

## Combating ‘Greenwashing’: New Proposals from the UK Financial Conduct Authority (“FCA”)

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The FCA has recently published a Consultation Paper (CP22/20) aimed at addressing its “*growing concerns that firms may be making exaggerated, misleading or unsubstantiated sustainability-related claims about their products; claims that don’t stand up to closer scrutiny (so-called ‘greenwashing’)*.”<sup>1</sup> This follows the November 2021 Discussion Paper (DP21/4), concerning the FCA’s proposed approach to UK Sustainability Disclosure Requirements (“**SDRs**”)<sup>2</sup> and a sustainable investment labelling system.<sup>3</sup> More generally, the FCA has consistently emphasised its determination to combat greenwashing in recent times.<sup>4</sup>

In the Consultation Paper, the FCA focuses on (i) specific sustainable investment labels, (ii) qualifying criteria required to use one of these labels, (iii) product- and entity-level disclosures, and (iv) naming and marketing rules. The FCA is clear, however, that these are only a “*starting point*” for an expanding and evolving regime.

The FCA’s proposals have a broad scope, extending beyond the asset management sector, with a proposed “*general ‘anti-greenwashing’ rule*” which would apply to all regulated firms. Further, there are important differences between the FCA’s proposed approach and other regimes (e.g., the EU Sustainable Finance Disclosure Regulation (“**SFDR**”) and recent proposals by the US SEC), which firms will need to navigate to the extent a product falls within more than one regime.

The FCA expects to publish final rules by 30 June 2023 (with the present consultation closing on 25 January 2023). While many of the rules on disclosures and marketing are not planned to come into force until (provisionally) 30 June 2024, the general anti-greenwashing rule is expected to apply immediately on publication of the new rules in June 2023. Further details of the FCA’s key proposals are outlined below.

### Labelling, Disclosures and Marketing

The proposed rules on labelling, classification, disclosure and marketing are principally focused on funds and portfolio managers based in the UK.<sup>5</sup> However, there are also specific proposals for distributors of

<sup>1</sup> See <https://www.fca.org.uk/publication/consultation/cp22-20.pdf>, published on 25 October 2022.

<sup>2</sup> The SDRs reflect the FCA’s proposed “*integrated, economy-wide disclosure regime that will increase the provision of standardised sustainability-related information along the value chain.*”

<sup>3</sup> See <https://www.fca.org.uk/publications/corporate-documents/strategy-positive-change-our-esg-priorities> and <https://www.fca.org.uk/publication/discussion/dp21-4.pdf>.

<sup>4</sup> See, for example, our recent client alert “[ESG Disclosures: UK Regulation and Litigation Risks](#)”.

<sup>5</sup> See 1.11 and 1.22 CP22/20. See also 3.7 CP22/20.

investment products to retail investors in the UK (e.g., advisers and investment platforms), as well as the generally-applicable anti-greenwashing rule referred to above.

A separate consultation is expected in due course for overseas funds marketed in the UK, and the FCA is also seeking views on expanding the regime to FCA-regulated asset owners (e.g., life insurers and pension providers) in respect of their investment products.<sup>6</sup>

### **Sustainable investment labels**

The FCA proposes to introduce the following three labels for investment products, with each designed to deliver a “*different profile of assets and consumer preferences*” (i.e., the labels are meant to be mutually exclusive, although there is no intended hierarchy among them):<sup>7</sup>

1. **Sustainable Focus:** “*Products with an objective to maintain a high standard of sustainability in the profile of assets by investing to (i) meet a credible standard of environmental and/or social sustainability; or (ii) align with a specified environmental and/or social sustainability theme*”;
2. **Sustainable Improvers:** “*Products with an objective to deliver measurable improvements in the sustainability profile of assets over time. These products are invested in assets that, while not currently environmentally or socially sustainable, are selected for their potential to become more environmentally and/or socially sustainable over time, including in response to the stewardship influence of the firm*”; and
3. **Sustainable Impact:** “*Products with an explicit objective to achieve a positive, measurable contribution to sustainable outcomes. These are invested in assets that provide solutions to environmental or social problems, often in underserved markets or to address observed market failures.*”<sup>8</sup>

In order to apply any of these labels to an investment product, an in-scope firm would need to (a) ensure that the FCA’s qualifying criteria (discussed below) have been met, and (b) make the required associated disclosures. If not, the firm would be prohibited from using any of the above labels for in-scope products, or any of a number of ESG-related terms under the proposed naming and marketing rules (outlined below).

