ALLEN & OVERY

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UK FCA's new package of sustainability disclosure requirements, labelling rules and anti-greenwashing rule

The Financial Conduct Authority's (**FCA**) new package of sustainability disclosure requirements (**SDR**) and investment labelling rules is a key pillar of the UK government's efforts to introduce an economy-wide SDR regime. All FCA-authorised firms should pay attention to the anti-greenwashing rule which will come into force on 31 May 2024, and engage with the FCA's consultation on its proposed anti-greenwashing guidance. In addition, UK asset managers and distributors should familiarise themselves with the new rules, including the new labels that they may choose to use from 31 July 2024. In this bulletin, we explain how the key components of the FCA's new package fit together and highlight key considerations and actions for firms.

1. To what extent does the FCA's package apply to firms?

The FCA's new anti-greenwashing rule applies to all FCA-regulated firms in relation to communications with their UK-based clients or (in general terms) financial promotions issued to persons in the UK. The scope of the anti-greenwashing rule is extensive.

By contrast, the other rules in the FCA's new package have a more limited scope. Those rules only apply to UK firms and their UK-domiciled funds marketed in the UK,[1] subject to certain nuances. For example: certain rules only apply to retail business; fund managers of certain AIFs are not subject to certain public disclosure obligations but instead are subject to an "on demand" disclosure obligation; and there are minor exceptions where the regime applies to non-UK funds.

However, there are indications that the regime may be expanded over time – see what's on the horizon for UK SDR at section 13 of this bulletin.

To see our publication on FAQs on the FCA's new package of rules, please click here.

[1] The following are currently out of scope: overseas funds sold into the UK; portfolio management products or services; other types of products or services (e.g., structured products, bonds, fund link investments, pension products etc.); and certain types of funds – e.g., Social Entrepreneurship Funds (SEFs) and Qualifying Venture Capital Funds (RVECAs).

2. How the different components of the FCA's new package fit together

Pursuant to the FCA's new package of rules, fund managers will need to decide:

(a) whether they wish to be "in" (i.e. to use a sustainability label) or "out" in relation to any particular fund; and

(b) for those who wish to be "out" (i.e. not to use a sustainability label) in relation to a retail fund, whether they wish to use sustainability-related terms in the name of or marketing for the fund. If yes, they must comply with additional conditions and disclosure requirements.

As the regime gets phased in over time, all funds manufactured or sold in the UK will fall within one of the following categories:

(a) retail/institutional funds with the following labels: "sustainability impact"; "sustainability improvers"; "sustainability focus"; or "sustainability mixed goals";

(b) retail funds that use sustainability-related terms in their name or marketing (subject to exclusions); and

(c) all other funds that do not fall into the above categories.[2]

The following overview table* shows when each key component of the FCA's new package will apply.

Rule / label	Date coming into application	Applies to sustainability-labelled funds?		Applies to unlabelled funds using sustainability terms in name and marketing?	
		Retail	**Institutional**	**Retail**	**Institutional**
Anti-greenwashing rule	From 31 May 2024.	Yes – applies to all firms regulated by FCA.			
Sustainability-related labels	From 31 July 2024.	Yes	Yes	No	No
Entity-level sustainability disclosure rules	From 2 December 2025 (firms with above £50bn in AUM). From 2 December 2026 (firms with £5bn or more in AUM).	Yes – applies to UK asset managers with AUM of £5bn or more, even if labels and terms are not used.			
Product-level pre-contractual disclosure rules	From 31 July 2024 for labelled funds. From 2 December 2024 for unlabelled retail funds.	Yes	Yes	Yes	See footnote[3]
Ongoing product-level sustainability disclosure rules	From 12 months after the labels or terms are first used, and annually thereafter. However, on-demand product-level disclosures should be provided from 2 December 2025 within a reasonable period.	Yes	Yes	Yes	See footnote[4]
Naming and marketing rules (excluding the anti-greenwashing rule)	From 31 July 2024 for labelled retail funds. From 2 December 2024 for unlabelled retail funds.	Yes	No	Yes	No
Consumer-facing disclosure rules	From 31 July 2024 for labelled retail funds. From 2 December 2024 for unlabelled retail funds.	Yes	No	Yes	No
Distributors to communicate labels and consumer-facing disclosures	As soon as reasonably practicable after the firms produce the labels / disclosures.	Yes	No	Yes	No
Distributors to provide notice on overseas funds	By 2 December 2024.	No	No	Yes	No

**For illustration purposes, the above overview table distinguishes between retail-only funds and institutional-only funds.*

In the next few sections of this bulletin, we elaborate on each of the key components of the FCA's new package of rules and provide examples of actions for firms to consider.

