposals in the CP and follow up with further consultations, including to expand the scope of the regime to overseas and pension products. Our analysis as to the scope is set out in the table below.

	Funds using the label	Other funds with integral “sustainable characteristics”	All other funds	Portfolio mandates using label	Retail	Institutional	Other
Strand 1 – Labels	✓			✓	✓	✓	
*Prohibition on use of key terms in name/marketing (ESG, etc.) to support regime		✓ (subject to limited carve out)	✓	✓ (subject to exemption if 90% of portfolio = fund label)	✓		
Strand 2 – Consumer-facing disclosures	✓	✓	✓	N/A but a different (limited) disclosure rule applies	✓		
Strand 3 – Detailed disclosures	✓	✓ (but limited)		As above	✓	✓	
(1) Pre-contractual							
(2) Ongoing sustainability-related performance information disclosures (NB: highly complex scope and other provisions apply)	✓			✓ (as above, PLUS on demand in limited scenarios)	✓	✓	
(3) Entity-level disclosures	✓ (subject to size threshold)	✓ (subject to size threshold)	✓ (subject to size threshold)	✓ (subject to size threshold)	✓ (subject to size threshold)	✓ (subject to size threshold)	
Strand 4 – Naming and marketing rules See also comment re prohibition above*		✓	✓	✓ (subject to exemption if 90% of portfolio = fund label)	✓		
Strand 5 – Distributor rules							✓ (retail only)
Strand 6 – General anti-greenwashing rule							✓ (all firms, products, services)

1 <https://www.fca.org.uk/news/speeches/strategy-positive-sustainable-change>

2 <https://www.fca.org.uk/publication/consultation/cp22-20.pdf>

3 UK Government, Greening Finance: A Roadmap to Sustainable Investing, 18 October 2021. <https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing>

4 <https://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf> FCA, Finalised Guidance FG22/5 Final non-Handbook Guidance for firms on the Consumer Duty, July 2022

5 FCA, Guiding principles on design, delivery and disclosure of ESG and sustainable investment funds, 19 July 2021. <https://www.fca.org.uk/news/news-stories/guiding-principles-on-design-delivery-disclosure-esg-sustainable-investment-funds>

6 SDR CP, 1.31 (Figure 1)



Implications for firms, including boards and senior management

Boards and senior management teams should note the following key points from the FCA's CP.

Embarking on a classification exercise

First, in-scope firms should plan to embark on a similar classification exercise to that undertaken for the Sustainable Finance Disclosure Regulation (SFDR). In this context, they will be required to compare the new labels against their existing product range, and any new products in development. The labels are backed by a prohibition, such that relevant firms cannot use the types of prescribed terms ("ESG", "impact", etc.) in a product's name or marketing material if they decide not to use the label. We discuss this further below.

Anti-greenwashing rule

Second, the new anti-greenwashing rule is notable. Although the FCA has emphasised that this merely reiterates existing rules rather than imposing new obligations, the rule is indicative of the FCA's increased focus on greenwashing and its intention to stringently enforce against non-compliant firms, moving forward. In this context, due consideration should be applied to ensure that claims made in the firm's annual reports, publications, advertisements and client communications are in line with the FCA's ESG Sourcebook. Firms should consider whether current governance models and oversight arrangements are adequate. In the face of the ever-present challenges of data collection and integrity, boards should ensure that there are robust reporting processes and controls in place to ensure accurate disclosures, with appropriate Risk and Audit involvement.

Divergence from international regimes

Third, we expect that the proposed new UK regime will give rise to further fragmentation internationally, which firms with a global footprint will have to come to terms with. In particular, there will be operational challenges for firms with products and strategies straddling both the EU and UK regimes. As set out below, this is because different disclosures will be required to be made by different operating entities in different jurisdictions.

Broadened scope of regulatory requirements

Fourth, and more broadly, the FCA has set out a clear direction of travel towards a broadened scope of regulatory requirements, through capturing more products and expanding the nature of disclosure, that reflects the parallel developments of standards such as those being produced by the International Sustainability Standards Board (ISSB). In this light, boards should consider adopting a proactive approach to forward planning for other requirements, especially retail consumer-facing products to be caught within the SDR's scope. Ensuring that robust sustainability KPIs and investment policies (and control frameworks) underpin their portfolios of products, even in advance of the FCA publishing rules on these, will give firms a head start once the regulations are rolled out.

Staying abreast of new disclosure requirements

Finally, firms need to stay abreast of new disclosure requirements (including consumer-facing disclosures and the three types of more detailed disclosures, as discussed below). They should plan ahead to ensure that policies, procedures and reporting frameworks are in place to accurately make the required disclosures, with due consideration given to the expectations set out in the FCA's Consumer Duty in relation to consumer understanding and testing of communications.

Enforcement and litigation risk

Finally, boards should be mindful of enforcement and litigation risk. By proposing the introduction of a specific rule that is designed to tackle greenwashing, the FCA is setting down a very clear marker for the industry. The FCA has expressly stated in its CP that, when it reviews sustainability claims made by firms, the anti-greenwashing rule will be an "explicit rule on which to challenge firms" and take enforcement action. This is a much more forceful enforcement statement than we have previously seen from the FCA on greenwashing, which may signal the start of a new era of enforcement investigations into suspected greenwashing across the financial services industry. These enforcement investigations would sit alongside the considerable number of investigations that the FCA is working on in relation to other ESG-related topics, including governance, culture and "non-financial misconduct". With increased enforcement risks, firms should also be aware of the increased potential for NGOs and pressure groups to pursue follow-on litigation, as discussed further below.



