

Chapter 4

Sustainability labelling, naming and marketing

4.2 Criteria for applying sustainability labels

4.2.1 **R** A *manager* must, in order to use a *sustainability label* in relation to a *sustainability product* under ■ ESG 4.1.1R(2)(a), ensure that both the general and specific criteria which relate to that particular label have been met and continue to be met on an ongoing basis.

4.2.2 **G** ■ ESG 4.2 sets out the relevant general and specific criteria and the ongoing responsibilities of a *manager* with respect to meeting those criteria, and ■ ESG 5 sets out the locations at which information associated with the criteria must be disclosed, either in a *consumer-facing disclosure*, a *pre-contractual disclosure*, Part B of a *public product-level sustainability report* or in a *sustainability entity report*.

4.2.3 **G** A *manager* is reminded of ■ ESG 3.1.4R – namely, that where it delegates its activities to another person it still remains responsible for ensuring compliance with ■ ESG 4.2.

General criteria: general features of a sustainability product using a sustainability label

4.2.4 **R** A *sustainability product* using a *sustainability label* must:

- (1) have an explicit *sustainability objective* as part of its investment objectives that:
 - (a) aligns with one of the *sustainability labels* set out under ■ ESG 4.1.1R (as detailed further under ■ ESG 4.2.13R, ■ ESG 4.2.14R, ■ ESG 4.2.16R and ■ ESG 4.2.18R); and
 - (b) is clear, specific and measurable;
- (2) meet the following requirements:
 - (a) at least 70% of the gross value of the product's assets must be invested in accordance with its *sustainability objective*, except where:
 - (i) the product is still to be fully invested in assets, as set out in the product's investment strategy under ■ ESG 4.2.9R(2)(b); or
 - (ii) the *manager* is taking steps under ■ ESG 4.2.22R.
 - (b) the product's assets must be selected with reference to a robust, evidence-based standard that is an absolute measure of

environmental and/or social sustainability, as applicable under ■ ESG 4.2.13R, ■ ESG 4.2.14R and ■ ESG 4.2.17R(1); and

(c) where the product invests in assets that are not in accordance with its *sustainability objective*, those assets must not have attributes that conflict with that objective; and

(3) have robust and evidence-based key performance indicators (KPIs) that can demonstrate the product’s progress towards meeting its *sustainability objective*.

4.2.5 **G** A *manager* may, in determining the *sustainability objective* of a sustainability product, refer to the standards produced by the Sustainability Accounting Standards Board in order to help determine the topics that a *retail client* would reasonably associate with *sustainability characteristics*.

4.2.6 **G** In relation to ■ ESG 4.2.4R(2)(a), not meeting the 70% threshold is only likely to be justified in relation to *sustainability products* that are designed to build their initial portfolio over time, such as may be in the case of an *LTAf*.

4.2.7 **G** In relation to ■ ESG 4.2.4R(2)(b), assets should be selected using a methodology or approach which:

(1) is applied in a systematic way; and

(2) may be based on, or determined by, an authoritative body, industry practice or a proprietary methodology for determining:

(a) the *sustainability characteristics* of a product’s assets; and

(b) the ability of those assets to contribute to a positive environmental or social outcome.

4.2.8 **G** The KPIs under ■ ESG 4.2.4R(3) should measure the *sustainability product’s* progress towards achieving its *sustainability objective* and/or the performance of individual assets towards achieving that objective.

General criteria: manager requirements in relation to the use of a sustainability label

4.2.9 **R** A *manager* must, in addition to ensuring that a *sustainability product* meets the requirements set out in ■ ESG 4.2.4R:

(1) determine whether pursuing that product’s *sustainability objective* could result in negative environmental and/or social outcomes;

(2) determine the *sustainability product’s*:

(a) investment policy for achieving its *sustainability objective*; and

(b) investment strategy for meeting the requirements under ■ ESG 4.2.4R(2), including, where appropriate, the timescales by which the product is expected to be fully invested in assets;

