Deloitte Sustainability Disclosure Requirements (SDR) Implementation Survey 2024

Early implementation challenges on the path to a maturing sustainability investment landscape in the UK

October 2024

Table of contents

Executive summary

Since the Financial Conduct Authority (FCA) published final rules concerning its new Sustainability Disclosure Requirements (SDR) in late 2023, the asset management industry has been busy analysing the application of the rules, with some firms preparing for implementation and adapting their sustainability strategies.[1] The new rules introduced four labels for sustainability-related investment products, each with general and specific criteria firms need to meet for their use and disclosure. These labels aim to minimise greenwashing, protect consumers, standardise sustainability information, and ultimately help investors make more informed decisions.

For some asset managers, this has meant a significant shift in how they design, market and report on sustainability-related products, demanding a robust and demonstrable commitment to sustainability. While it's still early days for the sustainable transition, firms have interpreted these new rules as a positive for the industry. However, implementation has varied, with some firms making early applications to use product labels for existing thematic funds, impact funds or Article 9 funds of the Sustainable Finance Disclosure Regulation (SFDR), while others have taken a more cautious 'wait-and-see' approach.[2]

In addition, acknowledging that it has taken longer than expected for some firms to make the required changes, the FCA recently afforded some firms of UK authorised investment funds 'limited temporary flexibility' until 17.00 on 2 April 2025 to comply with the 'naming and marketing rules', but only in 'exceptional circumstances'.[3] The afforded flexibility applies to firms that have both submitted a completed application for approval and those funds currently using the terms 'sustainable', 'sustainability', or 'impact' in their product names. The FCA has signalled the importance of getting SDR right for investors. Their pragmatic, outcomes-based approach, offering additional time for firms to operationalise necessary changes, has been welcomed by the industry.

However, there are complexities with the implementation of SDR that have led firms to question the strategic purpose of marketing sustainable funds, whether that be with or without the new product labels.[4] This report highlights the opportunities, strategic challenges and implementation obstacles that SDR presents to the investment management community. Our findings are based on a quantitative survey of 37 individual firms, who together represent £17 trillion of assets under management (AUM). This survey is further backed by seven detailed qualitative interviews with a representative cross-section of survey participants.

Our resulting research digs into some of the key implementation challenges facing asset managers in the UK when it comes to achieving full compliance with these new rules, and provides actionable recommendationsto to guide firms in successfully navigating SDR implementation.

Six key findings from the report are:

1. Avoiding 'greenwashing' continues to be a major focus

The financial services industry has been actively engaging with the evolving regulatory landscape surrounding sustainability, particularly regarding greenwashing risks. While the importance of mitigating these risks is widely recognised, the implementation of new regulations and guidance has presented challenges due to the complexities involved. This report aims to provide insights into these specific challenge areas, offering potential solutions as the industry strives to achieve greater clarity and consistency in sustainable finance. For example, to implement SDR effectively, firms should conduct comprehensive assessments of their operations and product offerings against the regulatory requirements and develop tailored SDR training for employees to ensure a broad and consistent understanding of the regulation and associated terminology where required.

2. Firms need to ensure accurate and consistent sustainability-related information and communication across all client touchpoints

While strong returns remain a priority, investors are also increasingly building sustainability factors into their decision-making. They look for investments that not only mitigate environmental and social risks but also contribute a positive impact, driving growth in the wider ESG market. SDR disclosures also aim to provide standardised sustainability information, enabling consumers to make informed investment decisions, regardless of whether a product uses a label or simply incorporates sustainability-related terminology. To mitigate greenwashing risks and improve customer outcomes, firms should consider implementing sustainability reviews across the entire product lifecycle, ensuring accurate and consistent sustainability-related information and communications at all client touchpoints.

3. The product labelling landscape for sustainable finance is still divided

Firms with a desire to market UK-based sustainable products subject to SDR currently face the crucial choice of whether to pursue product labelling or to comply with naming and marketing rules, forgoing the label. While a significant number of firms plan to pursue product labelling, many others are opting for alternative approaches, including using sustainability-related terminology without a label, or by simply adopting a 'wait-and-see' approach. Using sustainability-related terminology in a product name without a label carries significant weight, potentially shaping investor perceptions and market positioning. Firms must therefore ensure full transparency and alignment between each fund's stated purpose, investment objectives and underlying asset characteristics, through rigorous sample testing and performance monitoring.

4. Despite the challenges, most firms we spoke to remain committed to making SDR a success

A majority of firms surveyed for this study demonstrated an appetite to pursue product labelling or incorporate sustainability-related terminology in their fund names. This motivation is strengthened by a desire to enhance transparency and consumer understanding of sustainability-related offerings. Moreover, firms recognise the opportunity to improve the overall quality and availability of sustainability-related data, ultimately benefiting investors and the industry. In response, we recommend that firms should consider conducting due diligence on data providers, develop proprietary benchmarks based on industry standards, and consider independent audits to verify sustainability claims.

5. Sustainability standards are a moving target, demanding ongoing reviews

The ongoing discussion surrounding what constitutes a 'robust, evidence-based standard of sustainability' represents an opportunity for collaboration between regulators and market participants.[5] The concept of an 'absolute measure' of sustainability is still evolving, leading to a diversity of interpretations within the industry. As the understanding of sustainability deepens, a more standardised approach to measurement and reporting will be beneficial for both market participants and investors. Indeed, when defining sustainability standards, we recommend firms go beyond simply stating their chosen criteria to provide a robust justification of the appropriateness of standards, as well as how the firm assesses the materiality of environmental and social factors across different sectors where applicable.

6. Scrutinising asset selection and justification processes is critical for firms manufacturing labelled and non-labelled sustainable investment products

Many firms are seeking to adopt transparent asset selection processes that incorporate both quantitative and qualitative judgments. In doing so, clearly documenting the criteria and standards underpinning these decisions is critically important. This includes outlining the specific factors considered in qualitative assessments, referencing established frameworks and providing detailed evidence to support judgments, ultimately demonstrating a robust and informed decision-making process. As would be expected for any new process or aspect of governance, however, evidence of robust internal validation, quality assurance and continuous monitoring of effectiveness will be vital. Hence, while stringent requirements for using sustainability labels have caused frustration, this rigour is generally regarded as a positive. As with any new regulatory framework, early problems are to be expected. The robustness of the process underscores a commitment to establishing trustworthy and reliable standards for sustainable investing. The ultimate success of this endeavour though will depend on firms' ability to balance regulatory expectations with market demand and operational feasibility.

About the survey

Why?

This survey examines the practical implications of implementing the SDR, exploring both the opportunities and challenges faced by asset managers and distributors. It focuses specifically on the use of SDR labels, the incorporation of sustainability-related terminology in fund names, and the fulfilment of new disclosure and reporting obligations.

When?

Survey fieldwork was conducted between March and May 2024. Interviews were conducted between June and August 2024.

Who?

We surveyed 38 individuals from 37 firms (see characteristics of firms surveyed on page 06) concerning their intentions, motivations and barriers to using investment labels. The survey findings are further supplemented by seven detailed interviews and other informal client interactions, delving into the strategies and challenges firms have encountered in implementing SDR.

Disclaimer

This study is based on data gathered from a sample of market participants in the UK. Given that our respondents are either already involved in the market or have strong views on the topic, care should be taken when interpreting these findings, which may not be a direct corollary for activity and sentiment across the whole UK marketplace.

Characteristics of firms surveyed

Target respondents

Our survey targeted key decision-makers responsible for SDR implementation, including Chief Compliance, Legal, Risk, Sustainability and Operations Officers, as well as Heads of Product, across a diverse range of asset managers, distributors and asset owners in the UK market.