Sustainable investment labels

The FCA is proposing to create the following series of “sustainable investment labels”:

- sustainable focus;
- sustainable improvers (intended to capture climate transition funding, which is being welcomed by the industry); and
- sustainable impact.

Relevant firms can choose to use the labels, provided they meet the prescribed criteria.

The labels will apply to both retail and institutional-facing businesses and, for the most part, to both funds and segregated mandates (including model portfolio services). There are three key points to be aware of, consistent with industry lobbying efforts:

- the focus is on intentionality, that is, what does a particular product “seek” to do?;
- there is no hierarchy, unlike in the SFDR, ie the FCA has taken pains to ensure one label is not considered superior to another;
- in response to lobbying, the FCA has decided not to introduce a mandatory requirement for firms to seek independent verification of a label at this stage – for many in the industry, this will be welcome.

The purpose of the regime is threefold: (i) to help consumers more easily navigate the market for ESG investment products; (ii) to help consumers understand the different approaches taken to sustainability by different firms and products, and to better compare products; and (iii) to help consumers find products meeting their sustainability preferences.

The FCA has said: “[Our consumer research shows that consumers find labels useful and help consumers understand the sustainability characteristics of funds](#)”. The market generally considers this to be true.

For now at least, the scope is tightly limited: funds and segregated mandates. As such, fund-link products, structured products, CLOs, derivatives, bonds and SIPPs will all be out of scope, although the FCA is considering fund-link products and pensions further. The scope will also be limited to UK fund and portfolio managers for now, although this may give rise to concerns about the lack of a level playing field for UK firms. There is also a potential area for confusion regarding harmonisation; for example, a UK fund may be subject to a label, but an EU fund will not. With a “nod” to this, the FCA has imposed an obligation on UK retail distributors such as platforms, advisers, IFAs, private banks, etc. They will be required to provide a warning when they distribute “recognised schemes” to UK retail, where the relevant product uses certain prescribed terms in its name or marketing materials (eg “ESG”, “climate”, “sustainable”, “impact”, etc.). The warning will read: “This product is based overseas and is not subject to FCA sustainable investment labelling and disclosure requirements”. The FCA has also foreshadowed a further consultation on overseas funds, reflecting its new post-Brexit regime on this front. This new UK regime

allows funds such as EU UCITS funds to be sold into the UK to retail investors, which would otherwise have been an issue given that the UCITS Directive passport has fallen away post-Brexit. It should be noted that any attempt by the UK to impose labelling or SDR requirements on such overseas funds may be controversial, as EU fund managers are unlikely to wish to have to comply with both the EU regime (the SFDR and EU Taxonomy Regulation) and such UK rules, given the onerous nature of both regimes and the duplication this will involve.

In-scope firms will need to embark on a classification exercise, comparing the new labels against their existing product range, and any new products in development (akin to the exercise they do for SFDR compliance). The labels are backed by a prohibition, such that relevant firms cannot use “sustainability related terms”⁷ in a product’s name or marketing material if they decide not to use the label. But note that the focus of the prohibition is on retail, so firms with non-retail products will have more flexibility. It also appears that a model portfolio investing more than 90% of a portfolio in funds that use the label will be able to avoid using a label at the model portfolio level, if they wish.

Underpinning the label regime are three tiers:

- first, a series of overarching principles that must be met, covering the following grounds: sustainability objective, investment policy and strategy, KPIs, resources and governance, and stewardship;
- second, a series of “key considerations” which drill into each principle to provide detailed requirements that firms using the labels must comply with. Some are cross-cutting, applying to all three labels, and others apply on a solo basis;
- third, implementing guidance. Some of these requirements codify the content of the [Dear Chair](#) letter issued by the FCA in July 2021 – and will therefore be reasonably familiar to firms. Other points are new and will involve a learning curve.

On top of this, there is a disclosure. However, for the most part, the detailed disclosure and reporting rules are in the SDR element of the overall new rule (ESG 4) and not within the ESG labelling provisions (found in ESG 3).

Note also that, where sustainability-related features are integral to the investment policy and strategy of a particular product, but the relevant manager chooses not to use a label, the manager will need to ensure those features are communicated in a proportionate way to the sustainability profile of the product, in line with the FCA’s new naming and marketing rules. Although it is not clear what this will mean in practice, we expect, at a minimum, that the prescribed terms will not be able to be used in the product name.

⁷ See paragraph 3.2 of the CP.

Consumer-facing disclosures

Consumer-facing disclosures are the first tier of the FCA's disclosure requirements, intended to be short, simple communications that support consumers in understanding key features, comparing products, and therefore, making considered choices about investment products. These consumer-facing disclosures are required for all in-scope products (specifically, funds), not just those that will have a sustainability label (given the outcomes of the FCA's behavioural research).⁸ These consumer-facing disclosures only apply to retail-facing products and are otherwise not applicable to institutional investors.

The FCA underlines the importance of these disclosures being clear and concise, using language that is familiar and comprehensible to consumers, and accurately describing features in plain English.

There are some potential conflicts between the stated aims of the proposals and the detail of the requirements. For example, the consumer-facing disclosure is to be a new, standalone document, which summarises the information provided in the detailed product-level disclosures, and covers in particular the sustainability objective, a summary of key elements of the investment strategy, sustainability metrics and a summary of "unexpected investments". Providing all of this in a format that is consistent and comparable in no more than two pages of A4 could prove a tall order.

