

Chapter 4

Sustainability labelling, naming and marketing

4.2 Criteria for applying sustainability labels

- 4.2.1

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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.
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■ 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*.
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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.
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General criteria: general features of a sustainability product using a sustainability label

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

ESG 4/2

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■ Release 37 ● Jun 2024

		<p>environmental and/or social sustainability, as applicable under ■ ESG 4.2.13R, ■ ESG 4.2.14R and ■ ESG 4.2.17R(1); and</p> <p>(c) where the product invests in assets that are not in accordance with its <i>sustainability objective</i>, those assets must not have attributes that conflict with that objective; and</p> <p>(3) have robust and evidence-based key performance indicators (KPIs) that can demonstrate the product's progress towards meeting its <i>sustainability objective</i>.</p>
4.2.5	G	A <i>manager</i> may, in determining the <i>sustainability objective</i> of a sustainability product, refer to the standards produced by the Sustainability Accounting Standards Board in order to help determine the topics that a <i>retail client</i> would reasonably associate with <i>sustainability characteristics</i> .
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 <i>sustainability products</i> that are designed to build their initial portfolio over time, such as may be in the case of an <i>LTAf</i> .
4.2.7	G	<p>In relation to ■ ESG 4.2.4R(2)(b), assets should be selected using a methodology or approach which:</p> <p>(1) is applied in a systematic way; and</p> <p>(2) may be based on, or determined by, an authoritative body, industry practice or a proprietary methodology for determining:</p> <p>(a) the <i>sustainability characteristics</i> of a product's assets; and</p> <p>(b) the ability of those assets to contribute to a positive environmental or social outcome.</p>
4.2.8	G	The KPIs under ■ ESG 4.2.4R(3) should measure the <i>sustainability product's</i> progress towards achieving its <i>sustainability objective</i> 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	<p>A <i>manager</i> must, in addition to ensuring that a <i>sustainability product</i> meets the requirements set out in ■ ESG 4.2.4R:</p> <p>(1) determine whether pursuing that product's <i>sustainability objective</i> could result in negative environmental and/or social outcomes;</p> <p>(2) determine the <i>sustainability product's</i>:</p> <p>(a) investment policy for achieving its <i>sustainability objective</i>; and</p> <p>(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;</p>

- (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*.

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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*.

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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 <i>manager</i> must, in addition to the general criteria under ■ ESG 4.2.4R to ■ ESG 4.2.11R, ensure that a <i>sustainability label</i> is only used in relation to a <i>sustainability product</i> if the product meets the specific criteria applicable to that label.
		Specific criteria: sustainability focus
4.2.13	R	A <i>manager</i> may only use the ‘sustainability focus’ label where the <i>sustainability product’s sustainability objective</i> 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 <i>manager</i> may only use the ‘sustainability improvers’ label where the <i>sustainability product’s sustainability objective</i> 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 <i>manager</i> must, in relation to the use of the <i>sustainability label</i> ‘sustainability improvers’: <div><div>(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);</div><div>(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</div><div>(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).</div></div>
		Specific criteria: sustainability impact
4.2.16	R	A <i>manager</i> may only use the ‘sustainability impact’ label where the <i>sustainability product’s sustainability objective</i> 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 <i>manager</i> must, in relation to the use of the <i>sustainability label</i> ‘sustainability impact’: <div>(1) specify a <i>theory of change</i> in line with the product’s <i>sustainability objective</i>, describing how the <i>manager</i> 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 <i>manager</i> considers it appropriate; and</div>

- (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).