37 Firms representing **£17** trillion of AUM

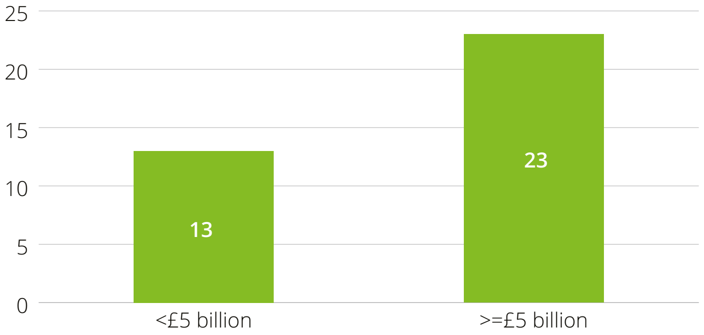
36 Respondents are Asset Managers

7 Respondents are distributors

5 Respondents are asset owners

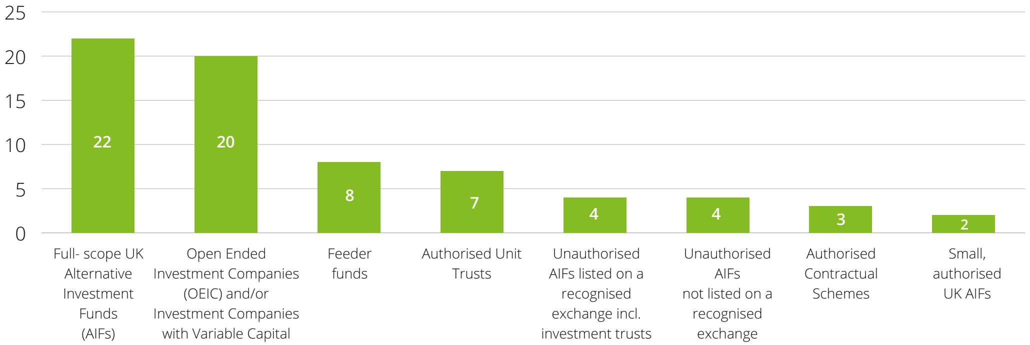
**Note: some respondents occupy more than one category*

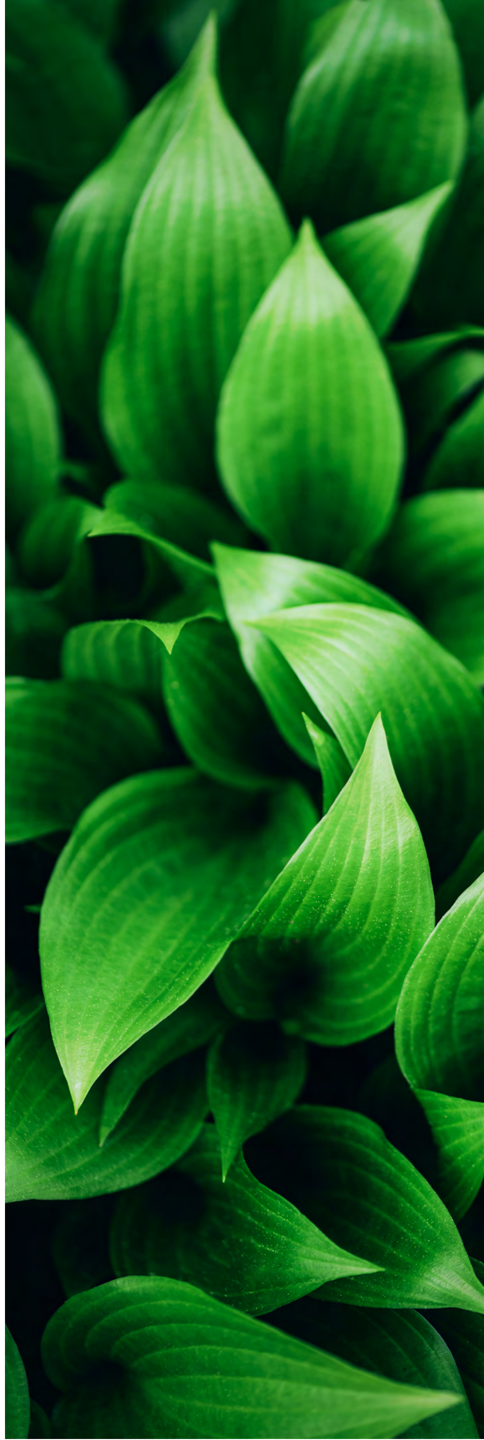
Proportion of respondents by size of asset base (n=36)



Proportion of respondents by role (n=38)

Proportion of respondents by products and services offered/distributed by their firm (n=38)





Greenwashing continues to be a major focus

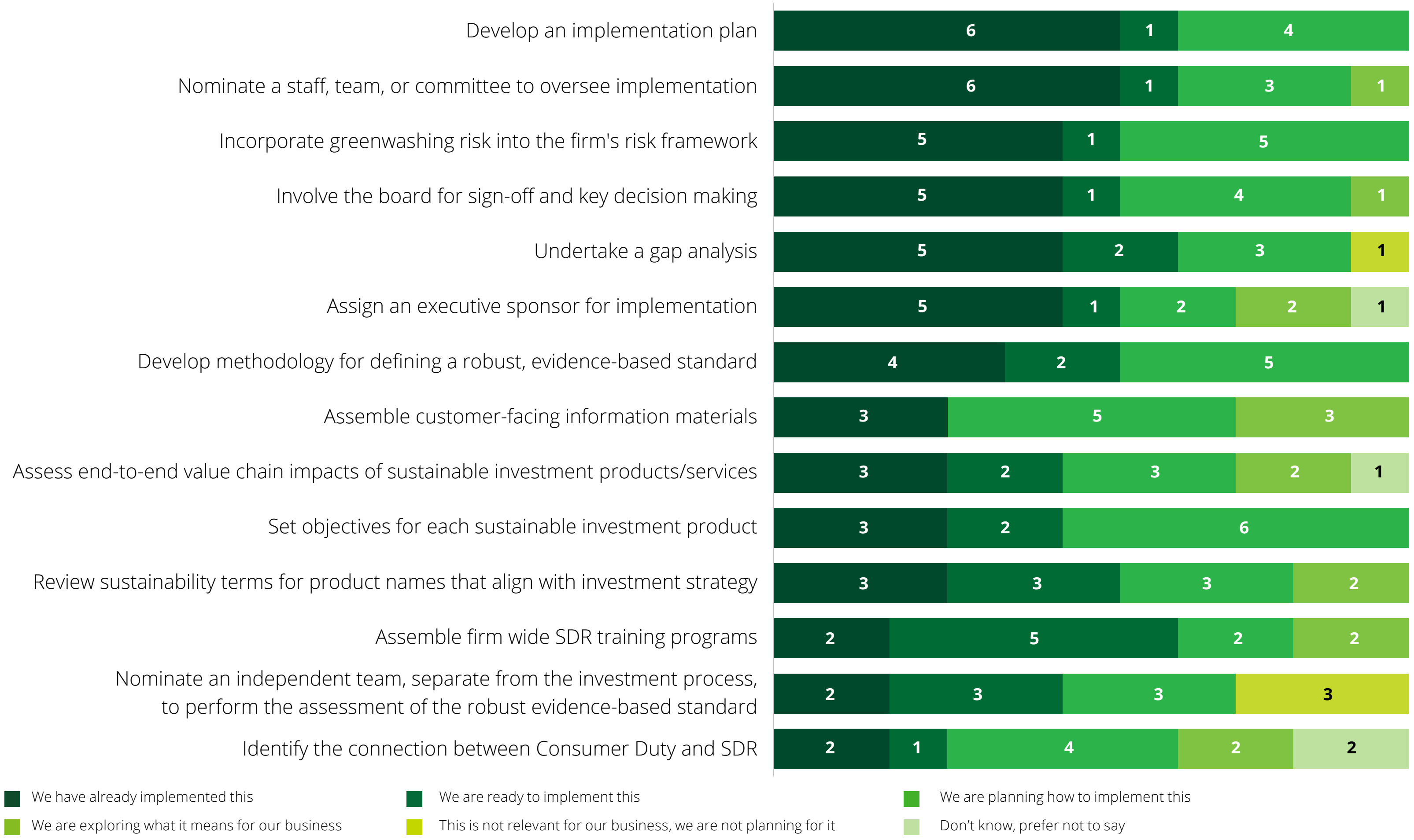
For the past several years, regulators across the EU, UK and US have emphasised that greenwashing risk is a serious issue for the industry, one that firms should proactively mitigate. The SFDR came into force in March 2021, followed closely by the FCA's first substantive guidance note on transparency in sustainability funds in July 2021, published as a 'Dear AFM Chair' letter.[6] However, while firms understood clearly the importance regulators placed on the issue, progress was slowed by a lack of clarity concerning how to properly define and implement the changes required.