[2] By way of example, the final category will include retail funds with no sustainability-related terms in their name or marketing materials. It would also include institutional funds whose managers decide not to use one of the labels, as well as funds out of scope, such as overseas funds sold to retail in the UK.
[3] The position is not entirely clear and so impacted firms may wish to reach out to their usual contact at A&O to discuss.
[4] As above.

3. Anti-greenwashing rule and guidance

The FCA's new anti-greenwashing rule applies to all FCA-regulated firms. It sets down a marker for both retail and wholesale firms regarding the FCA's expectations for all communications about financial products or services (including financial promotions) which refer to environmental and/or social characteristics. The rule will apply even to firms that approve financial promotions for unauthorised persons for communication in the UK, and irrespective of whether firms are subject to the Consumer Duty. Where unlabelled products are invested in labelled products, firms must comply with the anti-greenwashing rule.

The rule will come into force on 31 May 2024, and the FCA's proposed anti-greenwashing guidance is expected to come into force on the same day.

The anti-greenwashing rule will require all FCA-authorised firms to ensure that, in making sustainability-related claims in communications about financial products and services in the UK, the naming and marketing is clear, fair and not misleading, and consistent with the sustainability profile of the product/service. Sustainability-related references can take different forms, including statements, assertions, strategies, policies, and images.

The proposed guidance aims to clarify the FCA's expectations under the anti-greenwashing rule and existing, associated requirements.

The FCA is consulting on its proposed guidance from 28 November 2023 to 26 January 2024.[5] The draft guidance identifies and elaborates on the FCA's four key expectations that sustainability-related claims should be:

– Correct and capable of substantiation.
– Clear and presented in a way that can be understood.
– Complete – i.e. 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 take note of the seven hypothetical scenarios in the draft guidance, which are examples of when the FCA's expectations would not be met.

Although the FCA calls it a "new" anti-greenwashing rule, the rule is not substantively new. The FCA expects the rule and guidance to impose a minimal burden on firms, given that "*they broadly reaffirm and help clarify existing requirements and expectations for firms as outlined in the FCA Handbook, consumer protection law, CAP and BCAP Codes, and the CMA's and ASA's corresponding guidance*".

From a supervisory and enforcement perspective, the FCA can in principle rely on some existing rules in this area, but the introduction of the rule will give the FCA another explicit rule on which to challenge firms in relation to potential greenwashing. Likewise, the guidance will give the FCA four main areas on which to test and challenge firms about potential greenwashing (see shaded box on the left). In sections 11-12 of this bulletin, we delve deeper into the key enforcement and litigation risks for firms.

Firms should take the opportunity now to reassess their compliance with relevant greenwashing-related rules in light of the FCA's proposed guidance. Firms should assess what controls they already have in place and what further work may be required to ensure full compliance by 31 May 2024. As mentioned, the FCA has existing rules that it could, in principle, use to tackle misleading claims about firms' products and services, which is another reason why firms should not wait to act.

Firms should ensure that they have thorough systems in place to not only ensure that they can appropriately support any sustainability claims they make, but also to regularly monitor and assess the accuracy of such supporting evidence. FCA guidance clearly expects firms to ensure that all sustainability-related communications of financial promotions actually live up to what they are claiming and are capable of being substantiated with evidence at the time the claim is made. As such, firms will be best placed to address actual or threatened enforcement/litigation if they are diligent in sourcing and documenting the evidence which underlies their sustainability claims, and ensuring this evidence remains up to date.

The rule will come into force on 31 May 2024. Firms may wish to engage with the FCA's consultation on the proposed guidance, which is open until 26 January 2024. To see our publication on FAQs on the anti-greenwashing rule and draft guidance, please click here.

4. Entity-level disclosures: sustainability entity report

The FCA's new rules will require asset managers with AUM of £5 billion or more to produce a sustainability entity report, regardless of whether they use a label or sustainability terms. The report is focused on how the firms manage sustainability-related risks and opportunities in relation to the funds they manage on behalf of clients.

In that specific context, firms are required to disclose details of their governance, strategy, risk management, and metrics and targets in relation to dealing with sustainability-related risks and opportunities.

To foster coherence across sustainability reporting and disclosure obligations, the FCA has identified three widely-recognised corporate reporting standards as relevant for determining the contents of sustainability entity reports – namely, the International Sustainability Standards Board's (**ISSB**) IFRS S1, the Sustainability Accounting Standards Board (**SASB**) standards, and the Global Reporting Initiative (**GRI**) Standards. However, instead of line-by-line disclosures, the FCA has noted that asset managers should consider those standards "*through the lens of what information would be decision-useful for their clients and consumers*".

