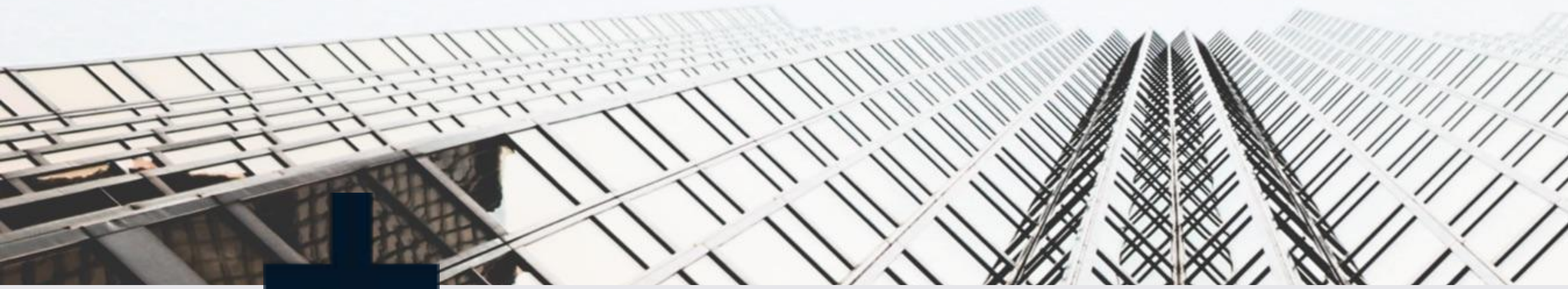
FUTUREPLUS

SDR REPORTING

A FUTUREPLUS GUIDE



INTRODUCTION

The proposal for the Sustainable Disclosure Requirement (SDR) is a set of new regulations for the UK markets. The aim of its introduction is to improve transparency in the market for investment products, and to prevent greenwashing around sustainability claims. This will be achieved through the introduction of rules governing the use of a product labelling system and strict governance around the use of sustainability language.

The following document explains the current proposals for the UK's SDR as they have been described in the Financial Conduct Authority (FCA) October 2022 Consultation paper. As the proposals for SDR are still in the consultation phase, they may be subject to changes and the final publication of the rules is not expected until June 2023.

The SDR marks the latest in a series of announcements of mandatory sustainable financial reporting regulations being introduced to markets, including SFDR (EU) and SEC (USA), yet sets itself apart from these two regulations through its main focus on ensuring transparency to consumers.

WHO DOES SDR APPLY TO?

Firms:

- Firms carrying out portfolio management
- UK Undertakings for Collective Investment in Transferable Securities (UCITS) management companies
- Investment companies with variable capital (ICVC) that is a UCITS scheme without a separate management company
- Full-scope UK Alternative Investment Fund Managers (AIFMs)
- Small authorised UK AIFMs

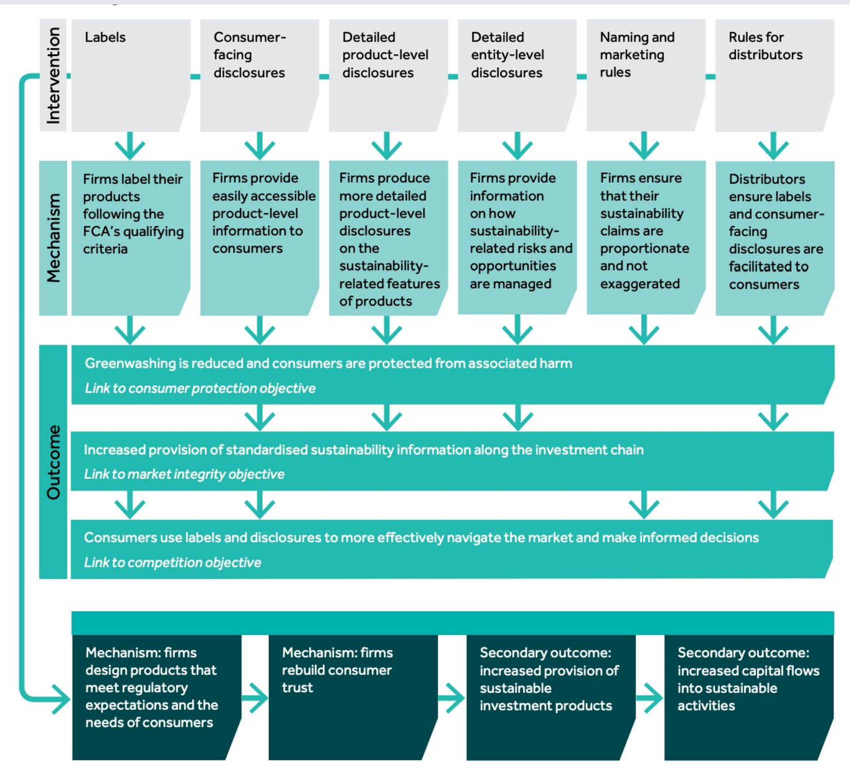
Products:

- Authorised funds (excluding feeder funds and funds in the process of winding up or termination)
- Unauthorised Alternative Investment Funds (AIFs), including investment trusts
- Portfolio management services can only use a label if 90% or more of the value of all constituent products in which they invest qualify for the same label

The different elements of SDR apply to firms/products distinctly. Specific information on the expected implementation timelines and scopes for different products can be found here.

OVERVIEW OF SDR

Summary table of SDR Interventions, mechanisms and outcomes:



SUSTAINABLE INVESTMENT LABELS

Products will be labelled based on intentionality and the primary channel that they can plausibly contribute to positive sustainable outcomes. Labels are designed not have a hierarchy and instead reflect the desires of different consumer preferences.

The 3 categories are:

THE 5 PRINCIPLES OF SDR

To meet the minimum criteria to be eligible for a label, funds must meet 5 overarching principles:

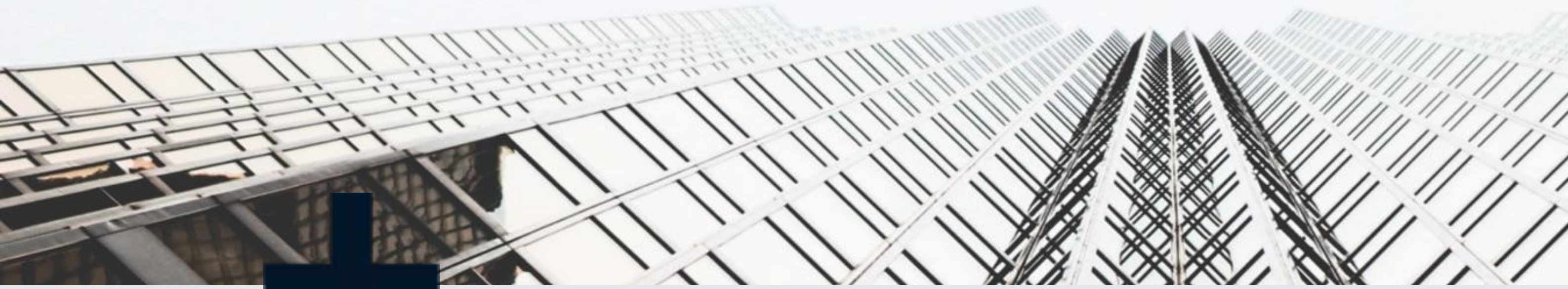
1. **Objectives**
2. **Investment policies and strategies**
    a. These must align with the fund's objective and detail asset selection criteria.
    b. Policies and procedures must determine, measure, monitor, evaluate and report to investors on the environmental and/or social sustainability profile of assets on an ongoing basis.
3. **KPIs**
    a. The fund must set credible, rigorous and evidence-based KPIs aligned with the sustainable objective, and perform ongoing monitoring.
4. **Resources and Governance (firm-level attributes)**
    a. Firms must carry out due diligence on all data, research and analytical resources that are used in relation to a fund.
5. **Investor stewardship**
    a. Where stewardship plays a significant role in the investment policy and strategy of a product, relevant KPIs must measure the stewardship activities' contribution to the achievement of the product's sustainability objective.

Using a sustainability label on assets is optional, but if you don't use one, the products must meet naming and marketing rules to ensure products are not greenwashing. Products without a sustainable objective but that use ESG integration strategies, or that apply negative screening or ESG 'tilts' would not be eligible for a label. Labels are designed to be mutually exclusive, and firms will not, therefore, be eligible for more than one label.