The subsequent publication of the SFDR Regulatory Technical Standards (RTS), as well as SDR itself, has helped provide more regulatory clarity and a greater understanding of the risks. Nevertheless, five key challenges remain for firms to address:

1. **how to ensure that all staff have a consistent understanding of sustainability language and how it applies to their products.** A lack of a standardised sustainability language is forcing firms to interpret sustainability-related concepts in their own way. Internal taxonomies would be useful here
2. **how to address the lack of standardised and regulated third-party ESG data, ratings and benchmarks**. This, in itself, is a further source of greenwashing risk
3. **how to determine where greenwashing risk sits within existing risk frameworks**
4. **how to identify and manage greenwashing risks that can arise in numerous ways across product lifecycles and client touchpoints.** Consider elements such as product design, marketing documents, verbal conversations, sustainability performance reporting and complaints, as well as a gap analysis of product governance processes
5. **how to ensure that technical sustainability-related information is disclosed in marketing documents and regulatory disclosures.** This must be done in a useful and fully comprehensible manner for consumers whose sustainability-related knowledge may be relatively limited.

The overarching requirement is for firms to acquire and communicate a deep understanding of greenwashing risk and take necessary steps to eliminate it. This extends to their taxonomies. For example, when asked priorities in preparing to mitigate greenwashing risk and implement SDR, six out of eleven firms planning to use SDR labels or terms in their names had already, or were ready, to incorporate greenwashing risk into their risk frameworks. The remaining firms indicated having plans to do so, underlining the importance of prioritising SDR risk measures (see Figure 1).

Figure 1. Firms prioritise greenwashing risk mitigation when implementing SDR



Question: 'Please indicate your current level of readiness for the following areas:' N=11 (firms planning to either pursue product labels or use sustainability-related terminology in fund names)
Source: Deloitte SDR Implementation survey, 2024

At the time of completing this survey, nearly a half of respondent firms did not have a designated person or team allocated to oversee SDR implementation. Furthermore, the vast majority **(82%) had not established a firm-wide SDR training programme to upskill staff with new and relevant knowledge** necessary to evidence sufficient understanding across internal business teams and stakeholders.

In a complex patchwork of regulations, it is clear that regulators in the EU and UK are increasingly aligned on what they want to achieve in relation to greenwashing, as well as the types of regulatory interventions required. Disclosure-based regulations and naming restrictions have emerged as strong global themes. However, the nuances of each regulation mean increased operational and compliance burdens for firms and a greater need for wide-ranging expertise. For example, the existing SFDR categories cannot readily be mapped to the new SDR labels while SFDR itself goes through its own fundamental review.[7] The qualitative naming restrictions under SDR also differ significantly from the quantitative guidelines on restriction of ESG terms in fund names laid out by the European Securities and Markets Authority (ESMA). Such disparities create further challenges for firms operating in multiple jurisdictions, particularly when they seek to present their products to the market in a uniform way.

Navigating product labelling: to apply or not to apply

Investors' priorities are shifting. While strong investment performance remains important, managing transition risks, avoiding harm to the environment and actively contributing to sustainability are also important considerations for investors.[8] Indeed, they increasingly look for pledges that mitigate such risks, driving demand for investment opportunities that also deliver a positive environmental or social impact. According to Bloomberg Intelligence, global ESG assets surpassed $30 trillion in 2022 and are projected to reach $40 trillion by 2030, representing over 25% of a forecast $140 trillion of global AUMs.[9] Firms also recognise the growing importance of incorporating intangible risks, such as climate change, geopolitical instability and transition risk into their investment strategies, particularly for long-term investments.

"I think if you're a long-term investor, especially in secondary equity markets, and you are not already considering long-term intangible risks like climate change, the increasing frequency of global conflicts and transition risk, then you should be."

Head of ESG, Fund Manager

Navigating the path forward and the options for firms

Firms undertaking business in relation to UK-domiciled sustainability products within the scope of SDR are mandated to label their products and/or comply with specific naming and marketing rules. The firms we interviewed face difficult decisions now about their designated firm-wide approach to sustainability, specifically:

1. whether to apply for a product label and ensure compliance with naming and marketing rules at the time the label application is authorised
2. whether to continue marketing sustainability-related product(s) with sustainability-related terms in the product name, ensuring compliance with naming and marketing obligations without a product label
3. whether to continue marketing sustainability-related product(s) without sustainability-related terms in the product name, ensuring compliance with naming and marketing obligations.

Currently, when UK distributors market overseas funds, they must display a notice informing consumers that these funds are not subject to SDR. Pension products and portfolio/wealth management firms are not currently in-scope, although the FCA is currently consulting on changing this, possibly in 2025. Closed-ended alternative investment funds (AIFs) under regulation 74 of the Alternative Investment Fund Managers Directive (AIFMD) are also exempt from the definition of a sustainability product.

However, while the choices are clear, the decision about whether to opt for SDR product labels or not is dividing the industry. While firms broadly support the SDR's objectives, uncertainty around costs, commercial viability and investor demand has led to differing implementation strategies, with a significant portion of firms opting to delay labelling decisions while they monitor the market's reaction.

Others have indicated that, while they are not initially adopting the labels, they are opting to continue using sustainability-related terms and undertaking the necessary work to comply with the new regulations, leaving open the possibility of incorporating the labels over time. Nevertheless, our survey reveals a strong preference for label adoption among respondents. Nearly half of the firms surveyed indicated they would opt for a sustainability label (Option 1). A smaller proportion meanwhile plan to continue marketing products using sustainability-related terminology without seeking a label (Option 2).

Some firms believe sustainability is more than just a product label and choose to continue to market product(s) without sustainability-related terms in the product name. They contribute to the sustainable investment landscape through investing in high-quality companies committed to strong ESG practices, even if their product names don't explicitly reflect it.

Cost benefit is a key consideration when making this choice

While the survey reveals that almost three-quarters of respondents struggled with analysing the costs and benefits of obtaining a product label, the decision carries substantial financial and operational implications. For example, firms marketing unlabelled funds with sustainability-related terms in their fund names are still subject to the same product-level disclosures as labelled funds. Whether firms using exclusion criteria to meet the 'threshold' are required to produce a consumer-facing disclosure document is currently under debate.[10] Furthermore, the ongoing risk monitoring required for labelled products (including annual label recertification, standard reassessments, and the focus on quantitative data, continuous monitoring of the assets, KPIs and the 'threshold' itself) demands significant resources and expertise. Ultimately, the financial implications for firms navigating this decision remain unclear. Nevertheless, there are, of course, good reasons for taking the plunge, with growing demand for sustainable investment products a primary motivation. Three-quarters of survey respondents indicated that this factor in particular was driving their pursuit of product label(s), or at least their efforts to begin (or continue) marketing in-scope unlabelled products in compliance with SDR's naming and marketing rules. However, the financial benefits of pursuing a product label also remain unclear, particularly given the uncertainty surrounding the future performance of sustainable funds.