[5] The FCA's consultation focuses on the questions of: (i) whether the proposed guidance clarifies the anti-greenwashing rule and if not, what more the FCA can do to provide clarity; (ii) whether respondents have comments on the proposed guidance, including the examples provided therein; and (iii) whether respondents agree that the guidance should come into force on 31 May 2024.

It is significant that firms will be required to "consider" disclosing their impact **on** the environment and/or society, having regard to the GRI Standards. The FCA clearly recognises the increasing focus on sustainability impacts, beyond sustainability-related financial reporting. This is an interesting development, as so far it is rare for the double-materiality approach to be used outside EU frameworks.

Other content requirements for the sustainability entity reports include that: (i) firms that use a label or sustainability-related terms will be subject to additional requirements; and (ii) firms should include, or hyperlink to, the contents of their Task Force on Climate-Related Financial Disclosures (TCFD) reports (which cover a broader scope of a firm's business), if available.

Firms should use the international corporate sustainability reporting standards identified by the FCA only as a 'starting point' when considering the types of information to include in the sustainability entity report. Over time, the FCA may provide greater specificity as to the report's content requirements. Further, industry-led guidance may also emerge to identify specific types of information that may be useful for asset managers to disclose in the report. It would be advisable to internally document key decisions on what information to include in or exclude from the report, as well as the sources used to extract such information.

Entity-level disclosure rules will be phased-in from 2 December 2025 for the largest asset managers (with over £50 billion in AUM) and will be extended a year later to asset managers with £5 billion or more in AUM.

5. Four sustainability labels and qualifying criteria

The FCA has created the following four labels for relevant retail and institutional funds with sustainability objectives that aim to improve or pursue positive outcomes for the environment and/or society:

Sustainability Impact – This label is for funds that invest at least 70%[6] of their assets in accordance with an aim to achieve a **pre-defined positive, measurable** environmental and/or social impact.	**Sustainability Improvers** – This label is for funds that invest at least 70% in assets that have the **potential**, over time, to meet a robust, evidence-based standard of sustainability. Stewardship plays a key role in this category.	**Sustainability Focus** – This label is for funds that invest at least 70% in assets that **meet** a robust, evidence-based standard of sustainability.
Sustainability Mixed Goals – This label is for funds that invest at least 70% in a combination of the sustainability objectives of the other labels. For example, this may suit a fund-of-funds structure.[7]		

A few key points to note:

(a) From 31 July 2024, relevant firms can choose to use the labels (i.e. they are optional rather than mandatory), provided they meet the prescribed criteria. If a firm chooses to label a product, it remains responsible for ensuring that the label is appropriate. The FCA may challenge the application of any new fund submitted for authorisation or amendments to existing funds, but the absence of challenge does not mean that the label is appropriate.

(b) Minimum qualifying criteria apply for each label, including general principles and further label-specific requirements. Notably, firms are obliged to "take reasonable steps" to ensure that the data they are relying upon to meet the qualifying criteria is accurate and complete.

(c) Generally, labelled products must have at least 70% of their assets invested in accordance with the sustainability objective, and any other assets must not conflict with the sustainability objective.

To minimise greenwashing risks, firms should ensure that they can stand behind any claims they make regarding the environmental and/or social characteristics of a fund and its compliance with the qualifying criteria. Making informed choices of robust methods of measurement, credible sustainability standards and reliable third-party data will be key. Firms should be prepared to clearly communicate compliance with applicable qualifying criteria (e.g. when making disclosures about progress, positive impact, stewardship strategy, and evidence obtained from third parties).

Firms should familiarise themselves with relevant leading standards of sustainability. In particular, firms should look out for the forthcoming UK Green Taxonomy, particularly as the FCA will be looking to incorporate it into the financial regulatory regime.

Firms should take steps to ensure that they can meet the applicable qualifying criteria on an ongoing basis. Firms will also need to ensure that they will be in a position to make the necessary labelling changes and comply with relevant notification requirements, in the event that they no longer meet the applicable qualifying criteria.

[6] There are limited exceptions to meeting the 70% threshold for all labels.
[7] Firms using the "sustainability mixed goals" label will need to meet the requirements under the specific criteria for each of the other labels the fund is invested across and disclose the proportion of assets invested in accordance with each label.

6. Naming and marketing rules for retail context

The FCA's new package includes naming and marketing rules which apply when sustainability-related terms are being used for funds marketed to retail investors. The final rules are designed to ensure that consumers will have consistent information across labelled products and unlabelled products that use sustainability-related terms.

