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**The FCA's Sustainability
Disclosure Regime:
A Practical
Implementation Guide**



A. Introduction, Scope and Application

This is the opening briefing in a [series of alerts](#) focused on the Sustainability Disclosure Requirements (SDR) regime. In this briefing, we introduce the SDR regime and provide an overview of its scope, including by reference to: (i) UK domiciled funds; (ii) overseas funds; (iii) single managed accounts; (iv) passive funds; (v) fund of funds; and (vi) master-feeder structures.

1. Introduction

What is the SDR?

The FCA's [Sustainability Disclosure Requirements \(SDR\) regime](#) is the UK's flagship ESG regime, which will come into effect from May 2024 onwards. The SDR is primarily a product labelling regime, accompanied by entity-level disclosure requirements, a new anti-greenwashing rule and guidance and ESG marketing requirements. The FCA describes the aim of the new regime as follows:



...our aim with this Sustainability Disclosure Requirements (SDR) and investment labels regime is simple – financial products that are marketed as sustainable should do as they claim and have the evidence to back it up.

The regime will represent a "step up" in terms of regulatory compliance for UK authorised firms involved in managing or marketing in-scope products. At the outset, the SDR labelling regime will apply primarily to fund managers and distributors of UK funds, although other aspects of the new regulations, specifically the anti-greenwashing rule, will apply to all UK authorised firms. The FCA has, however, made clear that it intends to widen the scope of the regime significantly, and it is considering making rules for portfolio managers, pension and other investment products and certain overseas funds.

While certain aspects of the regime are voluntary, UK fund managers seeking to market their UK funds by reference to sustainability characteristics will need to consider whether they could be drawn within scope of the new regulations in some way. Firms implementing the SDR will need to carefully consider how the regime sits alongside pre-existing requirements, including the FCA's Principles for Businesses and the Consumer Duty, and be mindful that the regime sets a high bar in terms of the underlying investment strategy required to support SDR labelling. Firms will also need to track the regime as it expands over time, particularly as it becomes applicable to a greater range of financial products and as disclosure requirements increase in scope and complexity.

We have included a copy of the FCA's SDR implementation timeline at the Annex to this briefing.

2. Scope of the SDR

Direct application of the SDR

The final package of SDR rules, as [published](#) in late November 2023, comprises the following key aspects:

- **Anti-greenwashing rule** – all UK authorised firms will be required to comply with an anti-greenwashing rule which requires sustainability-related claims to be clear, fair and not misleading. The FCA is currently consulting on [guidance](#) that will support the new rule. Our second briefing in this [series](#) covers the anti-greenwashing rule.
- **Labelling regime** – a new voluntary labelling regime, which allows UK AIFMs and UCITS Management Companies to apply SDR labels to their UK AIFs and UCITS (whether authorised or unauthorised). At present, SDR product labels cannot be applied by non-UK managers accessing UK investors (e.g. under the UK National Private Placement Regime). The FCA is, however, working with HM Treasury on extending the SDR to overseas recognised schemes, which we would expect primarily to cover non-UK UCITS. Our third briefing in this [series](#) covers the new labelling regime, and our fourth briefing discusses related operational requirements.
- **UK distributors** – FCA regulated firms that distribute products to UK retail investors will be required to make specified disclosures with respect to both SDR labelled funds, and certain unlabelled funds that use ESG terms in their marketing documents. Our fifth briefing in this [series](#) covers the launch and distribution requirements.
- **Product-level disclosure regime:**
 - UK AIFMs and UCITS Management Companies managing SDR-labelled UK funds will be required to make product-level disclosures (both pre-contractual and ongoing) with a view to disclosing the sustainability characteristics and performance of their funds over time. UK retail funds which use ESG terms in their naming or marketing materials will be required to make similar disclosures, regardless of whether they have been labelled for SDR purposes.
 - Where in-scope funds are distributed to retail investors, UK managers will also need to provide consumer-facing product-level disclosures.
- **Entity-level disclosure regime** – UK asset managers with assets under management of £5 billion or more (calculated annually based on a three year rolling average) will be required to make entity-level disclosures detailing how they are managing sustainability risks and opportunities. Our sixth briefing in this [series](#) covers these fund-level and entity-level disclosure requirements.

The SDR does not, at present, include rules on single managed accounts, overseas funds, pension products, although the FCA has stated that it will expand the scope of the SDR to each of these products over time (see “Application of the SDR to Specific Products” below). Based on the current implementation, the SDR is therefore considerably narrower in scope than the SFDR, which applies to portfolio management services, certain pension and insurance products and AIFs marketed under EU national private placement regime (NPPR) frameworks.

Evolving UK corporate disclosure regime

As with the EU's SFDR regime, there is a threshold question as to whether corporate disclosures are likely to keep pace with the data demands of the new SDR labelling regime – as noted by the FCA:



Central to [the SDR] is the Government's plan for an economy-wide SDR regime, which the Government elaborated on in its 2023 Green Finance Strategy.