Ambiguity also exists around the future policy landscape impacting sustainable investment, adding yet further complexity to the question of SDR implementation. While there is political support for sustainable finance in some regions, potential shifts in political priorities, particularly in key markets, could significantly impact the future global trajectory of sustainable investing.

> "Performance hasn't been there for a few years now and probably won't be for a few more. If that changes, it could change very quickly, especially with the stimulus in the US from the Inflation Reduction Act that stimulates green investment. You could see a sudden change where these are the funds that start outperforming."
>
> **Chief Risk Officer, Asset Manager**

As the UK's sustainable investment landscape evolves, firms are carefully evaluating the optimal approach to marketing these products, carefully balancing commercial viability with their commitment to robust internal governance and full SDR compliance. This delicate balancing act reflects the industry's dedication to delivering genuine environmental and social value to investors while navigating a complex and evolving regulatory framework.

> "We've got a couple of products that are sustainable that will fall into the disclosure category, but the bigger issue for us is understanding what we need to have in place, and what the operating frameworks need to look like for future sustainably labelled funds, or for sustainably unlabelled funds."
>
> **Chief Risk Officer, Asset Manager**

Against this backdrop, it is a high priority for firms to offer a diverse range of funds in order to meet the needs of new and existing investors while adhering to the FCA's Consumer Duty principles for their portfolio products. The careful consideration that needs to be given to the balance between regulatory compliance and commercial objectives extends to the cost-benefit assessment of adopting product label(s). This is especially true when it comes to addressing the concerns of the industry about their ability to raise sufficient capital to cover the associated infrastructure costs of implementing change.[11]

Industry participants are continuing to watch the evolving landscape closely, with many firms adopting a cautious approach informed by their prior experiences with SFDR. Again, though, the changing political landscape of recent elections and the manifesto commitments of the new UK Government to support climate-related clean energy will also play into their thinking. Nevertheless, since investor sentiment and expectations can shift quickly, some firms are simply opting to 'wait-and-see', allowing the dust to settle before deciding on their future course.

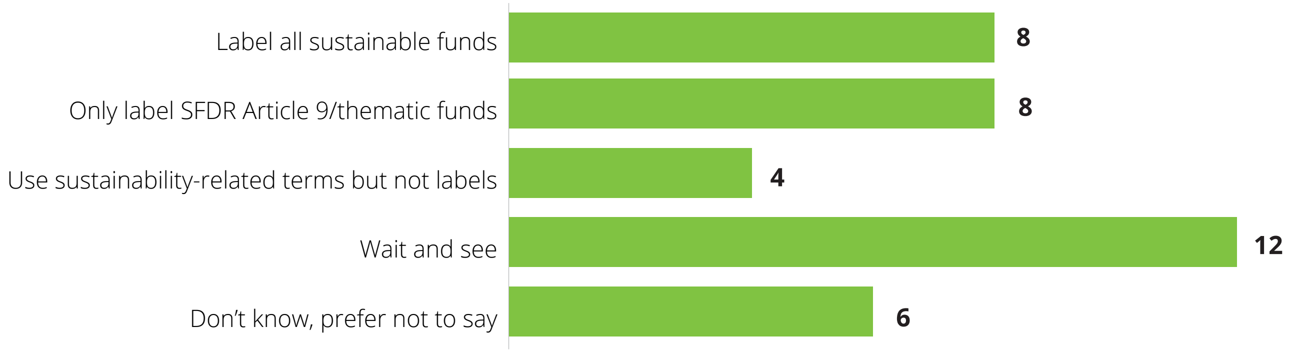
Current labelling intentions of in-scope firms

Do firms want to use labels? And if so, why?

The industry's experience with SFDR Articles 6, 8 and 9, which outline the three categories under which financial markets participants must classify and disclose sustainability-related information for their investment products, have been challenging. This, in turn, has raised questions about the effectiveness of all external categorisations, such as labels or articles, in conveying product characteristics. In the case of SFDR, the non-prescriptive criteria in Article 8 resulted in widespread greenwashing concerns. Specifically, European policymakers such as ESMA and the European Commission are concerned that SFDR categories are being used as marketing tools rather than mechanisms to deliver greater transparency.[12] The FCA developed its SDR labelling regime through extensive stakeholder engagement, including with disclosures and labels advisory groups, using lessons learned from the implementation of SFDR.[13] Unlike SFDR categories, SDR labelling criteria include explicit requirements around stewardship, governance and resources, offering greater clarity through quantitative thresholds that apply to all labels.

About two in five of the firms in our survey planned to apply for a label. Of these, half were currently marketing Article 9 or thematic funds, while the other half planned to change their investment strategies and pursue labels across their entire sustainable fund range, including existing Article 8 funds (see Figure 2). Only four opted to market funds with sustainability-related terminology in the product name without a label, while one-third had adopted a 'wait-and-see' approach.

Figure 2. Intentions to use sustainable investment labels and sustainability-related terms



Question: 'Will the fund(s) you manage or distribute be using sustainability-related terms or labels?' (N=38)
Source: Deloitte SDR Implementation survey, 2024

What factors are influencing firms' timelines for pursuing SDR product label applications?