A non-exhaustive list of sustainability-related terms are in the FCA Handbook at ESG 4.3.2R(2), including a catch-all category for "*any other term which implies that a sustainability product has sustainability characteristics*". In-scope funds can use sustainability-related terms in product names and marketing only if:

(a) they use a label (however, the word 'impact' still cannot be used in the names of products labelled "sustainability focus", "sustainability improvers" or "sustainability mixed goals"); or

(b) they do not use a label but comply with prescribed requirements – for example, firms must produce **consumer-facing, pre-contractual and ongoing product-level disclosures** (see sections 7-8 of this bulletin discussing those disclosures).

There remain doubts as to whether the naming and marketing rules will disincentivise firms from adopting sustainability-related investment approaches or from using sustainability-related terminology (i.e. 'greenhushing' or hiding ESG credentials to avoid scrutiny and regulatory requirements). Firms should note that the International Organisation of Securities Commissions considers that greenhushing is a malpractice that may come under regulators' clear, fair and not misleading rules.

Firms should have documented processes and controls in place to ensure the sustainability-related terms they are using appropriately reflect the underlying characteristics of the products. Processes and controls should be aligned with the FCA's rules, including the 70% benchmark to determine whether a product can be described using sustainability-related terminology.

The anti-greenwashing rule is particularly relevant when it comes to complying with the naming and marketing rules, with the former forming the foundation for the latter. Firms should ensure that their approaches to naming and marketing align with the FCA's expectations on anti-greenwashing. It is particularly important to ensure that firms properly evidence internal decisions about, and underlying facts or evidence for, naming and marketing, so that firms can assist with (and, where necessary, defend themselves against) enforcement investigations or litigation.

The naming and marketing rules will come into force from 31 July 2024 for labelled funds and from 2 December 2024 for unlabelled funds. Before the naming and marketing rules come into force, firms should ensure that their approach to naming and marketing complies with the anti-greenwashing rule which will come into force earlier on 31 May 2024.

7. Consumer-facing disclosures for retail investors

The new rules on consumer-facing disclosure for retail clients apply to labelled funds and unlabelled funds that use sustainability-related terms in their name or marketing.

Firms must annually produce a standalone consumer-facing disclosure that does not exceed two pages. The disclosure must be presented in a prominent place, alongside other key investor information, on the relevant digital medium through which the product is offered.

To address the current lack of consistent and accessible sustainability-related information, the FCA has set parameters for the format and content of consumer-facing disclosures.

Firms must now consider how to produce clear, concise consumer-centric disclosures without exceeding the strict page limit and without breaching the anti-greenwashing rule, and how to maintain internal records of the process surrounding, and evidence for, the disclosure drafting. The FCA supports industry collaboration on best practice for these disclosures, and so firms should remain attentive to developments in this space. Notably, the FCA has not prescribed a template, but encourages the industry to consider developing a template for voluntary use.

Please refer to our overview table at section 2 of this bulletin for the key timings to watch.

8. Detailed product-level disclosures

The FCA's package includes final rules for certain product-level (i.e. fund-level) disclosures. They are applicable to labelled funds and unlabelled funds that use sustainability-related terms in their name or marketing. These detailed disclosures are intended for institutional investors, as well as retail consumers who want to know more.

(a) **Pre-contractual disclosures** – The FCA expects firms to make changes to these disclosures particularly when first using a label, and when revising or ceasing to use a label. The disclosures will be made either in a fund prospectus, prior disclosure document or Part A of the sustainability product report, depending on the type of fund manager concerned.

(b) **Ongoing product-level disclosures** – These must be made annually from when a relevant fund manager first starts to use a label. They must either be made in a sustainability product report (Part B), or be issued on demand, as below. Where a firm is required to produce a public TCFD product report, it must include the content of that report (or a hyperlink to it) in Part B of the public product-level sustainability report.

(c) **On-demand disclosures** – These apply where it may be inappropriate to require a particular type of fund manager to make a public disclosure, such as a fund manager of a UK AIF that is neither authorised nor listed. In this case, the fund manager must provide the relevant report to eligible clients on demand.

Firms should keep disclosures under review and update them as appropriate, including when revising or ceasing to use a label.

Please refer to our overview table at section 2 of this bulletin for key timings to watch.