The CP recognises there is a risk that consumers will consider sustainability-related information in isolation from other decision-useful information, including costs and charges. Therefore, the consumer-facing disclosures are required to be provided alongside other key investor information and, for products which qualify for a label, should be "no more than one mouse click away" from where the label is presented. Clear and careful signposting will be critical to avoid confusion for consumers. Where a firm is providing portfolio management services to a retail client there is a more limited requirement to provide an index of sustainability products in which it invests, including links to the relevant consumer-facing disclosures, which may present administrative challenges.

The FCA's Consumer Duty, which will apply from July 2023, includes detailed rules and guidance on how firms are expected to support consumers' understanding of products and services by ensuring communications meet their information needs, are likely to be understood and equip them to make effective decisions. There is a significant emphasis on understanding the characteristics of the target market for a product or service, considering consumers' capabilities and tailoring communications to meet their needs, including putting in place testing and monitoring.

It is clear that the FCA's own behavioural research and disclosure testing has been a key driver in shaping its SDR proposals and expectations of firms. The CP explicitly refers to the new Consumer Duty requirements, and notes that firms will need to carry out their own testing of communications of consumer-facing disclosures for the SDR, in particular in relation to "unexpected investments". This term, "unexpected investments" is used by the FCA to describe any types of holdings that a firm would reasonably expect consumers of the product to find "surprising", ie inconsistent with the sustainability objective. A firm may also be faced with the burden of conducting consumer testing to determine the types of holdings that consumers would or would not expect a product to invest in, in order to internally determine which investments may be reasonably perceived to be inconsistent with the sustainability objective of a product.

Interestingly, there is an explicit comment that any disclosures that firms produce should improve comprehension "at least as much" as the consumer-facing disclosure that the FCA tested in its research. We expect that there will be significant discussion across the industry on the preferred format and approach for these disclosures, and measures of comprehension. Firms may wish to consider whether their own consumer communications research aligns with that of the FCA.

Detailed disclosures

The FCA's disclosure proposals focus on delivering information on the sustainability-related features of investment products to relevant investors in an accessible way. In this light, the FCA proposes new requirements for pre-contractual disclosures, ongoing sustainability-related performance information and entity-level disclosures. We discuss these below.

Pre-contractual disclosures

The FCA's enhanced disclosure proposals introduce more detailed disclosures for fund managers, which may be extended to include certain FCA-regulated asset owners. These disclosures are an extension of the brief, consumer-facing disclosure requirements targeting retail investors, and provide more granular information that will be of interest to institutional investors and broader classes of stakeholders.

In accordance with the FCA's pre-contractual disclosure obligations, firms will need to include key sustainability-related information in pre-contractual materials⁹ relevant to in-scope investment products from 30 June 2024 (or as otherwise directed).

In-scope products will include all products using a sustainable investment label. However, the CP indicates that all products that do not qualify for a sustainable investment label, but nevertheless adopt sustainability-related features that are "integral to their investment policy and strategy", should also make disclosures as to the product's investment policy and strategy in a manner proportionate to the product's sustainability profile. Firms providing portfolio management services will not be required to produce their own pre-contractual disclosures (although they will need to provide investors with easy access to such disclosures). This and similar proposals through the consultation may give rise to significant IT challenges for portfolio managers (and the platforms that support them).

Under the FCA's proposal for pre-contractual disclosure, firms will need to address the qualifying criteria for sustainable labelling by providing detailed disclosure of the product's sustainability objectives, investment policy and strategy. In doing so, firms will need to make appropriate reference to their data sources, data limitations, methodologies and stewardship strategy. The FCA gives further guidance as to the content of these disclosure requirements at paragraph 5.50 of the CP.

The FCA proposals do not currently include requirements to mirror

⁸ Financial Conduct Authority, October 2022. Occasional Paper: Matter of fact-sheets: improving consumer comprehension of financial sustainability disclosures. Retrieved from <https://www.fca.org.uk/publication/occasional-papers/occasional-paper-62.pdf>

⁹ In the first instance, pre-contractual disclosures will need to be included in a dedicated section in all: (i) fund prospectuses; (ii) prior disclosure documents produced by full-scope UK AIFMs under FUND 3.2 of the FCA Handbook; and (iii) other pre-contractual materials in relation to in-scope products (such as alternative investment funds managed by small AIFMs), although the types of pre-contractual materials subject to these rules are expected to expand over time.

the “Do No Significant Harm”¹⁰ approach in the EU SFDR. However, firms are encouraged to consider any adverse social or environmental impacts that may arise in pursuing particular sustainability objectives. Firms will also need to provide detailed disclosure of “unexpected investments” and, in relation to “Sustainable Impact” products, make assessments as to whether investing in assets in line with the product’s theory of change could give rise to unintended negative consequences. The FCA has indicated that it will provide implementation guidance to assist firms. However, it is unclear at this stage how firms are expected to undertake these assessments or which relevant benchmarks products should be assessed against.

While the FCA recognises that sustainability-related metrics may be less developed than those relevant to climate-related impacts (and purports to account for such differences in the proposed SDR), the CP clearly signals a trend towards heightened and increasingly in-depth sustainability disclosure requirements. Fund managers (and other regulated entities) are encouraged to approach their disclosure obligations with diligence and to seek appropriate advice to ensure that they are meeting their disclosure obligations in this evolving regulatory landscape.