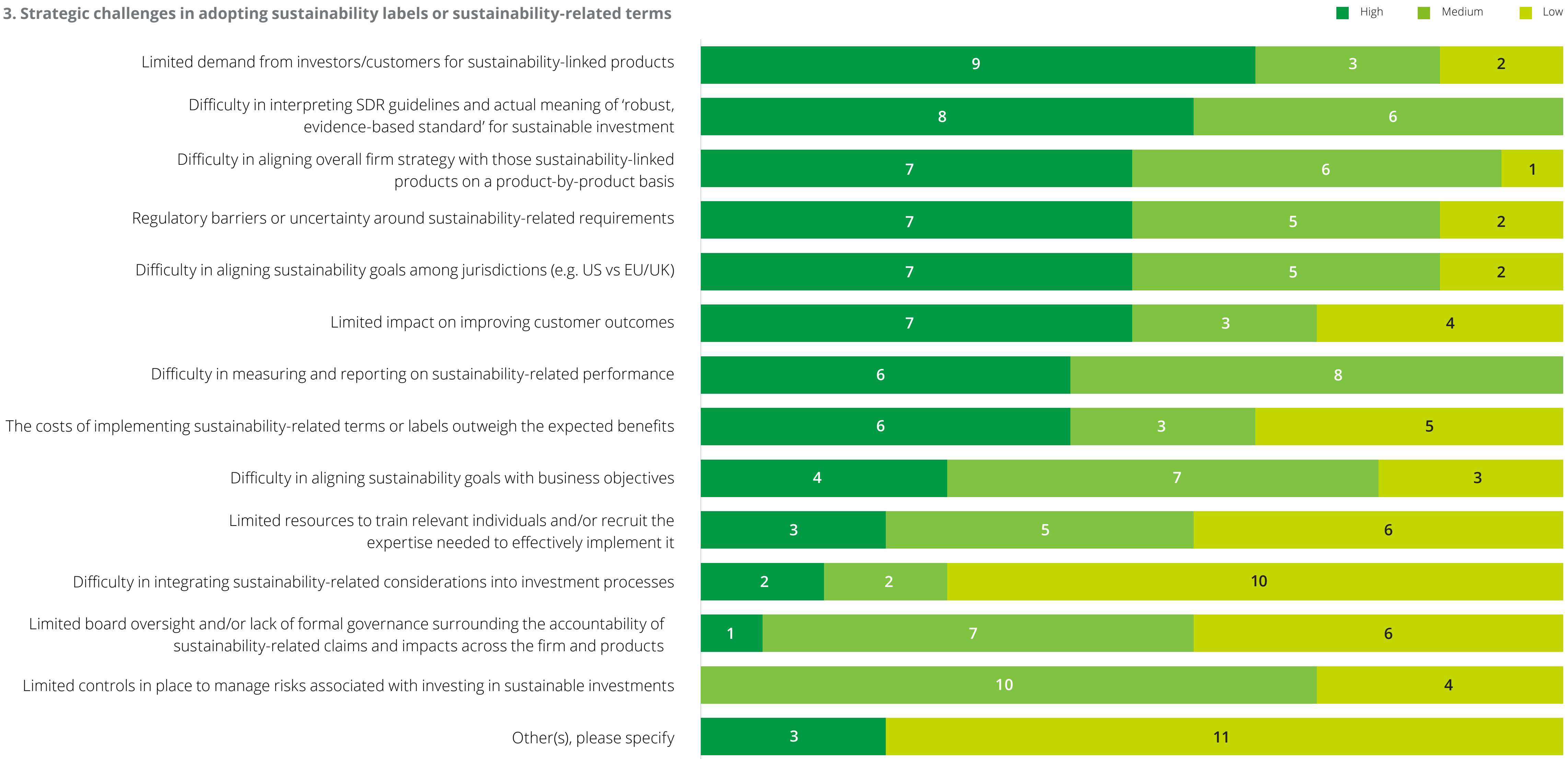
Figure 3 illustrates the strategic challenges facing firms that are either taking a 'wait-and-see' approach to SDR or that remain undecided about pursuing product labels (n=14). Firms' strategic approaches to SDR implementation are intricately linked to their diverse assessments of investor appetite for sustainability-focused investment products. Two-thirds of firms that took a 'wait-and-see' approach or remained undecided cited limited demand as a key obstacle. Nevertheless, as we will see later in this report, the three-quarters of survey respondents actively pursuing labels, or who already use sustainability-related terminology in their fund names, anticipate strong investor demand going forward (see Figure 6) so there is clearly a difference of opinion here.

Uncertainty seems to stem from three sources:

- **the regulatory landscape.** The effectiveness of regulatory frameworks in mitigating greenwashing and ensuring transparent disclosures is unclear but will undoubtedly influence future demand over the long term
- **financial performance.** Sustainable investment product performance will be compared with that of other investment products over time
- **tangible impact.** Whether sustainable products deliver tangible impacts in line with their sustainable investment objectives will also influence investor confidence over time and will be a factor determining whether demand will be sustained over the longer term.

While current retail investor demand for sustainability-linked products remains uncertain, influenced in part by concerns over recent performance trends in specific exclusionary funds, firms recognise the possibility of a rapid shift in investor sentiment and are acting accordingly.

Figure 3. Strategic challenges in adopting sustainability labels or sustainability-related terms



Question: 'What strategic challenges prevent your firm from using sustainability-related terms or labels at this stage?' N=14 (Firms either taking a 'wait-and-see' approach to SDR or remain undecided about pursuing product labels)
Source: Deloitte SDR Implementation survey, 2024

The application of robust evidence-based standards for sustainable investment products has emerged as another important theme. As the sustainable finance landscape continues to evolve, the industry is actively engaged in defining and interpreting key concepts, such as 'absolute measures' of environmental or social sustainability in the policy statement. This collaborative effort between regulators and market participants will be crucial for establishing clear and practical standards for the benefit of both investors and the industry. These efforts extend to interpreting language used in the regulation (like 'robust'), as well as to Key Performance Indicators (KPIs), stewardship, resources and asset allocation which all need to be aligned with the sustainability objective of the fund.

Given the flexibility firms have in developing proprietary frameworks, several questions arise:

- whether industry standards are necessary
- if and how existing frameworks should undergo internal or external verification
- if verified internally, should this responsibility fall to the second- or third-line of defence
- what relevant quantitative data is available to substantiate the classification, and how can we effectively complement this with the typically more abundant qualitative data, which is often the case for these types of products
- who should provide such verification if warranted – consultants or lawyers perhaps
- how should firms address the independent assessment obligations set out in the SDR, requiring firms to confirm that the sustainability standards they have set in place are fit for purpose?

Engaging consultancies or law firms to undertake independent assessments introduces a new dynamic, as such institutions would effectively be asked to confirm whether the sustainability standards set by their client firms are fit for purpose. This carries some risk for those third-party institutions since investment firms must disclose the basis on which standards are considered appropriate as well as the function, or third-party provider, responsible for carrying out the assessment.[14] One way around this obstacle would be to have consultants and lawyers supporting internally-led independent assessments rather than having them conduct assessments independently. Nevertheless, this uncertainty, coupled with the non-prescriptiveness of the rules concerning which asset classes should be included in the 70% threshold, forces firms to rely heavily on subjective judgement, exposing them to further regulatory risk.[15]

Sustainable product complexity and compliance challenges could disincentivise distributors, impacting the product strategies of manufacturers

Another concern for UK firms has been the lack of 'sustainability preferences rules', specifically amendments to existing Conduct of Business Sourcebook (COBS) Suitability Rules as they apply to clients' ESG preferences.[16]

In the EU, new rules concerning sustainability preferences mean that distributors now have 'guard rails' (albeit somewhat complicated ones) allowing them to match sustainable products with clients' preferences. This has not been easy for firms to implement however, due to the lack of investor education and the highly technical nature of the rules themselves.

The lack of specific sustainability preferences rules in the UK, beyond the general Consumer Duty guidelines, poses a challenge for distributors and third-parties involved in the sustainable investment chain. The absence of clear rules could also lead to a knowledge gap between fund managers and other financial professionals regarding sustainability-related issues. Consequently, there is an increased risk of unintentionally misrepresenting funds marketed under SDR. While the FCA has indicated its intention to introduce specific sustainability preferences rules, the timeline for implementation remains under review.

While the evolving landscape of sustainability-related products presents complexities and requires careful consideration of associated risks, it also offers significant opportunities. Investment advisers may initially find it prudent to approach the promotion of these products at a slower pace, as they deepen their understanding of this evolving area. Similarly, asset managers will need to assess carefully and manage evolving compliance requirements and associated risks as they integrate sustainable products into their offerings.

This period of adaptation and learning could lead to strategic adjustments within the industry, with innovation and development encouraging product refinements, exploration of collaborative mergers, and the adoption of comprehensive cost-benefit analysis as a means to ensure well-informed fund launches. It is important to note that the FCA's secondary objective of fostering international competitiveness and growth within the UK economy also remains a key consideration, as the regulator seeks to strike a balance between managing risks and fostering innovation.