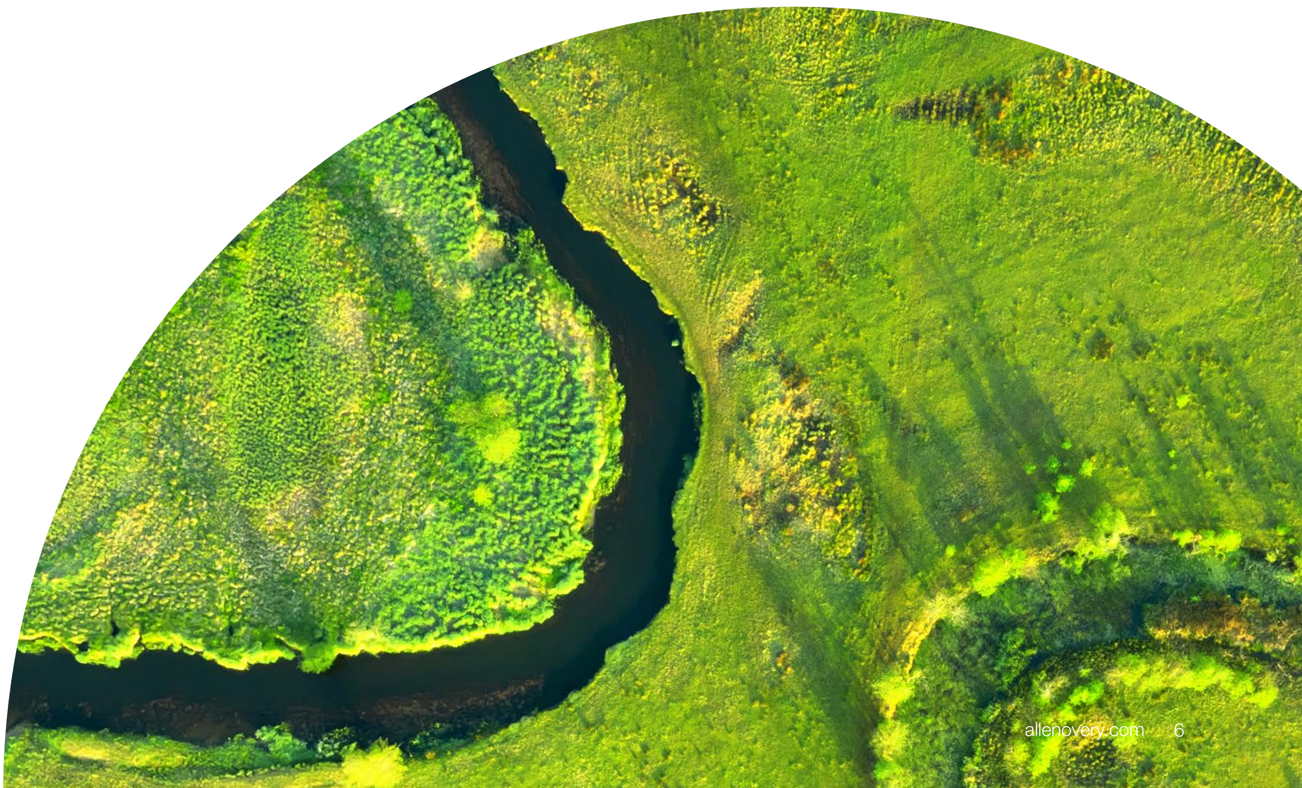
9. Distributors to communicate sustainability information to retail investors

The new rules require distributors, such as advisers and platforms, to communicate the labels and consumer-facing disclosures (for labelled funds and unlabelled funds) to retail investors.

In addition, distributors must provide a notice on overseas products (recognised schemes, including Exchange Traded Funds) to clarify that they are not subject to the UK sustainability disclosure and labelling regime.

Distributors should take steps to meet these requirements, for example by ensuring that the labels and disclosures are kept up to date in accordance with any changes that the firm makes to its products, and reviewing their documented processes and procedures for the same. Distributors should also ensure that they comply with the anti-greenwashing rule.

Please refer to our overview table at section 2 of this bulletin for key timings to watch.



10. Divergence from international regimes

A clear message that comes through the FCA's package is a determination to "stay the course" in terms of the regulatory drivers for the FCA's proposals, and the key building blocks it initially proposed. In a number of places throughout the policy statement, the FCA emphasises that at 'every stage of forming these rules' it has sought to create interoperability, including by considering what other regulatory bodies are doing, such as those in the EU.

But it is equally clear the FCA wishes to go its own way – and so it has. The FCA's final rules differ from the EU Sustainable Finance Disclosure Regulation (**SFDR**) in certain important respects, from a practitioner's perspective – e.g.:

(a) EU regime – template. UK – no template.

(b) EU regime – portfolio managers in scope. UK – no (but this is subject to consultation in early 2024).

(c) EU regime – includes funds sold into the EU from outside the EU. UK – only local funds and fund managers are subject to the sustainability disclosure and labelling regime (however, the FCA is continuing to work with HM Treasury on the approach to overseas funds).

(d) EU regime – consistent requirements for retail vs institutional. UK – no.

