An overview of the FCA's Sustainability Disclosure Requirements ("SDR") and fund labelling regime as well as new anti-greenwashing rules

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Introduction

With the introduction of the FCA's Sustainability Disclosure Requirements ("SDR") and fund labelling regime, as well as new anti-greenwashing rules, sustainable investing in the UK is entering a new era. Ultimately, this new policy framework will enhance investor protections while taking important steps towards reducing greenwashing risk and restoring confidence in this vital investment area.

For advisors and their clients, the learning curve for adopting the regime may seem steep – at least initially. This nuts-and-bolts guide has been designed to help you navigate the new policy framework, providing key information about how it will impact different areas of the funds industry and what you need to know to apply the framework to your advisory practice.

This guide outlines:

- SDR and the fund labelling regime
- Anti-greenwashing rules
- Timelines
- Where you can get further assistance

The Nuts and Bolts of SDR

In November 2023, the FCA published its long-awaited Sustainability Disclosure Requirements (SDR) and investment labels' policy statement, with the aim of ensuring that financial products marketed as sustainable do not mislead consumers.

This is an important moment for our industry and one which, in our view, will help customers navigate a complex landscape and ultimately combat greenwashing.

Given the recent growth of the industry, the number of new entrants, and the range of terminology currently used (often interchangeably), we believe bringing clarity to the market is essential and our primary reaction is one of support. The final policy statement has taken into account our feedback on several points, including on the concept of additionality, the need for an absolute measure of sustainability, and support for qualitative standards to reduce reliance on ESG ratings.

In our view, the final set of rules have found a good balance between principles and prescription, which should avoid many of the pitfalls seen in the EU's SFDR regime.

We see the policy statement as a positive step forward for the industry and one which will help combat greenwashing and build trust in the sustainable investment market.

Given our longstanding approach to Responsible and Sustainable investment, our product range – and, indeed, our processes, governance structures and fundamental purpose as a business – is intrinsically aligned to the FCA's new SDR and investment labelling regime.

Carlota Esguevillas
Head of Responsible Investment

SDR Implementation timeline and overview:

The FCA implementation timeline for SDR is set out below. This timeline applies to asset managers, with the 'anti-greenwashing rule' applying to all authorised firms, including advisers.

Implementation times

Publication
28 November 2023

Anti-greenwashing rule and guidance comes into force
31 May 2024

Firms can **begin to use labels,** with accompanying disclosures
31 July 2024

Naming and marketing rules come into force, with accompanying disclosures
2 December 2024

Ongoing product-level and entity-level disclosures for firms with AUM > £50bn
2 December 2025

Entity-level disclosures rules extended to firms with AUM >£5bn
2 December 2026

SDR Implementation timeline and overview:

The final package includes

An anti-greenwashing rule for all FCA authorised firms to reinforce that sustainability-related claims must be fair, clear and not misleading. We are also consulting on supporting guidance

Four labels to help consumers navigate the investment product landscape and enhance consumer trust

Naming and marketing rules for investment products, to ensure the use of sustainability-related terms is accurate

Consumers-facing information to provide consumers with better, more accessible information to help them understand the key sustainability features of a product

Detailed information in pre-contractual, ongoing product-level, and entity-level disclosures, targeted at institutional investors and consumers seeking more information

Requirements for distributors to ensure that product-level information (including the labels) is made available to consumers

What is it and why is it important?

When SDR comes into place on 31 July 2024, it will underpin a major shift in how the UK investment industry designs and markets sustainable investment products. It will set a high bar, having learnt lessons from the EU's own flagship policy, SFDR.

Overall, the policy aims to promote transparency, accountability, and consistency in how firms integrate sustainability considerations into their business activities and investment practices. Different firm types may have varying obligations under SDR, but the overarching goal is to ensure that investors have access to relevant information to make informed decisions aligned with their sustainability preferences and objectives.

It is important to remember this is a new policy. The learning curve will be steep for the entire UK investment industry. And while the fund labelling regime appears intuitive and has been tested on retail investors, clients will still require help in understanding what the labels mean and how they may or may not be aligned with their financial goals and broader values.

How will SDR apply to different types of firms?

UK Asset Managers: SDR applies to all UK asset management firms and these firms must apply the new rules when marketing sustainability products. This includes adopting appropriate investment labels, supported by intention-led sustainability objectives, adhering to requirements around pre- and post-contract disclosures, and applying the naming and marketing rules. Sustainable investment-type funds which do not meet the threshold for a label (or where an asset manager decides not to apply one) will also be required to comply with SDR disclosure and labelling rules.