Ongoing sustainability-related performance information

The FCA proposes that firms disclose the sustainability-related performance of their products in a dedicated “sustainability product report” that builds on the Task Force on Climate-Related Financial Disclosures (TCFD) product report. This will be required for all products that qualify for a sustainable investment label (see above).^{11,12}

The sustainability product report must be published on the firm’s website (eg via a link from the homepage),¹³ display the relevant sustainable investment label and state the product’s sustainability objective and the degree of progress towards meeting that objective. The report must contain the following disclosures:

Investment policy and strategy: details on how the firm invests in accordance with its investment policy and strategy on an ongoing basis;

KPIs: details of the product’s performance against its KPIs;

Stewardship:¹⁴ details of its specified (credible, rigorous and evidence-based) KPIs related to stewardship, including engagement and voting activity relevant to the delivery of the product and details of outcomes of its stewardship activities;¹⁵

Category-specific criteria: the report will also contain the following in respect of specific labels:

Label	Sustainable Focus	Sustainable Improvers	Sustainable Impact
Criteria	<p>KPIs: The firm must disclose the KPIs specified in accordance with the requirements for this category Chapter 4 of the CP. See below.</p> <p>Stewardship: The firm must disclose how that strategy has been applied to achieve continuous improvement in environmental and/or social sustainability of the product’s assets and the outcomes achieved.</p>	<p>KPIs: The firm must disclose details of the KPIs specified in accordance with the requirements for this category under Chapter 4.</p>	<p>KPIs: The firm must disclose the KPIs specified in accordance with the requirements for this category under Chapter 4, also including:</p> <ul style="list-style-type: none"> – its analysis as to how its actions have contributed to the impact achieved; or – an explanation as to why its actions have not done so. <p>The firm must also disclose details as to how its rights and influence (including through direct control as relevant) have been applied to pursue the pre-defined, positive, measurable real-world outcome specified in the product’s sustainability objective, in line with its theory of change for the product.</p>

Others: firms should also disclose other metrics that institutional and retail consumers might find useful in understanding their approach to meeting sustainability objectives; an explanation of the methodology(ies) used; contextual information alongside KPIs/metrics, such as the use of proxies and assumptions; and historic annual calculations on KPIs/metrics after the first year of reporting.

Data and methodology: the FCA proposes that firms must use the most up-to-date information available within their reporting period when making disclosures, in line with the approach taken in the FCA’s TCFD rules. Where firms have encountered and addressed data gaps, they must explain how they have addressed such gaps. Where firms are unable to address data gaps, they must explain these gaps, why they have not been able to address them, and the future steps they will take to address such gaps. Where data gaps or methodological challenges are unable to be addressed by proxy data or assumptions without the disclosure being misleading, firms must not disclose such metrics.

The CP encourages firms to be transparent on the quality of data by explaining the proportion of each sustainability product for which data have been verified, reported, estimated or unavailable.

¹⁰ That is, disclosures on how a sustainable investment does not significantly harm the sustainability objective.

¹¹ SDR CP, 5.58-5.78.

¹² Note that firms providing portfolio management services will not be required to produce such reports, but must provide retail investors with easy access to any relevant disclosures (eg by hyperlinks on their website).

¹³ In certain client relationships (eg firms that provide discretionary portfolio management services and UK AIFMs managing unauthorised AIFs that are not listed on a recognised investment exchange), where public disclosures are not appropriate, the FCA proposes on-demand reporting.

¹⁴ Only relevant where stewardship plays a significant role in the product’s investment policy and strategy.

¹⁵ Note that these disclosures can be made in existing stewardship-related reporting (eg reporting as a signatory of the UK Stewardship Code 2020), and then cross-referenced in the sustainability product report.

Sustainability entity report

On top of disclosures on a firm's products, firms themselves should disclose how they are taking sustainability-related matters into account when managing investments on behalf of institutional and retail consumers. This should be disclosed in a dedicated "sustainability entity report" that builds on the TCFD entity report, and must be published in a prominent place on the firm's website (eg via a link from the homepage).¹⁶

The FCA recognises that different firms will take different approaches to the topics covered by the umbrella term "sustainability". Its CP therefore does not stipulate the topics that firms must disclose on, but gives the following general guidance:

- firms should disclose on the sustainability-related topics they have prioritised in their governance, strategy and risk management, and the rationale for such disclosure;
- disclosures should be made under the four pillars of TCFD's recommendations: (i) governance around sustainability-related risks and opportunities; (ii) actual and potential impacts of sustainability-related risks and opportunities on their businesses, strategy and financial planning; (iii) how the firm identifies, assesses and manages sustainability-related risks; and (iv) the metrics and targets used to assess and manage relevant sustainability-related risks;

- disclosures should be in respect of firms' operations, and how they manage assets on behalf of clients;
- firms may refer to the ISSB's proposed general sustainability-related disclosure requirements (IFRS S1) to determine the content of their disclosures, but the FCA does not expect fund managers to disclose each line item (given the IFRS S1 is targeted at corporate entities and not fund managers);
- firms may refer to the Sustainability Accounting Standards Board (**SASB**) standards to help determine the sector-specific information to disclose;
- where a firm uses a sustainable investment label on its product(s), it must: (i) describe the arrangements and resources it has in place to oversee the sustainability research, data and analytical tools that it uses in supporting that product's sustainability objective; and (ii) describe the resources, governance and organisational arrangements that appropriately support and incentivise the high-quality delivery of its documented investment policy and strategy in line with that sustainable investment product's sustainability objective.