- (3) obtain or undertake an assessment of the standard referred to under ■ ESG 4.2.4R(2)(b) to confirm that it is appropriate for determining which assets the product invests in, ensuring that:
 - (a) the assessment, whether obtained from a third party or undertaken by the *manager*, is independent from the *manager's* investment process; and
 - (b) the individuals responsible for carrying out the assessment are appropriately skilled;
- (4) identify any assets which the *sustainability product* invests in for reasons other than to pursue its *sustainability objective*;
- (5) identify the KPIs that the *manager* will use for the purposes of ■ ESG 4.2.4R(3);
- (6) have an escalation plan setting out the actions that the *manager* will take if any of the *sustainability product's* assets do not demonstrate sufficient performance against either the product's *sustainability objective* or the KPIs under ■ ESG 4.2.4R(3);
- (7) in relation to the *manager's* governance and resources, ensure that:
 - (a) there are appropriate resources, governance and organisational arrangements in place, commensurate with enabling the *sustainability product* to achieve its *sustainability objective*;
 - (b) there is adequate knowledge and understanding of the assets in which the *sustainability product* is invested; and
 - (c) there is a high standard of diligence in the selection of any data or other information used (including when third-party ESG data or ratings providers are used) to inform investment decisions for the *sustainability product*; and
- (8) in relation to investor stewardship:
 - (a) identify the investor stewardship strategy needed to support the achievement of the *sustainability product's sustainability objective*, including the activities which are expected to be undertaken and the outcomes which are expected to be achieved; and
 - (b) ensure that the investor stewardship strategy and appropriate resources are applied in order to support the achievement of the *sustainability objective*.

4.2.10 G In meeting the requirements of ■ ESG 4.2.9R(6), a *manager* should, where possible, include in its escalation plan its anticipated timescales for addressing any matters that may result in insufficient performance by the *sustainability product's* assets against the product's *sustainability objective*.

4.2.11 R A *manager* must, with respect to a *sustainability product* that is an index-tracking product, only use an index that has a methodology which is aligned with the product's *sustainability objective* and the requirements in ■ ESG 4.2.4R(2).

Specific criteria

4.2.12 R A manager must, in addition to the general criteria under ESG 4.2.4R to ESG 4.2.11R, ensure that a sustainability label is only used in relation to a sustainability product if the product meets the specific criteria applicable to that label.

Specific criteria: sustainability focus

4.2.13 R A manager may only use the 'sustainability focus' label where the sustainability product's sustainability objective is consistent with the aim of investing in assets that are environmentally and/or socially sustainable, determined using the robust, evidence-based standard set out under ESG 4.2.4R(2)(b).

Specific criteria: sustainability improvers

4.2.14 R A manager may only use the 'sustainability improvers' label where the sustainability product's sustainability objective is consistent with the aim of investing in assets that have the potential to improve environmental and/or social sustainability over time, determined by the potential of those assets to meet the robust, evidence-based standard set out under ESG 4.2.4R(2)(b).

4.2.15 R A manager must, in relation to the use of the sustainability label 'sustainability improvers':

- (1) identify the period of time by which the product and/or the assets in which the product invests is expected to meet the robust, evidence-based standard set out under ESG 4.2.4R(2)(b);
(2) identify short and medium-term targets for improvements in the sustainability of the product and/or the assets in which the product invests, commensurate with the investment horizon of the product; and
(3) obtain robust evidence to satisfy itself that the assets in which the product invests have the potential to meet the robust, evidence-based standard set out under ESG 4.2.4R(2)(b).

Specific criteria: sustainability impact

4.2.16 R A manager may only use the 'sustainability impact' label where the sustainability product's sustainability objective is consistent with the aim of achieving a pre-defined, positive, measurable impact in relation to an environmental and/or social outcome.

4.2.17 R A manager must, in relation to the use of the sustainability label 'sustainability impact':

- (1) specify a theory of change in line with the product's sustainability objective, describing how the manager expects its investment activities and the product's assets to contribute to achieving a positive and measurable impact, in accordance with the robust, evidence-based standard set out under ESG 4.2.4R(2)(b) where the manager considers it appropriate; and

- (2) specify a robust method to measure and demonstrate that the *manager's* investment activities and the product's assets are achieving a positive environmental and/or social impact.