### **Qualifying criteria**

Products qualifying for a sustainable investment label must meet the following threshold criteria:<sup>9</sup>

1. Five overarching principles (“*general criteria*”), covering (a) sustainability objective; (b) investment policy and strategy; (c) KPIs; (d) resources and governance; and (e) investor stewardship. For example, as regards a product’s sustainability objective, the relevant general criterion requires that “*a sustainable investment product must have an explicit environmental and/or social sustainability objective.*”<sup>10</sup>
2. A number of key (“*cross-cutting*”) considerations associated with each of the overarching principles above. For example, as it relates to a product’s sustainability objective, a firm would need to determine that objective “*in clear, specific and measurable terms as part of its investment objectives*” and maintain adequate processes to “*monitor the product’s performance against its sustainability objective.*”<sup>11</sup>
3. Certain category-specific key considerations relevant to a particular label. For example, as it relates to the ‘sustainability objective’ principle, where the product has a ‘sustainable focus’ label, the objective must “*align with requirements in the ‘investment policy and strategy’ section ... ie to invest predominantly (at least 70%) in assets that meet a credible standard [i.e., a*

<sup>6</sup> See also 1.36 and 3.8 CP22/20.

<sup>7</sup> See 3.2 and 4.23 CP22/20. In its Discussion Paper 21/4, the FCA had originally considered five labels based on ‘intentionality’ (‘not promoted as sustainable’, ‘responsible’, ‘transitioning’, ‘aligned’ and ‘impact’). However, respondents expressed concerns about the number and complexity of those labels.

<sup>8</sup> See 4.28 – 4.43 CP22/20 for a more detailed explanation of the key features of each product category.

<sup>9</sup> See Chapter 4 CP22/20.

<sup>10</sup> See 4.55 CP22/20.

<sup>11</sup> *Ibid.*

robust, independently assessed, evidence-based and transparent standard] *for environmental and/or social sustainability; or that align with a specified environmental and/or social sustainability theme.*"<sup>12</sup>

Firms which meet the necessary criteria for their investment products and seek to use the relevant label would be required to notify the FCA that they are using the label within one month of first doing so.

### **Consumer-facing disclosures**

In the context of the proposed SDRs, the Consultation Paper includes proposals for consumer-facing disclosures to complement the use of the sustainability labels. These disclosures would provide a summary of a product's key sustainability-related features, with the aim of helping consumers to gain a better understanding of those features, compare similar products (or the same product over time), and hold providers accountable for their claims.<sup>13</sup>

The disclosures would be contained in a new, standalone document, published in a prominent place on the firm's website. Further, where the product qualifies for a sustainability label, the disclosures should be "*no more than 'one mouse click away' from where the label is presented.*"<sup>14</sup>

In terms of the content of the disclosures, the FCA proposes that they should include information on product labels, sustainability goals and approaches, sustainability metrics, and a summary "*of the types of holdings that the firm would reasonably expect consumers... to find 'surprising' (ie inconsistent with the sustainability objective)...*" (among other things).<sup>15</sup> Disclosures should be reviewed at least annually (and prior to any proposed changes to products).

The requirement for in-scope firms to produce consumer-facing disclosures would extend to all in-scope products: where a product is not engaged in any sustainability-related strategies, the disclosures will be more limited and "*no sustainable label*" must be included in the relevant field.<sup>16</sup>

### **Detailed disclosures**

Under the FCA's proposals, more detailed disclosures would be available for institutional investors and other stakeholders (or retail investors interested in receiving additional information). These disclosures include:

1. pre-contractual disclosures regarding the sustainability-related features of a product (including its sustainability objective, policy and strategy). This would apply both to products using a sustainable label and products having sustainability-related features integral to their investment strategy (but not using a label);
2. a 'sustainability product-level report' to provide ongoing sustainability-related performance information (for products which use a label);<sup>17</sup> and
3. a 'sustainability entity report' with entity-level disclosures on in-scope asset managers' management of sustainability-related opportunities and risks (regardless of whether they use labels).<sup>18</sup>

### **Naming and marketing rules**

For firms providing in-scope products to retail investors which do *not* qualify for, or use, one of the sustainable labels, the FCA proposes certain naming and marketing rules to prohibit the use of

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<sup>12</sup> *Ibid.*

<sup>13</sup> See 5.18 CP22/20.