The proposals on data and methodology are the same as those discussed in the sustainability product report.

Naming and marketing rules

The FCA proposes applying the following naming and marketing rules to retail products only (and not institutional investor products):¹⁷

- if a firm's product does not qualify for any sustainable label, it is prohibited from using terms including (but not limited to): "ESG", "environmental", "social", "governance", "climate", "impact", "sustainable", "sustainability", "responsible", "green", "SDG" (sustainable development goals), "Paris-aligned" or "net zero" in its product names and marketing; and

- a firm providing Sustainable Focus or Sustainable Improver products is prohibited from using the term "impact" in the naming and marketing of these products.

Note that these prohibitions will not apply in relation to disclosures of factual information in pre-contractual disclosures, the summary of information in consumer-facing disclosures, or any other disclosure requirements to which a firm may be subject.

Requirements for distributors

The CP also recognises the importance of market intermediaries, such as distributors,¹⁸ in communicating sustainability-related information along the investment chain, and includes a number of proposals for regulating the conduct of distributors in relation to sustainable investment labels and associated disclosures:

- distributors will be required to ensure that sustainable investment labels in respect of in-scope products offered to retail investors are displayed prominently on all relevant digital platforms, and provide investors with easy access to all relevant consumer-facing disclosures, irrespective of whether the relevant product uses a sustainable investment label;
- distributors must not apply or use sustainable investment labels in respect of any products that were not assigned by the relevant firm;
- distributors must keep all digital platforms and marketing information updated with any changes to product labels and disclosures; and
- where prohibited sustainability-related terms are used in relation to the naming and marketing of overseas products, distributors to retail investors of such products must: (i) prominently display a notice with such products alerting investors to the fact that the products are based overseas and are not subject to FCA sustainable investment labelling and disclosure requirements; and (ii) provide investors with a hyperlink to the relevant FCA materials.

The above proposals in relation to non-overseas products are consistent with current expectations on distributors for the distribution of financial products in the UK, and the FCA reminds distributors that they will need to continue complying with existing obligations (including under the FCA Consumer Duty rules).

In respect of the proposed rules applying to overseas products, the FCA has indicated that these measures are temporary and will be reviewed following a separate consultation on how the FCA's SDR could apply to overseas products, further highlighting the need for firms to remain diligent but flexible in respect of evolving sustainability-focused regulation.

¹⁶ SDR CP 5.83-5.103.

¹⁷ The reasoning behind this is that the FCA "[does] not consider this to be proportionate at this stage" to apply these restrictions to institutional investors also.

¹⁸ The FCA considers that "**distributors**" include market intermediaries that offer, sell, recommend, advise on, arrange, deal, propose or provide a product or service.

Anti-greenwashing rule

The creation of a general “anti-greenwashing” rule, applying to all regulated firms, is not given much prominence in the CP, receiving only a couple of paragraphs and a comment that this is, in effect, a restatement of existing requirements to ensure that information communicated to clients is clear, fair and not misleading. However, the FCA wants firms to understand that this applies when they are making sustainability claims, and goes on to state that this very high-level and broad requirement will give them an explicit rule whereby they can challenge firms on potential greenwashing and take enforcement action where appropriate.

The rule will require firms to ensure that the naming and marketing of financial products and services in the UK is clear, fair and not misleading, and consistent with the sustainability profile of the product or service, ie proportionate and not exaggerated. This rule reiterates existing rules under PRIN 2.1, Principle 7 and COBS 4.2.1., which require firms to pay due regard to the information needs of their clients

and communicate information to them in a way that is clear, fair and not misleading. This sits alongside other pre-existing requirements that the FCA could already turn to in order to tackle greenwashing, including Principle 2 (“A firm must conduct its business with due skill, care and diligence”), Principle 3 (“A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems”) and specific provisions in its Conduct of Business Sourcebook.

However, the FCA has considered it necessary to add a specific rule to the ESG Sourcebook to link this directly to sustainability claims, in order to ensure that firms understand that these principles apply when they make sustainability claims, and to give the FCA an explicit rule on which to challenge firms for greenwashing. The anti-greenwashing rule also underlines the need for proportionality, ie that firms’ claims must be proportionate to the sustainability profile of the product or service.

Divergence from/coherence with international regimes

Although the FCA has been at pains in its industry engagement to listen to the experience firms have had of the SFDR in the EU, it has been fairly clear throughout that it wishes to go its own way. It is therefore fair to say that the UK regime proposed in the consultation is not aligned with that of any other jurisdiction.

The proposed new UK regime will therefore give rise to further fragmentation internationally and firms with a global footprint will have to address this. In particular, there will be operational challenges for firms with products and strategies straddling both the EU and UK regimes. Different disclosures are required to be made by different operating entities in different jurisdictions, with the new RTS disclosure requirements for the SFDR and the EU taxonomy applying from 1 January 2023, and the UK regime (for the most part) proposed to come into force in stages from 30 June 2024.

There is also a concern regarding fragmentation within the UK market once the new regime begins to apply:

- a UK fund must use a label in some scenarios, but a structured product or fund-link policy with the same objective, sold in the UK market to the same clients by the same distributor, need not;
- a UK fund must use a label in some scenarios, but an EU UCITS sold into the UK with the same objective need not; and
- EU funds sold to UK retail will be subject to the SFDR and EU taxonomy, with disclosures in line with the RTS templates – retail clients will get a different disclosure document for their UK fund investments.