> "Investment advisers get paid the same amount to recommend a sustainable or a non-sustainable product. So, if sustainable products are materially more complicated, and are also attached to additional perceived risks by the adviser community like anti-greenwashing, what actually happens is those advisers are disincentivised and are much more likely to sell something simple."
>
> **Head of ESG product, Asset Manager**

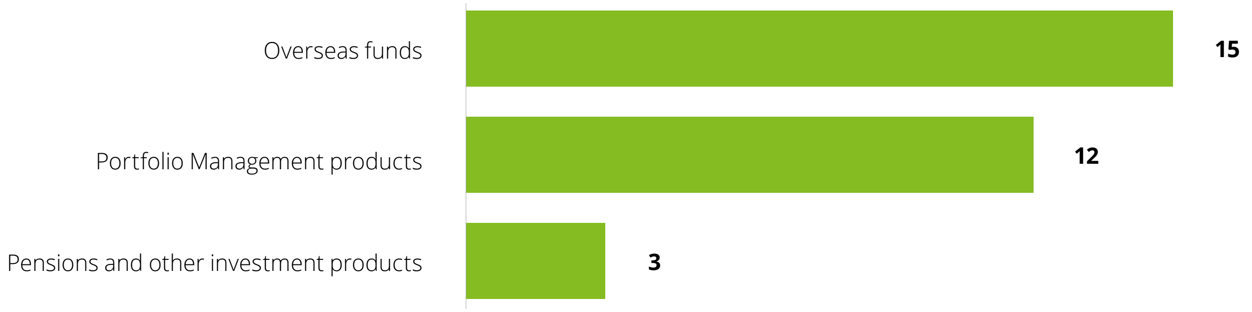
Gaining an edge: Out-of-scope firms leverage regulatory awareness
The FCA has emphasised that the rules are a starting point and will evolve over time, potentially expanding to include portfolio management, overseas funds and pension products. Firms currently not in-scope are watching regulatory developments closely. Figure 4 shows exempt products as at the date of this report, but the FCA is currently consulting on extending the SDR regime to portfolio management via CP24/8 and it is expected to consult on bringing overseas funds into scope thereafter.[17]

"We expect to be in-scope for the later phase. Portfolio management will certainly impact us. We are watching closely, also to the extent that the rules expand out to overseas funds."

Head of Sustainability Legal, Governance & Reporting, Asset Manager

As Figure 5 shows, three-quarters of respondents who offer/distribute portfolio management products have implemented a clear process for collecting data and reporting sustainability information. However, around half do not plan to implement an information-sharing template across the whole value chain.

Figure 4. Products offered by respondents that are currently exempt from sustainable investment labels



Question: 'Which of the following products currently exempt from the Sustainable Investment Label regime and disclosure requirements do you offer?' (N=21)
Source: Deloitte SDR Implementation survey, 2024

Figure 5: Approach to sustainability disclosure in portfolio management products

Question: 'What approach is your firm taking when thinking about the disclosure of sustainability-related information in the portfolio management process in general?' (N=12)
Source: Deloitte SDR Implementation survey, 2024

Unlocking potential: The opportunities SDR presents firms and the broader market

While the industry in general is committed to making SDR a success, interviews conducted for this report revealed a range of more practical implementation challenges that firms were encountering when trying to embed the changes necessary to meet the SDR requirements, particularly around product label compliance.

Motivations to apply for product labels or use sustainability-related terms in product names

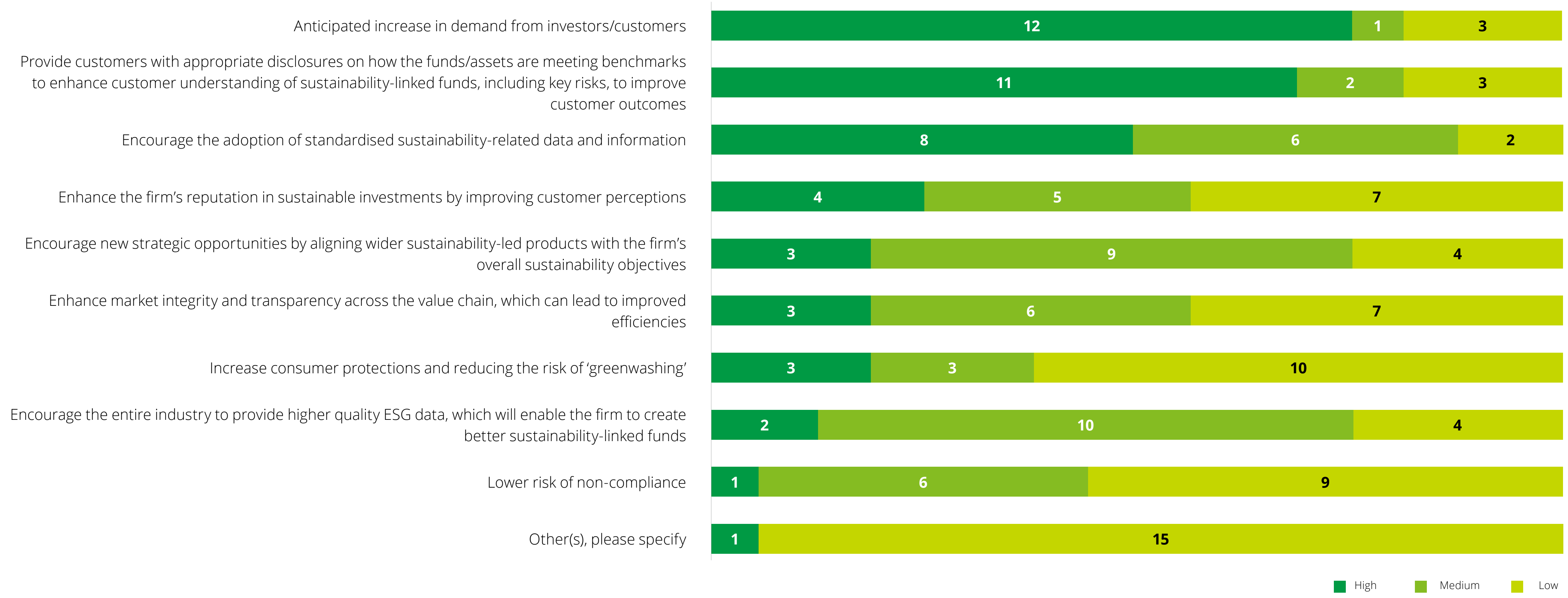
Just over a half of the firms we surveyed intended to pursue product labels, or market funds using sustainability-related terminology in the product names. Consequently, it is important to understand the factors driving these important decisions.

Given the similar effort required by both approaches, it's understandable that the motivations behind them are broadly similar, with a significant driver for about three-quarters of firms being the anticipated surge in investor demand for sustainability-related products (see Figure 6).

Providing appropriate disclosures to improve consumers' understanding of sustainability-related products is also important for firms. This was especially true for those opting to continue using sustainability-related terminology in their product names, while producing consumer-facing, pre-contractual and ongoing product-level disclosures.

One half of respondents also highlighted the opportunity for improving sustainability-related data and information across the sector. Improved transparency would make it easier to provide retail clients with clear information about sustainable investment products.

Figure 6. Motivations for adopting sustainability investment labels/terms



Question: 'What motivates your firm to use sustainability-related terms or labels?' N=16 (firms planning to either pursue product labels or use sustainability-related terminology in fund names)

Note: Respondents were asked to rank according to the importance level, e.g., 1 indicates most important motivator to use sustainability investment label, 10 indicates least important motivator to use sustainability investment label. High denotes rank 1 to 3, Medium from 4 to 7, and Low denotes 8 to 10 ranking.

Source: Deloitte SDR Implementation survey, 2024

Sustainable regulatory interoperability and offshore fund regulation

While the SDR is narrower in scope than the EU's SFDR, it goes further in some respects by providing rules for non-labelled products that have sustainability-related terms in their names. This is in addition to the FCA's guiding principles first released in July 2021, which set out the regulator's expectations regarding the design, delivery and disclosure requirements for ESG and sustainable investment funds.