SUSTAINABLE FOCUS LABEL

Sustainable Focus

- Assets that mainly have an environmentally or socially sustainable focus.
- Assets meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme.
- 70% of a fund's assets must meet a credible standard. Meaning that a fund's assets must show socially or environmentally sustainable outcomes that are robust, independently assessed, evidence-based and transparent.
- *Details on what the standards will be have not yet been detailed, however, there is an indication that Taxonomies (e.g. the EU Taxonomy) could be used.*

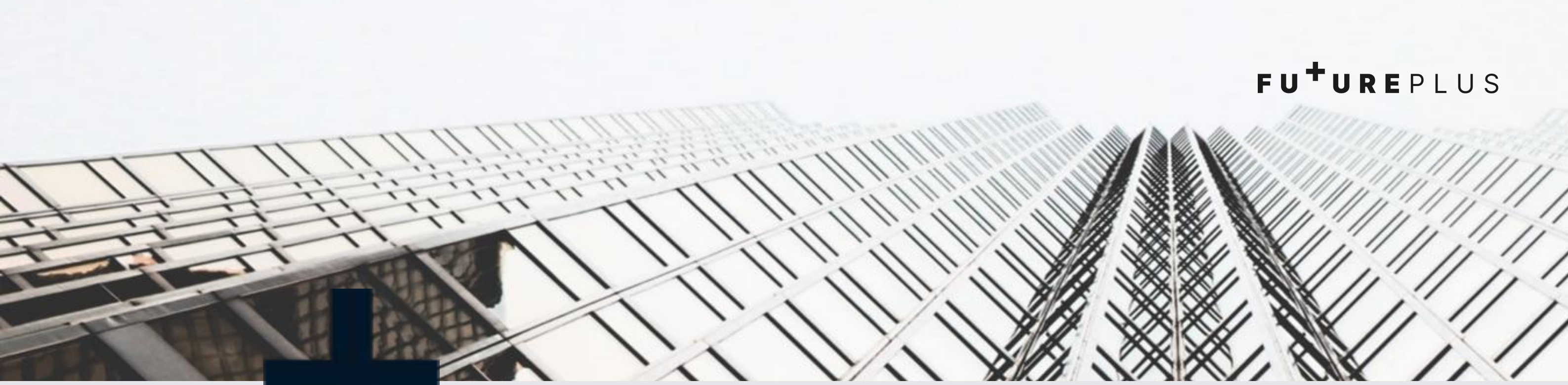


SUSTAINABLE IMPROVERS LABEL

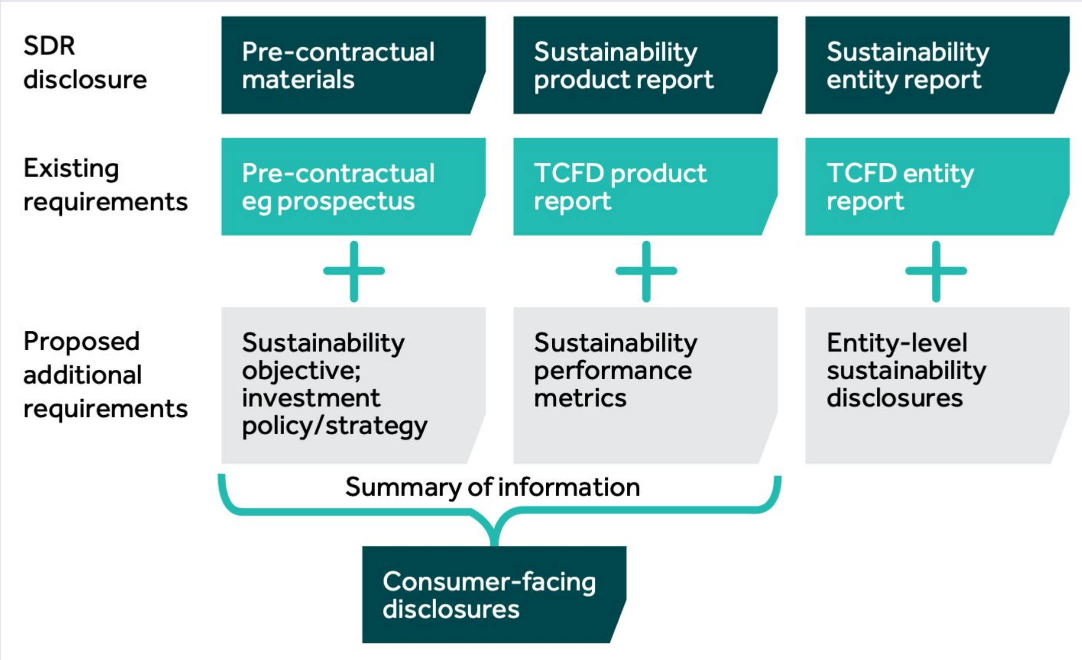
- Assets that aim to improve environmental or social sustainability over time, even if they are not currently sustainable.
- Assets’ objectives are to deliver measurable improvements in their sustainability profile over time. Assets are selected for their potential to become more environmentally or socially sustainable over time, including in response to the influence of the firm. Firms must provide detailed information on their investment strategy, and how they identify which assets they will and won’t invest in.
- Assets will be required to have clear and measurable KPIs relating to social or environmental sustainability to achieve this label. For this label, SDR may choose to prescribe the KPIs that funds must measure and report on. Metrics for this label will likely be based on information detailed in the UK Governments Transition Plan Taskforce (TPT) and/or correlate to disclosures under the International Sustainability Standards Board (ISSB) corporate reporting standards.
- Funds must have long-term sustainability profiles for assets that project over 1 year.
- Assets that incorporate ESG considerations primarily to manage financial risk will not be eligible for this category.