(e) EU regime – governance related requirements, DNSH, PAI. UK – no, but there are some requirements that give rise to overlapping considerations. Further information about aspects of fragmentation between the UK and EU regimes is explained in our publication on FAQs on the FCA's package of rules, available here.

As many will know, the European Commission is making its own tentative steps towards a potential EU labelling regime for funds and other products/services in scope of SFDR. But, if so, it may have a long road ahead, judging by the FCA's experience – the FCA received significant push-back from parts of the industry in some respects, including its proposals for portfolio management and cost-benefit analysis. It has often been said that the UK would have the advantage of being able to learn from the EU's experience in relation to SFDR – possibly the EU will now have an opportunity to learn from the FCA's experience.

Other points of divergence between the UK and overseas regimes on sustainability-related disclosures include:

(a) Marketing restrictions – The Policy Statement notes that the EU and US regimes have not introduced marketing restrictions. The impact of this difference will be more acutely felt if and when the FCA brings overseas funds into scope.

(b) Minimum thresholds – The FCA's rules provide that at least 70% of the gross value of a labelled fund's assets must be invested in line with the sustainability objective. By way of comparison, the Policy Statement notes that the thresholds (or proposed thresholds) are higher in the EU and US but lower in Singapore.

(c) Entity-level disclosure and reporting requirements – The ISSB's baseline standards should go some way to minimising major discrepancies in jurisdictions that choose to endorse the standards with limited amendments. However, hurdles to interoperability will remain, particularly in the context of entity-level disclosures where greater specificity as to content requirements would be welcomed (see section 4 above). See our bulletin on the challenges in global regulatory implementation and market adoption of the ISSB standards in a corporate reporting context here.

11. Enforcement risks

The finalised rules, especially when viewed in the context of the FCA's Consumer Duty, suggest that the FCA will devote significant time and attention to examining firms' practices and taking swift action where firms are deemed not to have taken their responsibilities seriously. The FCA has referred to the tackling of harm from greenwashing as a "*regulatory priority*" and flagged its concern that firms may be "*making misleading or exaggerated sustainability-related claims*".

The FCA intends to use the incoming anti-greenwashing rule to challenge, and potentially take further action against, a firm that it considers is making "*misleading claims*" about its products or services. While this rule is scheduled to come into force on 31 May 2024, and the other rules are expected to follow later in 2024 and beyond (see upcoming milestones in section 13 below), firms should not delay taking action to ensure compliance with the rules in advance of the relevant implementation dates, including via the actions discussed in section 3 above. As mentioned, the FCA can already, in principle, use other existing rules to tackle misleading claims about firms' products and services.

When asked about its proposed supervisory and enforcement approaches, the FCA only clarified that its "*usual*" approaches will apply to the new rules, which means that the FCA has a very broad toolkit at its disposal. Among other things, the FCA said that it will:

(a) monitor uptake and supervise use of labels, including potential challenges by the Fund Authorisations team – but firms should note that this team will not *approve* labels, so the absence of challenge does not mean that a firm is 'safe' from the need to diligently and regularly review its own labelling;

(b) use "*available market intelligence*" to identify potential rule breaches, and monitor any "*signs of greenwashing*" from a number of sources, including complaints to the FCA Supervision Hub, applications to its Fund Authorisations team and "*broader supervisory intelligence*"; and

(c) undertake a review three years after implementation of the rules, including in relation to any "*potential unintended consequences*" and compliance by firms.

The FCA set down a marker that it will consider enforcement action if it has "*reason to believe that serious misconduct may have taken place*". Firms should therefore 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. In this context, firms should be mindful of key enforcement risks:

(a) **Failure to make a disclosure**: Staying abreast of the incoming disclosure requirements and planning ahead to ensure that policies, procedures and reporting frameworks are in place to accurately make the required disclosures are important for firms. It is 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.

(b) **Disclosing incorrect (or, arguably, poor quality, unclear or misleading) information**: In its recent review of AFMs' embedding of ESG Guiding Principles, the FCA criticised the adequacy and clarity of ESG and sustainability-related disclosures, and it emphasised difficulties in reconciling firm-level and fund-level disclosures. In relation to the new rules, 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.

(c) **Misusing a label**: Similar 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 they should investigate the root causes of any inaccuracies to put in place further controls, thereby aiming to reduce the risk of reoccurrence.

(d) **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.