We expect that firms with a UK and EU product range will be looking closely at the consultation to identify the key points of difference, comparing the SFDR and the EU Taxonomy Regulation with the proposed new UK regime. Our analysis is set out in the table below.

Theme	SFDR and EU Taxonomy Regulation	UK SDR and sustainability labelling regime
Purpose	Not intended to be a labelling regime, but arguably is one	Labelling regime
Minimum standards	No minimum standards for Article 8 products; minimum standards for Article 9 products	Minimum standards for all products using the labels
Detail	Highly detailed and complex	Highly detailed and complex
Template required for product disclosures	Product disclosures required to be made using templates	No templates
Reporting requirements on PAI	Reporting required on PAIs (subject to an exception for small firms)	No PAI reporting
DNSH concept	Articles 8 and 9 products required to reflect the “Do Not Significantly Harm” (DNSH) concept	No DNSH concept (“which we consider may be too restrictive at this stage”), although some similar, albeit softer, requirements
Reporting against the taxonomy	Mandatory product-level reporting against the taxonomy (some products only)	No UK taxonomy yet, so no reporting yet required on this for any product
Reporting basis	Reporting based on a bespoke EU-based regime	Reporting based on TCFD, with a UK overlay and a promise to integrate ISSB requirements, when available
Coverage of product regime	Product regime covers funds, segregated mandates, some insurance products and some pension products	Product regime covers funds and segregated mandates only for now, but possibly some insurance and pension products in the future
Retail vs institutional	Retail and institutional (no difference)	Retail and institutional (although some aspects focus on the former)
Funds in/out of scope	In scope – funds sold into the EU under AIFMD	Out of scope – funds sold into the UK
Prohibition on specific words	No express prohibition on the use of specific words or phrases in product names or marketing material – although ESMA has issued guidance suggesting this is required under general anti-greenwashing considerations	Express prohibition on the use of specific words or phrases in product names or marketing materials, for retail-facing businesses, unless the sustainability label criteria is met
Good governance test	Articles 8 and 9 SFDR include a good governance test for products	Good governance is not explicitly a part of the UK regime

Enforcement risks

When taken together with the requirements of the forthcoming Consumer Duty, it is not difficult to see a future where the FCA will be devoting significant time and attention to examining firms' practices and taking swift action where firms are not deemed to have taken their responsibilities seriously. As discussed below, in relation to timing, the anti-greenwashing rule is intended to come into effect a year earlier than the labelling requirements, from the end of June 2023, as soon as the Policy Statement is published.

Firms should keep in mind that an enforcement investigation relating to ESG issues not only carries the risk of potentially significant sanctions (which, in addition to financial penalties and public censure, could also include the imposition of business restrictions and costly consumer or investor redress exercises), but also risks significant reputational harm and loss of client confidence.

The FCA has expressly flagged that it could take enforcement action if a firm fails to comply with a requirement to make disclosures (ie if it "has ignored" the requirements), makes misleading disclosures, misuses a label, or breaches the FCA's naming and marketing rules.

In this context, firms should be mindful of key enforcement risks;

- **Failure to make a disclosure:** Staying abreast of new disclosure requirements (including for consumer-facing disclosures and the three types of more detailed disclosures) and planning ahead to ensure that policies, procedures and reporting frameworks are in place to accurately make the required disclosures will be important for firms. It will be equally important to maintain open engagement and cooperate more generally with the regulator to discuss any issues and errors. The FCA may be amenable to providing a correction period to a firm if there has been a genuine mistake or justifiable reason for the failure to make a disclosure, but it would be more likely to open an enforcement investigation if the failure is perceived to have a significant effect on consumers, there were repeated failures to make disclosures, the failure was potentially intentional and/or the failure was identified by the firm without timely correction or escalation to the FCA.
- **Disclosing incorrect (or, arguably, poor quality, unclear or misleading) information:** Inadvertent inaccuracies are likely to be treated less severely if they are quickly identified and rectified. However, the FCA may be more concerned if the inaccuracy is perceived to have a significant effect on consumers (such as an inaccuracy in a consumer-facing disclosure as discussed above), given the overlap with the Consumer Duty. Further, repeated incorrect disclosures could trigger an investigation into whether these were intentional or a cause for wider concern. Accordingly, firms should ensure that they investigate the root causes and put in place further controls to mitigate the risk of reoccurrence.

Litigation risks

In addition to the above enforcement risks, the new rules may also enhance the litigation risk for firms, particularly as findings by regulators of a breach of relevant rules frequently form the basis of "follow on" litigation by claimants. In addition to claims under general law principles, this may include an increased risk of claims by consumers under s.138D of the Financial Services and Markets Act 2000 (**FSMA**), which provides a right of action against firms where a private individual has suffered loss as a result of a breach by the firm of FCA rules.

