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FCA Sustainability Disclosure Requirements Consultation Paper on the Extension to Portfolio Managers now published

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The Financial Conduct Authority (the "**FCA**") on 23 April 2024 has published its Consultation Paper CP24/8 (the "**CP**") on the extension of its Sustainability Disclosure Requirements ("**SDR**") to portfolio managers. This follows the publication of their SDR requirements for asset managers, which we reported on here in November 2023.

Our headline analysis is that there is limited scope to portfolio managers providing services to professional clients only. There is an 'opt in' to the labelling regime available and no obligation to meet the naming and marketing requirements and the associated disclosures.

However, there are some areas in entity-level reporting for asset managers over the £5 billion AUM, which may be an uplift from current entity-level reporting requirements under the existing ESG Sourcebook, in particular to include their approach to sustainability-related risks.

We breakdown the key areas of the CP below.

Who does the CP apply to?

The CP applies to firms providing portfolio management services from an establishment in the UK, which in this context includes:

- firms with the permission to manage investments; or
- private equity or other private market activities consisting of either advising on investments or managing investments on a recurring or ongoing basis in connection with an arrangement, the predominant purpose of which is investment in unlisted securities.

The CP is targeted at retail investors, inclusive also of wealth management services for individuals.

Please note that the scope does not include portfolio management services where the clients are based overseas.

Usefully for many asset managers, there is a further exclusion that portfolio management services provided to a client that is a fund or an Alternative Investment Fund Manager or management company for or on behalf of a fund are also not within scope.

What are the proposed requirements, in summary?

Where there are professional clients:

- naming and marketing rules are not applicable;
- SDR labels may be used, subject to meeting specific criteria;
- where a label is being used, a pre-contractual and detailed product-level disclosure must be published or provided to clients; and
- entity-level disclosure rules apply.

Where there are retail clients:

- naming and marketing rules will apply;
- SDR labels may be used, subject to meeting specific criteria;
- where a label is being used, a consumer-facing pre-contractual and detailed product-level disclosure must be provided; and
- entity-level disclosure rules apply.

What is meant by a SDR label for portfolio managers?

As with the broader SDR regime, there are four labels that a portfolio manager may use:

- Sustainability Impact
- Sustainability Mixed Goals
- Sustainability Focus
- Sustainability Improvers

To use a label, the portfolio management offering must meet the general and specific criteria relating to a label on an ongoing basis, which we summarised here, and prepare the associated disclosures. The labelling criteria applies to the agreement or an arrangement under which a firm provides portfolio management to a client — so at least 70% of the overall arrangement would need to be invested in accordance with the sustainability objective and other qualifying criteria would need to be met.

The FCA sets out a proposed approach to each of the following criteria points in terms of applicability to portfolio managers when using a label (where required — otherwise the SDR criteria as applicable to asset managers is drawn across):

- **Product level:** sustainability objective; investment policy and strategy; and KPIs. The most notable is that there is a set threshold of 70% of the gross value of the portfolio of assets that must be invested in accordance with the sustainability objective, in line with the broader SDR fund labelling requirements' threshold;
- **Firm requirements:** negative outcomes; investment policy and strategy and independent assessment; assets that do not pursue the objective; KPIs; escalation plan; resources and governance; and stewardship; and
- **Meeting the requirements on an ongoing basis:** ongoing requirements and review and use of data.

Whilst we do not cover each of the areas in detail here, the number of areas that need to be covered indicate that a label should not be used without appropriate consideration of the regulatory requirements underpinning it.

What are the product-level disclosures?

For all portfolio managers using a label, there is a requirement to provide a pre-contractual disclosure and ongoing product-level disclosures annually. Overall, this information must include disclosures on how the portfolio manager determines the assets the portfolio invests in with reference to the labelling requirements and the robust, evidence-based standard of sustainability that it uses. If the information is not made publicly available, then instead of a website disclosure, it should be provided via a different medium to clients.

Where there are retail clients and a label used, a separate maximum two-page consumer-facing disclosure is also required to be prepared and disclosed.

What are the entity-level disclosures?

For all portfolio managers with more than £5 billion in AUM, they are required to annually disclose in a sustainability report:

- their governance around sustainability-related risks and opportunities;
- the actual and potential impacts of sustainability-related risks and opportunities on their businesses, strategy and financial planning;
- how the firm identified, assesses and manages sustainability-related risks; and
- the metrics and targets used to assess and manage relevant sustainability-related risks.

Where a firm uses a sustainability label (or is subject to the naming and marketing rules where there are retail clients) they must also disclose information on their resources, governance and organisational arrangements. Firms may cross-refer to other reporting in their group, where appropriate.

What are the naming and marketing rules?

Applicable to retail investors only, sustainability-related terms can be used in names and marketing if the portfolio uses a label, or there is no use of label but there is compliance with prescribed marketing and naming rules as follows. As this briefing is intended for portfolio managers without a retail investor client base, we have not provided the detail of the naming and marketing rules here, but in summary the marketing and naming rules are driven at ensuring that there is appropriate transparency on the sustainability profile of the portfolio management service where sustainability-related naming or marketing is in place.

When will the rules come into effect?

The labelling, naming and marketing and associated disclosures are proposed to be effective from 2 December 2024 for portfolio managers. For ongoing product level disclosures, where a label is used by a portfolio manager, those reports are required by 2 December 2025.

For entity level disclosures, they are aligned with the broader SDR timetable applying to the largest firms with AUM greater than £50 billion from 2 December 2025 and for smaller firms with over £5 billion in AUM one year later in 2026.

What are the next steps?

The feedback window on the consultation paper ends on 14 June 2024.

For further information on how the CP may be of consideration for your business, please reach out to the Proskauer UK Regulatory team.

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Related Professionals

- **John Verwey**
  Partner
- **Rachel E. Lowe**
  Partner
- **Sulaiman I. Malik**
  Associate
- **Michael Singh**
  Associate