SUSTAINABLE IMPACT LABEL

- Assets that invest in solutions to environmental or social problems, to achieve a real-world impact with positive, measurable contributions to sustainable outcomes, often in underserved markets or to address observed market failures.
- Products would have to invest in-line with clearly articulated theories of change and evidence of their alignment.
- Assets would have to demonstrate how they assess adverse impacts, to ensure funds do not cause any unintended adverse social or environmental impacts.
- Industry standardised measurements and reporting of KPIs must be able to identify investors' contributions to positive outcomes.
- Funds must have escalation plans in the event that real-world outcomes become no longer feasible.



DISCLOSURES

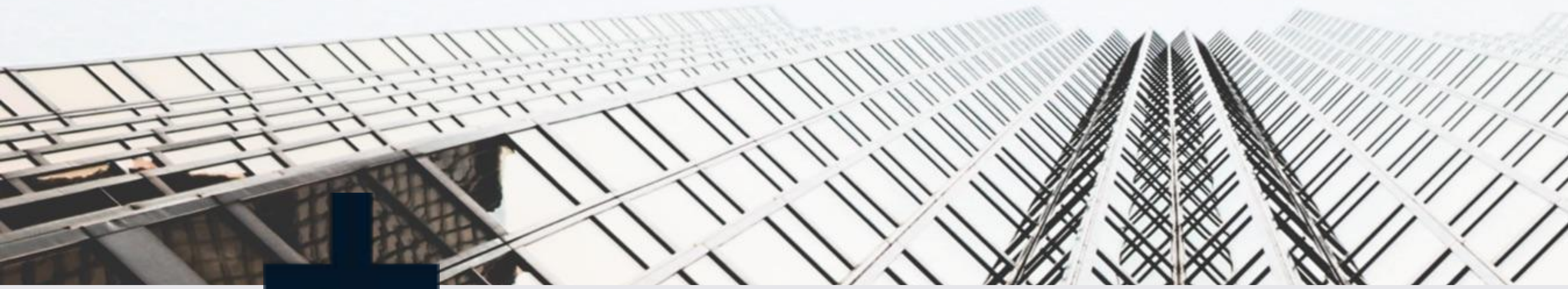


Pre-contractual disclosures

- Report information relating to sustainability objectives, investment policy and strategy, and stewardship approach.
- Pre-contractual disclosures are required for products that use the sustainability labels and are expected for any products that are incorporating sustainability into their strategy, even if they do not qualify for a label.

Sustainability product report

- Report information relating to progress towards sustainability objectives, ongoing sustainability-related performance information, and stewardship KPIs (where applicable). The report must address or explain any gaps in reporting for these areas.
- This report aims to build on the Task Force on Carbon-Related Financial Disclosures (TCFD) Product Report, and when the UK Green Taxonomy report is published, the SDR may adapt to incorporate disclosures relating to it.
- It is recommended that this report be available on the company's main webpage, with a click-through link available on the home page.
- This type of disclosure is only required for products that qualify for a sustainability label.
- Reports should be updated annually.