(e) **Breaching other naming and marketing restrictions**: The FCA will soon be able to commence enforcement action on the basis of the anti-greenwashing rule (discussed in section 3 above), which has a broad scope and "*forms the foundation*" of the FCA's naming and marketing rules. This is likely to be the 'hook' on which the FCA focuses its investigations, but the FCA can also rely on some of its existing rules in this area. For example, Principle 7 ("*A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading*"), Principle 12 ("*A firm must act to deliver good outcomes for retail customers*") and its pre-existing requirements relating to firms' systems and controls. In addition, as discussed, the FCA is bringing into force specific rules to prohibit firms from using certain sustainability-related terms for product names or marketing unless they have a label or meet other requirements (e.g. similar disclosures and statements). Firms that misuse sustainability-related terms 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.

12. Litigation risks

Findings by regulators of a breach of relevant rules frequently form the basis of "follow on" litigation by claimants. As such, in addition to the increased enforcement exposure explored above, the new rules may also enhance the litigation risk for regulated firms. Such claims may arise under common law principles (e.g. based on common law misrepresentation), although the new rules could also see 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.

This risk is perhaps heightened by the fact that the new rules do not contain any carve-out where a firm has taken reasonable steps. In particular, the new anti-greenwashing rule mirrors existing requirements, including in COBS 4.2.1, requiring marketing information to be fair, clear and not misleading. However, it is notable that 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 no equivalent "reasonable steps defence" in relation to the requirements in the new anti-greenwashing rule, or in the labelling and disclosure rules described above. 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, the introduction of increased disclosure requirements in relation to products and services 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, it is currently unclear how attractive greenwashing claims (whether under s.138D FSMA or common law) which rely on the proposed new rules are likely to be to potential claimants:

(a) Establishing causation and loss will be critical for claimants in bringing a successful greenwashing claim: that is, claimants will need to establish that the relevant breach (such as applying a sustainability label where the relevant criteria were not met) exposed them to an identifiable and measurable drop in the product's value, translating to loss to the claimant.

(b) Even where a product turns out not to be as "green" as it was marketed to be, it does not necessarily follow that this will have a material impact on the value of the product that will cause loss to investors, and investors will need to positively establish that this is in fact what has occurred. Quantification of losses may bring its own challenges; in the case of consumer claims, even where it is possible to identify a loss to consumers, the amount of the loss to each individual consumer is likely to be relatively small. The lack of an "opt-out" class action regime in the UK beyond the sphere of competition law could very well make the pursuit of litigation unattractive and uneconomical to individual consumers and reduce the likelihood that any such claims will make it to trial.

Nonetheless, firms should not discount the potential for greenwashing claims. NGOs and pressure groups are responsible for commencing a significant amount of greenwashing litigation worldwide. Such claims are often pursued, not to recover loss, but as a means of putting pressure on entities to change behaviours by "naming and shaming" those who make allegedly misleading environmental statements about product performance or business practices. The introduction of the new anti-greenwashing rule and enhanced disclosure and labelling requirements may further fuel claims of this nature by NGOs in the UK if firms are seen to be falling short of their regulatory obligations under the new FCA package.

For example, there has been significant concern expressed about funds marketed as sustainable which invest in fossil fuels. Claimants may focus in on specific rules, such as ESG 4.2.4R(2)(c) which requires that labelled funds must not invest in assets that have attributes that conflict with the product's sustainability objective.

To combat litigation risk, firms must approach all aspects of their sustainability-related communications with diligence, bearing in mind the suggested actions in section 3 above.

13. What to expect on the horizon for UK SDR

For a summary of the **upcoming dates** on which the key components of the FCA's new package will begin to apply, please refer to our overview table at section 2 of this bulletin.

In terms of future changes to the regime, the FCA has indicated that: (i) it will consult in **early 2024** to potentially bring portfolio management in scope, with a focus on retail; (ii) overseas funds may be brought into scope, subject to ongoing discussions with HM Treasury; (iii) other types of products may be brought into scope – e.g. certain pension products may be included in the medium term; and (iv) it will conduct a post-implementation review of the regime in three years' time, which will include considering whether to lower the £5bn threshold for entity-level disclosure requirements.

More broadly, the demand and support from investors, stakeholders, and regulators for more consistent, comparable, and reliable sustainability information continue to grow. The FCA is continuing to evolve the regime for sustainability-related disclosure and reporting in the financial sector. In **2024**, the FCA is likely to consult on:

(a) updating product-level and entity-level disclosure requirements to align with the upcoming UK Sustainability Disclosure Standards, which may be closely based on the ISSB standards. The FCA intends to finalise its policy position by the **end of 2024**, at least in respect of entity-level requirements, so that updated TCFD-aligned rules can enter into force for listed companies for the accounting periods beginning on or after **1 January 2025**;

(b) updating product-level disclosure requirements to refer to the upcoming UK Green Taxonomy, which is due to be consulted upon imminently; and

(c) updating the FCA's guidance on transition plan disclosures by drawing on the work of the UK Transition Plan Taskforce. A government consultation is also forthcoming on transition plan disclosure requirements for large public and private companies.