As already noted, the new general anti-greenwashing rule mirrors existing requirements, including in COBS 4.2.1, requiring marketing information to be fair, clear and not misleading. However, while the general rule in COBS 4.2.1 is subject to a carve-out such that a right of action under s.138D will not arise if the firm takes reasonable steps to ensure it complies with the fair, clear and not misleading rule, there is currently no equivalent carve-out in relation to the requirements in

- **Misusing a label:** Similarly to the approach to disclosures, inadvertent inaccuracies in the use of labels are likely to be treated less severely if they are quickly identified and rectified. However, repeated incorrect labelling could trigger an enforcement investigation into whether these are intentional or a cause for wider concern, including concerns around a firm's governance arrangements and wider systems and controls. Accordingly, firms should ensure that they create detailed policies and procedures for the labelling of investment products and reporting/escalation of any inaccuracies, and investigate the root causes of any inaccuracies in order to put in place further controls, thereby aiming to reduce the risk of reoccurrence.
- **Making intentionally false or misleading disclosures or deliberately misusing a label:** A firm is likely to face a much higher risk of FCA enforcement investigation and action if it is suspected of deliberately, recklessly or repeatedly making inaccurate or misleading disclosures, and/or inaccurately or misleadingly labelling its products. When considering which matters to initially refer to its Enforcement Division for investigation, the FCA is likely to select particularly poor examples of compliance or conduct, meaning that firms falling within this category are likely to be some of the first to be investigated and have action taken against them in the coming years.
- **Breaching other naming and marketing restrictions:** The FCA may be most likely to commence enforcement action on the basis of the general anti-greenwashing rule (discussed above), and its pre-existing requirements relating to firms' systems and controls. However, there is also a specific proposal for firms providing in-scope products to retail investors that do not qualify for the sustainable labels to not use sustainability-related terms (eg "ESG", "climate", "impact", "sustainable" or "sustainability", "responsible", "green", "SDG", "Paris-aligned" or "net zero") in their product names and marketing, and for "Sustainable Focus" or "Sustainable Improvers" products to not use the term "impact". Firms that misuse these labels can expect to receive at least some supervisory attention from the FCA, with enforcement action being reserved for firms that are identified as having repeated or deliberate issues in this area.

the proposed general anti-greenwashing rule, or in the more specific draft rules discussed above in relation to labelling and disclosure.¹⁹ This does raise the possibility that a firm could be held liable to consumers for misleading statements in relation to the sustainability aspects of a product even where it has acted reasonably.

More generally, increased disclosure requirements in relation to products marketed as sustainable bring with them increased risk of liability under the general law, including to institutional investors, where that disclosure turns out to be inaccurate or incomplete.

However, a key hurdle that claimants will face in bringing a successful claim for greenwashing will be establishing causation and loss: that is, claimants will need to establish that the relevant breach (such as applying a sustainability label in circumstances where the required criteria were not met) exposed them to an identifiable and measurable

¹⁹ See Appendix 1 to the CP.



drop in the product's value, translating to loss to the claimant. Even where a product turns out not to be as "green" as it was marketed to be, it is far from clear that this will have a material impact on the value of the product that will cause loss to investors. Furthermore, in the case of consumer claims, even where there has been loss, the amount of the loss to each individual consumer is likely to be relatively small, making the pursuit of litigation unattractive and reducing the likelihood that any such claims will make it to trial. The lack of an "opt-out" class action regime in the UK for such claims could simply make such claims uneconomical.

In light of these difficulties, it is currently unclear how attractive greenwashing claims (whether under s.138D of the FSMA or common law) which rely on the proposed new rules are likely to be to potential claimants.

However, firms should not discount the potential for greenwashing claims on this basis. NGOs and pressure groups are responsible for commencing a significant amount of greenwashing litigation worldwide. Such claims are often pursued by NGOs, not to recover loss, but as a means of putting pressure on entities to change behaviours by "naming and shaming" those who make misleading environmental statements about product performance or their business practices. The introduction of additional and/or enhanced disclosure and sustainable labelling requirements set out in the CP may further support claims of this nature by NGOs in the UK if firms are seen to be falling short of their obligations.

Timing: what to expect in terms of next steps

The FCA will review the feedback received (the FCA are seeking comment by 25 January 2023) and intends to set out final rules in a policy statement by the end of the first half of 2023.

Provisionally, the following timelines have been suggested:

- the labelling, naming, marketing and initial disclosure requirements would come into effect by 30 June 2024;
- the first ongoing sustainability performance-related disclosures must be published 24 months after publication of the PS (provisionally, from 30 June 2025);

- entity-level disclosures in the sustainability entity report will have a staggered implementation, with the largest firms producing their first disclosures 24 months after publication of the PS (provisionally, too; (first disclosures one year after that)).

By contrast, the "anti-greenwashing rule" will enter into effect as soon as the FCA publishes the relevant policy statement (expected to be on 30 June 2023).

Horizon: the FCA proposal – just the beginning

There are several areas where the FCA has signalled its intention to either expand its proposals to include new products or in-scope entities, or amend its existing proposals under the CP.²⁰

– Additions to scope:

- Pension products:²¹ The CP includes significant discussion on pension products, and poses several questions to respondents on what the appropriate labelling and classification regime, disclosure requirements, and naming and marketing rules would be for pension products;
- Other investment products:²² The FCA intends to bring other products that are marketed to retail investors into scope (for example, IBIPs and exchange-traded products), and is seeking views on the applicability of the CP's proposals to such products;
- Overseas products: The FCA will continue to work with the Treasury on how to treat overseas products, and intends to follow up with a separate consultation on this; and
- Financial advisers: The FCA is exploring how to introduce rules for financial advisers when considering sustainability matters in their investment advice, and intends to follow up with a separate consultation on this.