Specific criteria: sustainability mixed goals

4.2.18 **R** A *manager* may only use the 'sustainability mixed goals' label where the *sustainability product's sustainability objective* is to invest in accordance with 2 or more of the *sustainability objectives* in ■ ESG 4.2.13R, ■ ESG 4.2.14R and ■ ESG 4.2.16R.

4.2.19 **R** A *manager* must, in relation to the use of the *sustainability label* 'sustainability mixed goals':

- (1) identify the proportion of assets which are invested in accordance with each of the 2 or more *sustainability objectives* referred to in ■ ESG 4.2.18R; and
- (2) meet the requirements (as relevant) under ■ ESG 4.2.15R and ■ ESG 4.2.17R.

Manager requirements on an ongoing basis

4.2.20 **R** A *manager* must ensure that the general and specific criteria with respect to using a *sustainability label* are met on an ongoing basis, in particular:

- (1) The *manager* must ensure that:
 - (a) the requirements in ■ ESG 4.2.4R continue to be met;
 - (b) the *sustainability product's* investment policy, strategy and escalation plan under ■ ESG 4.2.9R(2) and ■ ESG 4.2.9R(6) are updated as appropriate;
 - (c) the independent assessment obtained under ■ ESG 4.2.9R(3) remains valid;
 - (d) the *manager* continues to maintain appropriate governance and resources in accordance with the requirements under ■ ESG 4.2.9R(7); and
 - (e) the *manager* continues to maintain an appropriate investor stewardship strategy and apply that strategy and its resources in accordance with the requirements under ■ ESG 4.2.9R(8); and
- (2) The *manager* must:
 - (a) monitor whether pursuing the *sustainability product's sustainability objective* could result in negative outcomes that have not already been identified under ■ ESG 4.2.9R(1).
 - (b) monitor whether the *sustainability product* is investing in assets that pursue its *sustainability objective* and identify any new assets that have not already been identified under ■ ESG 4.2.9R(4); and
 - (c) monitor the ongoing performance of the *sustainability product* in achieving its *sustainability objective*, measured against the product's KPIs set out under ■ ESG 4.2.4R(3).

- 4.2.21 **R** A *manager* must, in relation to a *sustainability product* that is an index-tracking product, ensure that the index continues to meet the requirements of ■ ESG 4.2.4R(2) when that index is rebalanced.
- 4.2.22 **R** (1) A *manager* must, when ensuring the matters set out in ■ ESG 4.2.20R are met:
- (a) apply, as appropriate, its escalation plan under ■ ESG 4.2.9R(6) where the product's assets do not demonstrate sufficient performance against the product's *sustainability objective* and/or the KPIs under ■ ESG 4.2.4R(3); and
- (b) subject to ■ ESG 4.2.25R, ensure that, if a *sustainability product* ceases to meet the general or specific criteria with respect to using a *sustainability label*, it takes action to restore compliance as soon as reasonably practicable.
- (2) A *manager* that is undertaking the steps set out in ■ ESG 4.2.22R(1) will be complying with the general and specific criteria with respect to using a *sustainability label*.
- 4.2.23 **G** Where a *manager* is taking action under ■ ESG 4.2.22R(1)(b) with respect to restoring compliance with ■ ESG 4.2.3R(2)(a), the FCA would ordinarily expect only minimal deviations from the requirements under ■ ESG 4.2.3R(2)(a).
- 4.2.24 **G** In relation to ■ ESG 4.2.22R(2), a *manager* is reminded of its obligation under ■ ESG 4.1.11R(2) to ensure that it reviews its use of a *sustainability label* at least every 12 *months* to determine whether the label continues to be appropriate.
- 4.2.25 **R** A *manager* must, where the steps taken under ■ ESG 4.2.22R are not sufficient for ensuring ongoing compliance with the general and specific criteria:
- (1) revise or cease the use of a *sustainability label* as soon as reasonably practicable; and
- (2) take the steps set out under ■ ESG 4.1.13R.
- 4.2.26 **R** Where a *manager* uses a *sustainability label* in relation to a *sustainability product*, it must take reasonable steps to ensure that the data it is relying upon in order to meet the requirements under ■ ESG 4.2 is accurate and complete (including using proxies and assumptions where appropriate).