Financial Advisers and Wealth Managers: Financial advisers and wealth managers have a responsibility to ensure that investment recommendations are suitable for their clients' individual circumstances, including their sustainability preferences. Under SDR, asset managers are required to provide clear pre-contractual fund factsheets. These must prominently display a fund's sustainability label, provide explicit information about the fund's characteristics, and should be a useful aid to conversations between advisors and their clients. For overseas products, advisers must place a notice funds to highlight they are not subject to UK labelling and disclosure requirements.

Pension Funds and Institutional Investors: SDR in its current form is largely a retail-focused regulation. However, the FCA may seek to extend this regulation to include pension products to address potential harms that could arise in this area of the market.

Sustainability Disclosure Requirements and Investment Labels

The FCA released new sustainability disclosure requirements and investment labels aimed at promoting transparency and empowering investors in the UK financial market. As professional financial advisers, it's crucial to understand the key changes and implications of this policy statement to effectively serve your clients.

Enhanced Sustainability Disclosure Requirements: The FCA is introducing enhanced disclosure requirements for financial advisers regarding the integration of sustainability factors into investment decision-making processes. Advisers will be required to provide clear and comprehensive information to clients about how sustainability considerations are incorporated into investment strategies. This includes disclosing the firm's approach to assessing and managing sustainability risks, as well as any negative impacts associated with investment decisions.

Introduction of Investment Labels:
The FCA is introducing standardised investment labels to facilitate easier comparison of sustainable investment products. These labels will provide clear and consistent information about the sustainability characteristics of investment products, helping investors make informed decisions aligned with their values and preferences. Labels will indicate whether an investment product is aligned with specific sustainability objectives, such as environmental protection, social responsibility, or governance best practices.

The new fund labels:

The FCA has set a high bar, applying a 70% minimum threshold to all labels. This means 70% of a fund's gross value must meet the product's sustainability objective and should not include assets that conflict with this objective.

Sustainability Impact™

Sustainability Impact. In this category, funds must have a specific objective to achieve a pre-defined, positive, and measurable impact in relation to an environmental and/or social outcome. So, under this label, we will see Impact funds – both across private markets and public equities – which have targeted a specific positive outcome and a commitment to measure that.

Sustainability Improvers™

Sustainability Improvers. In this category, funds will invest in assets which have the potential to improve their environmental and social sustainability over time – hence the name improvers – and the onus is on firms to evidence how, and in what time frame, their investments will improve their performance. And as you can imagine the onus here is very much on stewardship. In this category, we're likely to see best in class funds as well as those investing in sectors which we wouldn't consider as sustainable now but may have the potential to become so in the future.

Sustainability Focus™

Sustainability Focus. Here funds are required to invest in assets which are already environmentally and socially sustainable, with reference to a robust, evidence-based standard. They may invest thematically but are not required to. The onus instead is on the assets being sustainable, which – in contrast to the improvers category – the standard referenced needing to be an absolute measure of sustainability, something we welcome.

Sustainability Mixed Goals™

Sustainability Mixed Goals. This is primarily geared towards multi asset funds and allows investment in a combination of the other labels. Firms clearly must meet the requirements of the other labels, and then disclose the proportion of assets invested in accordance with any combination of the other labels.

Client Engagement and Education

As professional financial advisers, it's essential to engage with clients proactively and educate them about the importance of sustainability considerations in investment decision-making. Use the introduction of investment labels as an opportunity to facilitate meaningful discussions with clients about their values, preferences, and long-term financial goals. Help clients understand how sustainable investing can align with their objectives while potentially delivering positive impact and long-term returns.

It's essential for financial advisers to familiarise themselves with these new investment labels and effectively communicate their significance to clients. By understanding the sustainability characteristics of investment products, advisers can help clients align their investments with their values while pursuing their financial objectives. Moreover, providing clear and transparent information about these labels will empower clients to make informed decisions that reflect their sustainability preferences and long-term goals.

Source: FCA PS23/16: Sustainability Disclosure Requirements (SDR) and investment labels | FCA

The Anti-Greenwashing Rule

What is it and what do you need to know?

SDR is very much a policy designed with consumer protection (or "Consumer Duty") in mind. Greenwashing risk, poor investor understanding and the erosion of trust have been unfortunate feature of the investment industry in recent years. We therefore view the instruction of new anti-greenwashing rules on **31 May 2024**, which complement SDR, as a positive step.