It remains to be seen whether UK corporates will be required to make disclosures in a manner that draws them within scope of the SDR more generally, although we note that UK listed companies are already required to disclose in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (**TCFD**). Whilst the SDR is arguably more flexible than the SFDR in terms of the data inputs that managers may rely on to categorise their funds, the new regime will still require UK managers to rely on robust, evidence-based standards in selecting their investments.

More generally, in its SDR Policy Statement, the FCA refers to the development of a UK Green Taxonomy, which has long been promised by policymakers. It remains to be seen how widely any such taxonomy will be relied upon in practice and to what extent firms within scope of the SDR will need to disclose against the UK Green Taxonomy. For context, the EU's Taxonomy Regulation is not currently widely relied upon in SFDR disclosures, with many funds choosing to report a 0% alignment against the EU Taxonomy; however, this is largely due to a lack of available data that would satisfy the EU Taxonomy criteria, and this may well change going forward as more corporates are drawn within scope of the EU's Corporate Sustainability Reporting Directive (**CSRD**).

3. Application of the SDR to Specific Products

The FCA has made clear that the SDR is not intended to be a static framework, but that it will evolve over time and draw additional categories of entities into its scope. It is clear from its Policy Statement that the FCA is ultimately looking to extend the SDR to overseas funds, single managed accounts and pension products, and potentially other products and services over time. This would bring the SDR regime more into line with the SFDR framework, which also applies to overseas funds being marketed into the EU via individual NPPR regimes, as well as single managed accounts and pension and insurance-based investment products. However, as the FCA does not have the power to make these revisions alone, it will need to work with HM Treasury to extend the regime, particularly with respect to overseas funds.

a. Overseas funds

- The SDR currently applies to overseas funds in a limited manner, simply requiring distributors to add a notice to overseas products to make clear that these products are not subject to the UK's SDR requirements on labelling and disclosure.
- There are indications that any expansion of the SDR to bring third country funds more directly in scope of the requirements will initially be limited to retail-focused funds rather than applying more broadly across all non-UK alternative investment funds marketed in the UK. For example, the Policy Statement specifically refers in this context to "recognised funds", including those marketed under the UK Overseas Funds Regime, which will initially focus primarily on EEA UCITS.
- Funds which do not rely on the UK Overseas Funds Regime, but are instead marketed to professional investors under the UK NPPR, may therefore be less of a focus initially.

b. Single managed accounts

- The FCA has stated that the SDR will not apply to single managed account (**SMA**) arrangements in its current form, given that SMA portfolios are generally diversified, and would not be invested exclusively in SDR-labelled funds.
- The FCA is considering whether firms carrying out portfolio management may instead be permitted to assess the assets within their portfolios against the criteria for SDR labels. If the FCA were to proceed with this approach it would add a further layer of investment due diligence for managers seeking to attain an SDR label, given that they would effectively be required to "grade" underlying assets against the various SDR criteria.
- The FCA has, however, noted that its focus will be on portfolio management undertaken for UK retail clients, including managed portfolios and discretionary wealth management services. It is therefore unclear at present how any future rulemaking will impact portfolio management services provided to professional clients.
- A consultation on the application of the SDR to portfolio management services is due to be published in early 2024.

c. Pension and insurance-based investment products

- The FCA has noted that it will consider extending the SDR regime to pension and insurance based investment products in the "medium-term" and that it is engaging with the Department for Work and Pensions and The Pensions Regulator on this.
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d. Passive funds

- The SDR permits passive funds to use labels, with the general caveat that when "constructing a passive product with the intention of using a sustainability label, managers should ensure that the chosen index aligns with the sustainability objective for their product... and meets the qualifying criteria".
- Passive fund managers may nonetheless need to think creatively about compliance with SDR requirements given that certain aspects of the rules appear more naturally suited to actively managed portfolios.
- For instance, managers of SDR-labelled funds are required to set KPIs showing both the performance of assets against relevant sustainability criteria, and the progress of the product towards its sustainability objective. In circumstances where a manager is, in part, reliant on the decisions of an index provider (i.e. with respect to which securities are removed from or introduced to an index), thought will need to be given as to how these KPIs are phrased and presented to investors.
- The FCA Policy Statement indicates in this regard that managers of SDR-labelled passive funds will be expected to take steps to understand the index provider's methodology, and how this translates to the sustainability ambitions of the fund.
- There is also a suggestion that the manager should participate in "regular engagement with the index provider", with a view to "ensuring the product meets the [SDR] criteria on an ongoing basis"; however, it is unclear exactly what the FCA's expectations are with respect to such engagement. For instance, taking steps to understand an index provider's methodology as it evolves over time may be reasonable, but – unless the index is highly bespoke – the index provider will likely be cautious around clients attempting to assert influence on the ESG profile of investments included in its index given conflicts considerations.
- Finally, the FCA suggests that stewardship activities with respect to the assets within a portfolio may also be a means that the manager can adopt to move a passive fund's investments towards its KPIs.

