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Disclosure: FCA Proposes Regulation of Investment Firm Sustainability Claims

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Disclosure

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The UK's Financial Conduct Authority (FCA) has announced a proposal for regulating sustainability claims by investment firms. In its accompanying **consultation paper**, the FCA proposed three sustainable fund labels as part of its wider anti-greenwashing policy. The labels are: (i) "sustainable focus" funds, which have at least 70% of the fund invested in assets that "meet a credible standard of environmental and/or social sustainability, or that align with a specified environmental and/or social sustainability theme;" (ii) "sustainable improver" funds, which "invest in assets that, while not objectively environmentally or socially sustainable at present, have the potential to deliver measurable improvements in their environmental and/or social sustainability over time, including in response to the stewardship influence of the firm;" and (iii) "sustainable impact" funds, which "aim to achieve a positive, measurable contribution to real world sustainability outcomes," and "commit to deliver and report on [the investor's] contribution to a positive environmental and/or social sustainability outcome through financial as well as other types of investor" influence.

The FCA also proposed implementing restrictions on how certain terms, including "ESG," "green," or "sustainable," can be used in product names and marketing material together with a more general anti-greenwashing rule that will apply to all regulated firms. This announcement follows the government's **roadmap to sustainable investing** published in October 2021. The FCA's consultation is open until January 25, 2023, and it intends to publish the final rules by June 2023. Implementation will continue through 2025.

Sacha Sadan, the FCA's Director of Environment Social and Governance, stated that the proposal "places the UK at the forefront of sustainable investment internationally. We are raising the bar by setting robust regulatory standards to protect consumers in line with our wider FCA strategy."

Taking the Temperature: The FCA's proposal is notable in part because it diverges from analogous provisions in the EU's Sustainable Finance Disclosure Regulation (SFDR). This divergence obviously presents challenges for investment firms subject to dual UK and EU regulation. The SFDR requires investment funds to adopt one of three product classifications, Article 6 (non-ESG products, which still must disclose certain information on their consideration of sustainability risks), Article 8 (funds that promote—but do not have as an objective—sustainability) and Article 9 (funds with sustainability goals as their objectives). Sadan herself identified this issue, stating "we will not expect every Article 8 fund to just get in," *i.e.*, secure a sustainability label. She also distinguished the FCA's overall approach, stating that in "Europe, there is a perception that Article 9 funds are better than the others, which can be confusing. Investors quite rightly want to own a diversified portfolio which includes these different elements, such as impact and improvers." In the U.S., the Securities and Exchange Commission (SEC) has proposed yet another set of rules for investment funds, including requiring specific disclosures on ESG strategies and, for ESG funds that consider environmental factors, disclosures of greenhouse gas emissions. The SEC also proposed three categories of ESG funds: (i) Integration Funds, which take into account ESG factors but place no greater weight on them than non-ESG factors; (ii) ESG-focused funds, which make ESG factors a significant part of the investment thesis; and (iii) Impact Funds, which pursue a specific ESG outcome. Asset managers need to tread carefully through the thicket of overlapping but inconsistent regulation to the extent they are subject to multiple jurisdictions' authority and thoroughly document the basis for their sustainability disclosures.