SUSTAINABILITY ENTITY REPORT

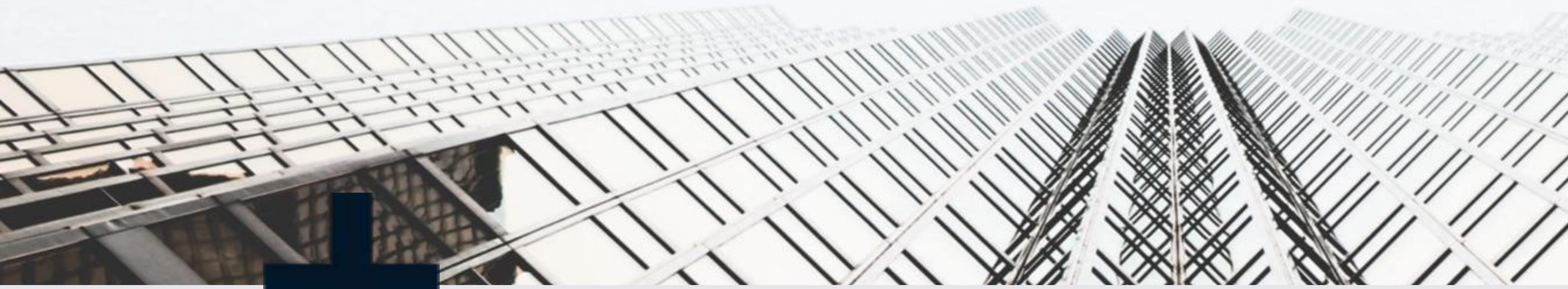
- The report will provide information on how firms are managing sustainability-related risk and opportunity, by detailing information on governance, strategy, risk management, metrics and targets.
- The entity reports may either incorporate TCFD entity report disclosures or require a link to the TCFD entity report. Additionally, reporting will be aligned with the ISSB's IFRS S1 Sustainability disclosure requirements.
- As sustainability has a very broad scope, SDR recognises that identified risks will vary depending on the focus and objectives of the fund, and therefore will not stipulate the specific scopes that the entity report needs to focus on.
- All products in-scope will have to provide pre-contractual disclosures, regardless of the use of sustainability labels.

SUSTAINABILITY CONSUMER-FACING DISCLOSURES

The requirement for funds to provide consumer-facing disclosures aims to aid consumer understanding of key sustainability features and improve trust.

- Funds will need to disclose to consumers a summary of the key sustainability-related features including information on the product's sustainability objective, investment approach and performance against objectives, labels, and unexpected investments.
- Disclosures will also be required to provide signposting/hyperlinking to further information.
- Disclosures must be in line with UK Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation disclosure obligations and presented to customers as a stand-alone document alongside the PRIIPs Key Information Document (KID).
- All products in-scope will have to provide pre-contractual disclosures, regardless of the use of sustainability labels.

Disclosures must be made available in a prominent place, such as the company's main business web page. For funds that have achieved a sustainability label, information must not be more than 'one click away' from the product information.



NAMING AND MARKETING RULES

Anti-greenwashing rules further ensure that marketing must be clear, fair and not misleading.

- These rules will apply to all FCA-regulated firms.
- Firms offering in-scope products without a label will be prohibited from using the terms:

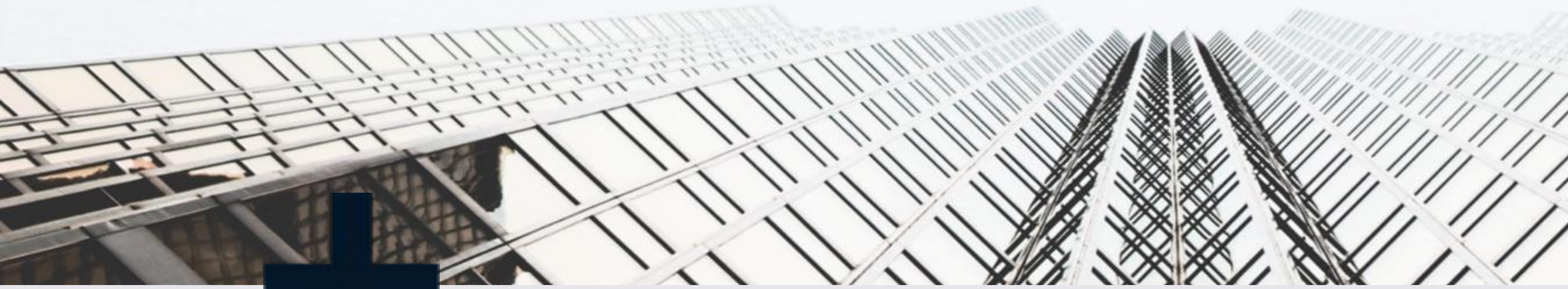
  ‘ESG’ (or ‘environmental’, ‘social’ or ‘governance’), ‘climate’, ‘impact’, ‘sustainable’ or ‘sustainability’, ‘responsible’, ‘green’, ‘SDG’ (sustainable development goals), ‘Paris-aligned’ or ‘net zero’, ‘Sustainable Focus’, ‘Sustainable Improvers’ and ‘Impact’ in their product names and marketing.
- This ban does not apply to pre-contractual disclosures so firms who have integrated sustainability or ESG into their investment strategies but do not have it as an objective are still able to describe their strategies using these terms.
- Firms may only use these terms to describe themselves if more than 90% of the value of the firm is included in assets that possess a label.
- Products offered to institutional investors would not be considered ‘in-scope’, and so not subject to these rules.

REQUIREMENTS FOR DISTRIBUTORS

- Requirements from distributors of “in-scope” products to ensure that sustainable investment labels and consumer-facing disclosures are made available to customers. With the label visible on the main page for the fund, with easy access to the consumer-facing disclosures.
- Consumer-facing disclosures will also need to be easily accessible on distributor's websites for non-labelled funds.
- Overseas funds that are not subject to FCA rules around prohibited terms must have a clear statement saying: “This product is based overseas and is not subject to FCA sustainable investment labelling and disclosure requirements”.

SDR TIMELINE AND NEXT STEPS

- SDR is currently in a consultation phase. Based on feedback from this consultation the FCA hopes to publish final rules and a Policy Statement within the first half of 2023.



- The Policy Statement aims to clarify rules on anti-greenwashing for all FCA-regulated companies, to ensure sustainability-related claims are clear, fair and not misleading. As this is a clarification, it will come into effect immediately upon publication. Provisionally 30/6/2023.
- Requirements for SDR labelling, naming and marketing, consumer-facing and pre-contractual disclosure requirements and rules for distributors would come into effect 12 months after publication. Provisionally on 30/6/2024 - or 1 year after the final rules are published.
- Reporting on ongoing sustainability-related performance information will be required 24 months after the final rules are published, provisionally 30/6/2025.
- Sustainability Entity Reports will have a staggered rollout, with the largest firms (over £50 billion AUM) being required to produce these 24 months after publication of the final rules, provisionally 30/6/2025. Firms (£50 - 5 billion) will be required to complete this report 1 year later. These requirements are subject to review, however.

REPORTING ALIGNMENT

SDR draws on or has designed reporting in line with the following: ISSB, Green Finance: A roadmap to Sustainable Investing, TCFD, and UK Green Taxonomy (when published)

SDR recognises that many of the firms that SDR will be applicable to operate internationally, and therefore have taken steps to ensure coherence with other international frameworks including SFDR and SEC. However, SDR differs from these frameworks as the focus is on consumer-focused labelling.

Of the 3 labelling categories:

- No label applicable equates to SFDR Article 6 Funds
- Sustainable Improvers and Sustainable Focus most closely equate to SFDR Article 8, although the labels are considered to have higher standards.
- Sustainable Impact correlates to SFDR Article 9 although Sustainable Impacts has a higher level of criteria to meet as funds are required to demonstrate additionality not only alignment with sustainable investment criteria.
- SFDR's 'Do no significant harm' principle was seen to be too restrictive at this stage, and an equivalent is therefore not included in SDR, however, Sustainable Impact products are required to consider their negative social and environmental impacts.

SDR Graphics used within this document were sourced from the FCA Sustainable Disclosure Requirements (SDR) and investment labels consultation paper, October 2022.