As a professional financial adviser, it important for you to understand the new policy's guidance to ensure compliance and integrity in your dealings with clients.

Indeed, all authorised firms must be aware of the new 'anti-greenwashing rule' applicable from **31 May 2024**. Any claims about the sustainability characteristics of products or services must be fair clear and not misleading.

In essence, the guidance on the anti-greenwashing underscores the importance of transparency, accuracy, and integrity in marketing and promoting sustainable investment products. As professional financial advisers, it's essential to adhere to these principles to build trust with clients and ensure they make well-informed decisions aligned with their values and objectives. By providing clear and balanced information, conducting thorough due diligence, and maintaining ongoing oversight, advisers can help combat greenwashing and promote genuine sustainability in the financial market.

Sustainability references should be:

- **Correct** and **capable** of being substantiated
- **Clear** and presented in a way that can be understood
- **Complete –** they should not omit or hide important information and should consider the full life cycle of the product or service
- Fair and meaningful in relation to any **comparisons** to other products or services

Source: FCA https://www.fca.org.uk/publications/guidance-consultations/gc23-3-guidance-anti-greenwashing-rule

Here's a summary of the key points:

1. Definition of Greenwashing

- Greenwashing refers to the misleading or exaggerated claims made by financial firms regarding the environmental or sustainability credentials of their products or services.
- The FCA emphasises that greenwashing undermines trust and transparency and can mislead investors into making decisions based on false or incomplete information.

2. Requirements for Disclosure

- Financial advisers must provide clear, accurate, and balanced information to clients regarding the environmental or sustainability characteristics of investment products.
- Disclosures should be tailored to the specific features and risks of each investment, avoiding generic or misleading statements that could be construed as greenwashing.

3. Transparency in Marketing Communications

- Marketing materials and communications must accurately reflect the environmental or sustainability attributes of investment products, without exaggeration or misrepresentation.
- Financial advisers should avoid using vague or ambiguous language that may obscure the true nature of the investments being promoted.

4. Due Diligence and Oversight

- Financial firms are responsible for conducting thorough due diligence on investment products to ensure they meet the stated environmental or sustainability criteria.
- This includes assessing the credibility and reliability of third-party ESG ratings and certifications used to validate the green credentials of investments.

5. Client Suitability and Understanding

- Financial advisers must ensure that investment recommendations are suitable for their clients' individual circumstances, including their risk tolerance, investment objectives, and sustainability preferences.
- Clients should be provided with sufficient information to understand the potential risks and returns associated with sustainable investments, as well as any limitations or uncertainties regarding their environmental impact.

6. Ongoing Monitoring and Review

- Financial firms are encouraged to establish robust monitoring and review processes to assess the ongoing environmental or sustainability performance of investment products.
- This includes regularly reviewing and updating disclosures to reflect any changes in the underlying investments or the broader ESG landscape.

FCA industry-led working group for financial advisers

The FCA has appointed Daniel Godfrey as chair and Julia Dreblow as vice-chair of a new working group focused on building capability in sustainable finance across the financial advice sector.

The FCA will sit as an active observer of the group and has asked that it be ready to report on how the advice sector can be supported in delivering good practice in the second half of 2024.

The chair will appoint the group's membership from across the advice sector, including both small and larger industry participants. The working group will also engage with stakeholders outside of the group throughout its work to ensure a balanced representation of views, including those of consumers.

https://www.fca.org.uk/news/news-stories/fca-establishes-industry-led-working-group-financial-advisers

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Further information and support

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0800 011 3821

clientservice@edentreeim.com

edentreeim.com

Our Responsible Investment Team

We have a specialist in-house Responsible Investment (RI) team who carry out thematic and stock-specific research to identify responsible and sustainable investment ideas for our range of Funds.

The team is also responsible for creating an on-going dialogue with companies, allowing us to engage on a wide variety of environmental, social and governance topics. For investors,

it's an added layer of assurance that our clients' money is being invested in companies that are operating in a responsible and sustainable way.

Our responsible and sustainable investment process is overseen by an independent Advisory Panel that meets three times a year, and comprises industry and business experts, appointed for their specialist knowledge.

Carlota Esguevillas
Head of RI

Amelia Gaston
Senior RI Analyst

Hayley Grafton
Senior RI Analyst

Cordelia Dower-Tylee
RI Analyst