The FCA has already expressed its intention to regulate overseas funds sold in the UK, in alignment with the SFDR. There is also an expectation from industry participants that the regulator may also establish interoperability between the two regimes. This would ensure a level playing field for SFDR funds sold in the UK, potentially mitigating the need to significantly reconfigure core components of sustainable funds and helping firms avoid substantial overhauls that could render existing systems obsolete.

Many firms are delaying their decision on applying for a product label, adopting a 'wait-and-see' approach. Some are monitoring regulatory developments and implementation challenges, while others face resource constraints due to the demands of other regulations, making it difficult to allocate sufficient expertise to sustainability-related initiatives.

For some firms, especially those who recently implemented SFDR in the EU, it seems to be a wise and practical decision to delay any final product labelling decision. The SFDR fund category downgrades that firms had to undertake after a series of regulatory clarifications by the EU resulted in over 300 products moving to Article 8 status from Article 9. This had to be done ahead of the implementation of the SFDR Level 2 regulatory technical standards in January 2023, creating a significant challenge for some firms which they would like to avoid when making changes to funds because of SDR.

Interviews also revealed concerns among firms regarding how offshore Article 8 and 9 funds would be brought into scope under SDR. Considering the current industry understanding of SDR implementation and its interoperability with existing marketed funds in the EU under SFDR, some firms remain uncertain which path to take without having to make material changes to their funds or apply for the use of a label.

The challenges of SDR to firms and the broader market

Implementation across the four product labels
We asked respondents to rate the difficulty in meeting both the general and specific criteria for sustainable investment product labels (see definition in the glossary). Many reported implementation challenges around achieving full FCA compliance in respect of product label applications.

Firms support the focus label but evidencing qualitative judgements remains difficult
Our survey reveals the strong intention of the industry to engage with and use the focus label – a decision that is best-aligned with firms' existing ESG strategies. Nevertheless, challenges have arisen when it comes to effectively evidencing appropriate asset selection as well as products' underlying strategies which is required in order to describe how the product aims to invest in assets that are environmentally and/or socially sustainable. This is determined using a robust, evidence-based standard — an absolute measure of sustainability. However, 'absolute measure' is an ambiguous term and firms are struggling to define it.

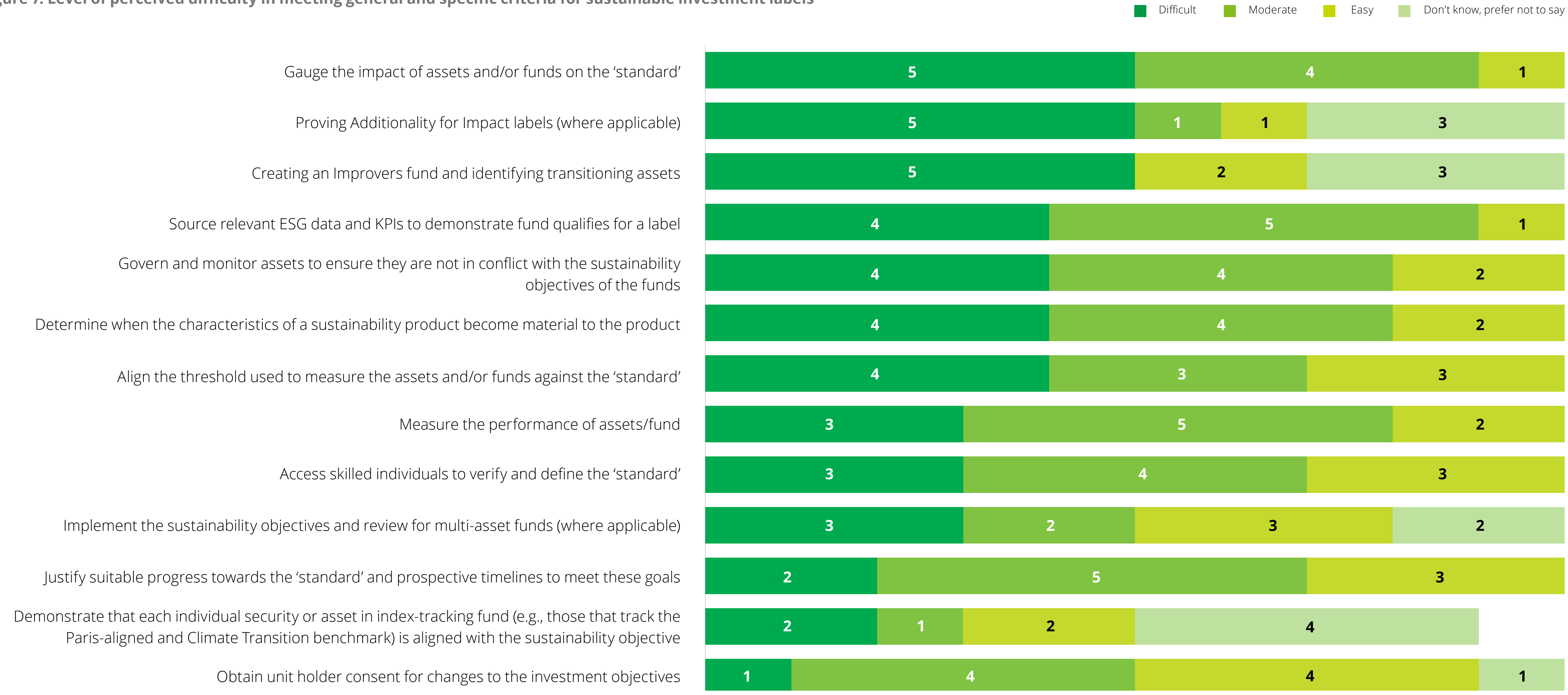
> "I think the FCA is dancing around this idea of defining sustainability and has not really come up with a reasonable explanation.... I mean, if you want to draw a very harsh line, essentially nothing is sustainable unless it's net zero, right?"
>
> **CRO, Global Asset Manager**

Firms are relying on both quantitative and qualitative data and have attempted to assemble proprietary frameworks to evidence their decision-making. There is also a clear preference from the regulator for quantitative data which can be challenging for certain products - especially for mixed goals labelled funds - hence in most cases, substantial work remains to be done to meet the FCA's expectations for attaining compliance with the label.

'Impact' and 'Improvers' labels are proving the most difficult to implement
While broadly welcomed, the 'impact' and 'improvers' labels present specific challenges for firms striving to meet their respective criteria (see Figure 7). For the impact label, the difficulty is proving 'impact' in the context of achieving a pre-defined positive measurable impact in relation to an environmental and/or social outcome. An example might be where a product enables more productive and healthy lives through activities that deliver educational benefits, improve wellbeing through preventative care and/or deliver improved health through the reduction of disease. The fund may then seek to achieve a positive impact in excess of the previous year, which will then become the benchmark for the following year, and so on.

Consistent with existing impact investing frameworks, other key difficulties facing firms include proving additionality for 'impact' labels, specifically when it comes to evidencing investor contributions by engaging with investee companies, as well as identifying assets that are in transition to becoming 'sustainable'.

Figure 7. Level of perceived difficulty in meeting general and specific criteria for sustainable investment labels



Question: 'Please rate the difficulty level in implementing – Sustainable investment labels' (N=10)
Source: Deloitte SDR Implementation survey, 2024

It is important to note that the definition of 'impact' varies depending on the product type involved, adding further to this complexity. For instance, an ecologically-focused product might have an objective related to renewable energy infrastructure, while a socially-focused one might target microfinance and low-income communities.

In particular, we have identified two areas where firms are struggling in the application of these impact labels:

1. Firstly, in evidencing the role of a product's associated assets in contributing to a positive impact (i.e., its 'additionality'). The concept of measuring positive impact in particular posed two specific issues for internal product teams in the firms we spoke to:

   A. the direct impact of the assets on the sustainability objective itself
   B. the investor's own contribution to environmental and/or social outcomes, and how each 'marginal pound' of capital invested contributes to a real-world positive sustainable impact.