– Amendments to rules:

- Listed issuers: The FCA intends to adapt its TCFD-aligned disclosure rules for listed issuers to refer to ISSB standards (once they are finalised and available for use in the UK), and intends to follow up with a separate consultation on this;
- Transition plans: The FCA intends to build on its TCFD-aligned disclosure rules, referencing the TCFD's guidance on transition plans and publications from the Government's Transition Plan Taskforce;
- Sustainability-related metrics: The FCA intends to build on its product-level disclosure requirements by adding a baseline of core sustainability metrics, as further ISSB standards are developed; and
- Entity-level disclosures: The FCA intends to build on its entity-level disclosure requirements by adding more specificity and granularity to the requirements for different sustainability topics, as further ISSB standards are developed.

20 SDR CP 8.5-8.20.

21 SDR CP 8.5-8.17.

22 SDR CP 8.18.

Recommendations for firms in scope

As noted above, although it is early days for the consultation, the FCA has spent a long time considering its proposed approach and discussing it with the industry. Put simply, it is not likely to make radical changes to the proposal at this point, although some tweaks around the edges are possible.

Firms in scope of the UK's new proposed rules may wish to consider the following actions below.

Get organised	<p>Over time, the FCA has repeatedly emphasised points around governance and accountability. In our view, it is looking to see that firms have organised themselves in the right way, with sensible governance arrangements (including clarity on individual roles and responsibilities) to deal with the impact of climate change on a firm's organisation, together with other ESG risks and opportunities. It is going to become increasingly important to ensure firms take a 360 degree approach – ie integrating climate change and ESG into all relevant functions within their firm, from product development to reporting to IT and risk management.</p> <p>The FCA will also wish to see good governance applied to mitigate greenwashing risk in particular, both at the entity and product level. Given the new requirements, now is a good time for firms to review their product governance framework to ensure that there is appropriate review and challenge of product proposals, ensuring alignment with regulatory expectations.</p> <p>The FCA has also discussed its expectation that firms should consider how to embed consideration of ESG factors into the performance and remuneration of senior individuals.²³</p>
Risk and control frameworks	<p>Risk frameworks will need to be reviewed and updated to ensure that ESG-related risks are being identified and managed appropriately – reputational, legal and conduct risks are all key considerations alongside financial risks. This creates a complex matrix at an enterprise, product and jurisdictional, and individual legal entity level, which requires careful planning and management.</p> <p>The role of each line of defence in managing risks will need to be reviewed, with consideration given to the implications of new regulatory requirements for compliance monitoring, oversight and assurance programmes.</p>
Skills	<p>The FCA has repeatedly acknowledged that it is having to “skill up” on climate change and ESG – and, in our view, it will recognise the same in most firms, as they need to develop the skills internally to identify, manage and report on climate change and ESG-related matters. This will cover all areas, including board members and the senior management team, across the first line business and control functions.</p>
Ensure firms are aware of relevant regulatory priorities	<p>The FCA is stepping up its supervisory and enforcement focus. Firms may wish to ensure they properly understand the regulator's priorities, and launch an implementation project to adapt to the new FCA regime if they are within scope.</p>
Plug into what the industry is doing	<p>Trade bodies are engaging constructively, identifying key issues and lobbying. Firms may wish to ensure they are plugged into what such trade bodies are doing.</p>
Training	<p>Focus on staff awareness building and training – some of this will likely need to be built over time. But in areas such as product development, this should reflect the current views and expectations of regulators eg on greenwashing.</p>
Impact analysis and implementation project	<p>A cost-benefit analysis in the consultation is a good place to start.</p> <p>We recommend firms in scope begin an impact analysis to identify the impact of the new rules (including on their firm's existing fund range) and identify what will need to change. New funds being considered for launch should also be assessed.</p> <p>Where relevant, in-scope firms may also need to do a gap analysis between their existing approach to stewardship and the new regulatory expectations.</p> <p>Staff training is likely to be required, as well as changes to governance. For governance, the FCA estimates EUR216,000 per firm using labelling and perhaps EUR200,000 for a platform.</p> <p>A project should be launched, focusing in particular on IT development to adapt to the new requirements and build the new client and FCA reporting systems. This is likely to require extensive work, in particular to gather and assess new data inputs. The FCA estimates costs at around EUR118,000 per firm for those using labelling, and perhaps EUR213,000 for a platform. It goes without saying that IT changes are a “long lead time” item – it should therefore be a priority to identify the detailed IT changes required.</p> <p>New prospectus and annual reporting requirements will need to be adapted too.</p> <p>Firms with an EU presence will have conducted a classification exercise for the SFDR. Such an exercise will now be required for their UK retail funds as against the new UK product labelling regime and this fourth category – a fund with sustainability characteristics integral to its investment policy or strategy.</p> <p>Firms will also have to work out what they will take this to mean – ie where the line should be drawn.</p> <p>If fund names need to be changed or other changes need to be made to fund objectives, policies, etc. regarding individual funds in a firm's existing range, a change programme will have to be carefully planned, bearing in mind the FCA's filing obligations and the potential need for meetings with shareholders/unitholders.</p> <p>Many firms will be familiar with the EU European ESG Template (EET) – an industry initiative designed to standardise ESG-related data exchange between industry participants. A UK EET is under development – relevant firms may wish to ensure they are plugged into this work as well.</p> <p>Firms should ensure they coordinate their implementation work on the new FCA requirements discussed above with their implementation project on the FCA's new consumer duty. The FCA will expect a joined-up approach.</p> <p>Careful thought will be needed by firms selling EU funds into the UK retail market – they are not in scope, but it is not clear how distributors and the market will react to what will be essentially a highly fragmented UK landscape, as explained above.</p>

23 <https://www.fca.org.uk/publication/correspondence/dear-chair-remuneration-committee-2022.pdf>