e. Feeder funds

- The SDR rules as currently drafted have a specific application to feeder funds – the key points are as follows:
 - feeder funds must only include in their name terms which are "consistent" with their associated master funds, and are subject to the same rules around the use of sustainability-related terms in product names (e.g., the production of a statement to make clear that the product is unlabelled);
 - managers of feeder funds must provide clients with easy access to the disclosures (pre-contractual, ongoing etc.) and statements which are detailed in sections 5, 9 and 10 of this guide;
 - following consultation feedback, the FCA has confirmed that feeder funds (including feeder non-UCITS retail schemes) "should be able to use the labels that their in-scope master fund uses". The rules permit the feeder funds to use the same label as its related master fund provided that "the predominant purpose of the feeder is to reflect the sustainability objective of the master fund". In addition, the manager must: (i) keep the label updated (in line with that used by the master fund); (ii) comply with the general SDR requirements for using labels (e.g., notifying the FCA and using the relevant graphic associated with the label); and (iii) permit clients access to the master fund's disclosures.

f. Fund of funds

The FCA notes in its Policy Statement that the SDR does not set out any specific requirements for fund of funds products:



Where a fund in scope of the regime invests in other funds, those funds will be treated as 'assets'. The rules apply as usual to the authorised fund, so the firm can apply the labelling criteria and must make the associated disclosures, or comply with the naming and marketing requirements.

The idea therefore seems to be that funds of funds will either:

- (i) adopt the same label as 70% plus of their invested assets, assuming that the investments either have a single SDR label or are considered by the manager to meet the standards required for that single SDR label; or
- (ii) be classified as "sustainability mixed goals" products, assuming that at least 70% of the fund's assets are invested in funds with a mix of SDR labels, or which are considered by the manager to meet the standards required for a mix of SDR labels.

In either case, the underlying investments must:

- a) have an SDR label; or
- b) be considered by the manager **"to meet, or demonstrate the potential to meet, sustainability criteria"** in line with SDR standards.

Where the fund of funds is classified as a sustainability mixed goals product, the FCA states that the fund must meet the criteria (and associated disclosures) of the sustainability focus and sustainability improvers labels respectively, for whichever proportion of assets within the portfolio that are either sustainable or improving.



Practical issues to bear in mind:

Fund of funds managers will need to become familiar with the SDR disclosure standards applicable to the assets they are investing in, and potentially adhere to more than one set of disclosure rules, depending on the composition of the fund's portfolio.

If the manager chooses to invest in funds with no SDR label, it will effectively need to assign an SDR characterisation to these funds. This will require managers to:

- understand the ESG profile of investments within underlying funds in some detail; and
- become familiar with third country ESG labels and how they equate to the new SDR classifications.

g. Listed investment trusts

Finally, the FCA has noted that listed investment trusts are in scope of the naming and marketing rules where the product markets **"sustainability characteristics to prospective retail clients"**.

Annex – SDR Implementation Timeline

The FCA's recent Policy Statement on the SDR provides the following implementation timeline:

Element of the regime	Timelines	
All firms		
Anti-greenwashing rule	31 May 2024	This gives all firms additional time to consider the guidance that we are consulting on Guidance Consultation (GC23/3)
Firms using product labels		
Labels, consumer-facing, pre-contractual disclosures and naming and marketing rules	From 31 July 2024	This allows firms that are ready to use labels earlier than 12 months after the PS is published to do so. Consumer-facing and pre-contractual disclosures must be published at the same time as the label is first used, and relevant naming and marketing rules must be met
Ongoing product-level disclosures	From 31 July 2025 (public) From 2 December 2025 (on demand)	Ongoing product-level disclosures must be either (i) published 12 months after the label is first used and annually thereafter, or (ii) provided to eligible clients on demand from 2 December 2025
Firms using sustainability-related terms without product labels		
Naming and marketing rules, consumer-facing and pre-contractual disclosures	2 December 2024	This allows a 12-month implementation period to produce relevant disclosures and statements. Firms must still comply with the anti-greenwashing rule from 31 May 2024.
Ongoing product-level sustainability disclosures	From 12 months after the terms are first used	Ongoing product-level disclosures must be produced annually
Distributors		
Labels, consumer-facing disclosures, notice on overseas funds	From 31 July 2024 (where firms are using labels) 2 December 2024 (notice on overseas funds)	The notice on existing overseas funds must be included by 2 December 2024.
Firms with above £5 billion in AUM		
Entity level disclosures	2 December 2025 (largest firms) 2 December 2026 (smaller firms)	The rules apply to larger firms (asset managers with above £50 billion in AUM) first and to smaller firms (with above £5 billion in AUM) one year later

Source – FCA PS23/16

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