<sup>14</sup> See 5.23 – 5.41 CP22/20.

<sup>15</sup> See 5.38 CP22/20.

<sup>16</sup> See 5.31 CP22/20. The first such disclosures would be published 12 months after publication of the FCA's PS (so, provisionally from 30 June 2024). See 3.6 CP22/20.

<sup>17</sup> The first such disclosures would be published 24 months after publication of the FCA's PS (so, provisionally from 30 June 2025). See 3.6 CP22/20.

<sup>18</sup> This rule, which would apply to firms with assets under management over £5 billion, would have a staggered implementation, with larger firms (with assets under management over £50 billion) producing their first disclosures 24 months from publication of the FCA's PS (i.e., provisionally, from 30 June 2025). See 3.6 CP22/20.

sustainability-related terms (including, but expressly not limited to, ‘ESG’, ‘green’, ‘sustainable’, ‘net zero’, etc.).<sup>19</sup>

### **General ‘anti-greenwashing’ rule**

In addition to the proposals outlined above, which are principally focused on asset managers, the FCA proposes a general ‘anti-greenwashing’ rule for all FCA-regulated firms. This rule would require such 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.”<sup>20</sup> As such, the general rule overlaps with existing requirements to ensure that information communicated to clients is clear, fair and not misleading.<sup>21</sup>

### **Interaction with regimes in other jurisdictions**

The FCA acknowledges that many firms may operate in multiple jurisdictions with different and/or overlapping regimes for sustainability-related disclosures and labels. In particular, the European Union, via the SFDR, and the US, via certain rules proposed by the SEC, may impose requirements on firms which need to be taken into account in parallel with the proposed SDRs and labels.

To assist firms in navigating those different regimes, the FCA has provided guidance in Annex 1 of its Consultation Paper to explain (i) how firms should view those different existing (in the case of SFDR) or proposed (in the case of the SEC) rules when considering the proposed UK requirements (in particular, as regards the labelling system); and (ii) the key differences between the FCA’s proposals and these two international regimes. However, while the regimes may not be inconsistent, there are important differences (e.g., the three FCA labels do not track the three categories provided for in Articles 6, 8 and 9 of the SFDR) and, although Annex 1 provides a starting point, firms will need to undertake a more detailed analysis where more than one regime applies.

### **Measuring success / Supervision and enforcement**

The FCA intends to monitor the use of the proposed labels and their usefulness to consumers by way of reviews of product characteristics, surveys, complaints reviews and a post-implementation review after three years of the regime coming into force.

The FCA will use its usual supervisory and enforcement powers to respond to compliance issues. Enforcement action may be taken “if a firm has ignored a requirement to make the necessary disclosures; made misleading disclosures or misused a label; or breached [the FCA’s] naming and marketing rules.”<sup>22</sup>

## **Conclusion**

The FCA’s recent proposals are a clear signal to firms that greenwashing, which “may be eroding trust in the market for sustainable investment products”, will not be tolerated by the regulator.<sup>23</sup> Irrespective of the exact scope of the final rules which the FCA publishes following this Consultation, there is no doubt that the sustainability-related disclosure and labelling regime is here to stay. Therefore, firms will need to analyse how the requirements are liable to impact their businesses, and to adopt any additional policies and procedures in the interests of ensuring compliance.

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<sup>19</sup> See 6.12 CP22/20.

<sup>20</sup> See 6.9 CP22/20. This rule would apply immediately on the publication of the FCA’s PS. See 3.6 CP22/20.

<sup>21</sup> I.e., under PRIN 2.1, Principle 7 and COBS 4.2.1.

<sup>22</sup> See 1.33 CP22/20.

<sup>23</sup> See 1.3 CP22/20.

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