Further, there are indications that the government may consult on phasing in compulsory Taskforce for Nature-related Financial Disclosures (TNFD) reporting, starting with the largest companies.

14. Actions for firms to consider

The anti-greenwashing rule and SDR regime will have implications for a number of functions within a firm. Important considerations arise for boards, senior management, and Legal, Risk, Compliance and Internal Audit teams.

In particular, boards should remain mindful of enforcement and litigation risks:

(a) The FCA has expressly stated that its new anti-greenwashing rule will be used to challenge firms and take enforcement action. This may trigger a wave of investigations into suspected greenwashing across the financial services industry, given that greenwashing harm is a regulatory priority for the FCA. 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".

(b) Where investigations lead to adverse findings by regulators, this may also expose firms to the risk of follow-on litigation. While we expect that claimants may often face difficulties in establishing causation and loss where firms have breached the new rules, firms should not discount the opportunity for NGOs and similar groups to commence proceedings as a means of applying pressure on firms to bring about institutional level changes.

In considering how to comply with the new FCA package of rules, boards and senior management teams will need to consider alignment with the overall aims of the Consumer Duty. The FCA has consistently underlined that it sees the new requirements as consistent with, and in some cases complementary to, the Consumer Duty which came into force this year. For those firms which are not in the scope of the Duty, the FCA expects them to keep in mind the overall aims of the Duty when applying the new rules and guidance. This means acting in good faith to deliver sustainability-related products and services; avoiding causing foreseeable harm, including harm caused through greenwashing and buying unsuitable products; and enabling retail customers to pursue their financial objectives.

There are also particular impacts for Risk, Compliance and Internal Audit teams. These control functions will need to consider how to factor coverage of the regulatory risks into their independent review schedules and assurance planning, as well as reflect on the regular monitoring and testing of particular controls that might be necessary. Senior managers and boards will seek second- and third-line views on the effectiveness of the implementation of the new rules, including key judgement areas such as the application of product labels and whether claims made can be substantiated, as well as the integrity of controls around disclosures and public reporting of key information and metrics. In addition to prioritisation of oversight activities, control functions will need to consider how best to upskill their teams to ensure that they have the requisite product, subject matter and regulatory expertise to form sound judgements on these issues.

Throughout this bulletin, we have provided examples of actions that firms should consider in light of the FCA's new rules. To align with the FCA's regulatory priorities, important action areas for firms include: (i) governance models, oversight arrangements and accountability mechanisms; (ii) product review and classification, including product and customer segment strategies; (iii) risk and control frameworks for sustainability claims; (iv) impact analysis and implementation; and (v) resourcing, skills and capability requirements, including related issues of data collection and integrity.

If you wish to know more about the implications of the FCA's new package and advice as to next steps, please get in touch with the authors of this bulletin, comprising a multi-disciplinary team of regulatory and disputes lawyers at Allen & Overy LLP and consultants from A&O Consulting.

Contacts

Matthew Townsend
Partner – Global Co-Head Environment, Climate and Regulatory Law Group
Tel +44 20 3088 3174
matthew.townsend@allenovery.com

Bob Penn
Partner – Financial Regulatory
Tel +44 20 3088 2582
bob.penn@allenovery.com

Andrew Denny
Partner – Litigation and Investigations
Tel +44 20 3088 1489
andrew.denny@allenovery.com

Sarah Hitchins
Partner – Litigation and Investigations
Tel +44 20 3088 3948
sarah.hitchins@allenovery.com

Tamara Cizeika
Counsel – Financial Regulatory
Tel +44 203 088 2329
tamara.cizeika@allenovery.com

Claire Haydon
Executive Director – A&O Consulting
Tel +44 20 3088 1941
claire.haydon@allenovery.com

Ying-Peng Chin
Senior Knowledge Lawyer – Environment, Climate and Regulatory Law
Tel +44 20 3088 3708
ying-peng.chin@allenovery.com

Danae Wheeler
Senior Associate – Environment, Climate and Regulatory Law
Tel +44 20 3088 3505
danae.wheeler@allenovery.com

Sam Jones
Executive Manager – A&O Consulting
Tel +44 20 3088 1893
sam.jones@allenovery.com

Jennifer Wyatt-Molloy
Lawyer – Litigation and Investigations
Tel +44 20 3088 2088
jennifer.wyatt-molloy@allenovery.com

Bethany Gregory
Associate – Litigation and Investigations
Tel +44 20 3088 1603
bethany.gregory@allenovery.com

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