   Here, firms also indicated challenges evidencing asset-level changes too (i.e., 'theory of change'), particularly when it comes to what 'changes' occur at asset-level that can help to differentiate an impact-labelled product from a product that may be invested in the same or similar assets without making an impact claim.

2. Secondly, there was the challenge of escalation planning. Firms found that setting escalation plans was difficult in cases where assets were not demonstrating sufficient progress towards achieving a pre-defined, positive and measurable impact.

"There is a wide lack of understanding between how each marginal pound of capital invested does or does not have a marginal impact in the real world, other than in the segregated returns that exists inside a firm."

Head of ESG, Asset Manager

For firms considering or applying for the 'improvers' label, a key issue is to identify assets currently in transition. The FCA has clarified that 'potential to become more environmentally or socially sustainable over time' means the potential to meet a robust, evidence-based standard – an absolute measure of environmental and/or social sustainability over time. This emphasis on the firm's asset selection process requires evidence-based selection of assets with improvement potential. As a result, firms need to establish short-, medium- and long-term targets for underlying assets, which may be difficult to define, particularly given SFDR's focus on short- and long-term targets without a medium-term. In addition, firms will also need robust stewardship frameworks and KPIs to evidence attainment of these targets.

The European Supervisory Authorities (ESAs) published a joint opinion of recommendations for SFDR's next iteration in June 2024, advocating clarity in the level of ambition and performance intended over both the short and long term.[13] This, it was made clear, should include quantitative targets and intermediate milestones. Helpfully, this aligns with the UK's SDR approach, despite SFDR lacking a dedicated transition/improvers category.

Passive equity funds tracking emissions-tilted indices, such as those with carbon-reduction objectives, present a unique problem for firms. While there is a general industry understanding that those aligned to the Paris Climate Accords and climate transition benchmark trackers should qualify for the 'improvers' label without requiring overlay strategies, the FCA has not yet confirmed this.

Indeed, while the criteria for label eligibility is established in the SDR, the selection of specific KPIs for measuring sustainability remains unclear. This includes determining appropriate improvement thresholds and acceptable deviations from benchmarks to track a product's progress toward its sustainability goals. Currently, firms are documenting their KPI selection process for each product, including the rationale behind chosen thresholds and tolerances for each metric. This decision-making process varies across firms, however, reflecting their unique risk appetites and sustainability strategies. Elsewhere, index methodologies, often outside the direct control of firms, present a further barrier for firms in meeting the SDR labelling criteria. Right now, firms are scrutinising each index methodology to ensure alignment with the SDR labelling criteria. However, more clarity on this would be welcome.

The miscellaneous 'mixed goals' label

Our survey found that the 'mixed goals' label was the second most popular choice after the 'focus' label. 'Mixed goals' is suitable for structures like fund-of-funds and applies to funds with at least 70% of assets aligned with a combination of other labels objectives. In practice, a 'mixed goals' labelled product may allocate assets across different sustainability objectives as long as the underlying assets align with the varying label criteria.

Objectively defining and aligning assets under each label within a mixed-asset portfolio, and then effectively measuring its suitability against each sustainability objective, is not a trivial task for firms to undertake. In particular, obtaining 'absolute' metrics to measure against product sustainability objectives in some asset classes has proven difficult. For example, firms face an evidential burden with fixed income funds invested in sustainable bonds. For a diversified fund, quantifying sustainability across diverse pillars, such as climate change and social impact, this also hard to do.

> "The first conversation we had was to push one quantitative metric to measure sustainability, which is very difficult for a diversified fund. We have six pillars, ranging from climate change and resource efficiency to diversity and inclusion, health/wellbeing, and others. These require very different metrics. Since the suggestion was to come up with a list of metrics used to reach the pillars, we probably [will] end up with 20 metrics. I doubt retail investors would be interested in that level of detail. It doesn't change the spirit or substance of the concept we got, but we must change the entire well-established fund for a disclosure requirement."

Head of UK Responsible Investment, Global Asset Manager

Challenges for non-labelled funds using sustainability-related terms in their product names

The SDR rules are designed to ensure consumers have consistent information across labelled and unlabelled products that use sustainability-related terms. To this end, the FCA has provided a list of sustainability-related terminology under ESG 4.3.2R(2)(m), setting out a blanket rule that encapsulates "any other term which implies that a sustainability product has sustainability characteristics".[18]

However, concerns remain that insufficient attention is being paid to the naming and marketing rules of unlabelled but in-scope products. In such cases, firms do not typically opt to apply for a label, but rather choose to begin (or continue) marketing funds with sustainability-related terms in the product name whilst meeting naming and marketing compliance obligations.

Elsewhere, there is some confusion among firms as to whether opting to use permissible sustainability-related terms in the product name without pursuing the use of a label would need to meet the 70% rule (meaning at least 70% of the products assets must have sustainability characteristics). Firms see the 70% rule as difficult to achieve and without clear clarification, and it is creating some ambiguity.

Separately, firms that use sustainability-related terms in the names and marketing of products will also need to make the same disclosures as those required for labelled funds, albeit with minor differences. This once again raises strategic questions about where the greatest cost/benefit lies. If disclosure requirements and associated compliance, operational and resource burdens are similar, pursuing labels might be more beneficial due to the potential reputational benefits associated with them.

Some firms afforded more time by the FCA to comply with the naming and marketing rules

The FCA afforded some firms of UK authorised investment funds 'limited temporary flexibility' until 17:00 on 2 April 2025 to comply with the naming and marketing rules. The extension applies to UK authorised investment funds in exceptional circumstances, where the firm:

- has submitted a completed application for approval of amended disclosures in line with the ESG handbook (ESG5.3.2R) for the respective fund by 17:00 on 1 October 2024; and
- is currently using one or more of the terms 'sustainable', 'sustainability' or 'impact' (or a variation of those terms) in the name of a fund and is intending either to use a label or to change the name of the fund.

Firms have consistently emphasised the significant time and effort required to meet the SDR's labelling, naming, and marketing rules. This has been recognised by the FCA in its latest public press release that states: "some firms wishing to use an investment label, or which need to change the names of their products, require more time to meet the higher standards and prepare the disclosures needed for our approval".[19]

So, while implementation may be challenging, the FCA is clearly committed to providing ongoing support and flexibility for firms needing additional time to put the new guidelines into practice.

But are SDR product labels 'truly' voluntary?
Firms seeking to market funds in the UK without adopting an SDR product label face significant challenges due to restrictions on product naming terminology. These restrictions potentially exceed those of SFDR, creating difficulties for firms when planning for future UK market access. While challenging, this approach may suggest SDR's intent is to establish a higher standard for sustainability-related claims made in respect of sustainability-related investment products.

However, funds face pressure to rebrand entirely if they don't qualify for the use of a label, calling into question the whole voluntary nature of the labelling regime. For example, an existing 'impact fund' that doesn't meet the general and specific criteria for an 'impact label' might be forced to undergo a complete rebranding. This has the potential to cause business disruption that extends beyond a simple name change.

In addition, the difficulty of measuring impact as an investor, particularly in public equities, was highlighted by some of the firms we talked to, especially when evidencing and tracing causation through company engagement. These industry participants were concerned that the proposed rules, in their current form, could have negative material implications for overseas funds if they were brought into scope.

"Labels aren't voluntary if you can't keep your product name unless you label, for example, impact funds. And, for an offshore fund, they would be voluntary because I think it's unlikely the FCA would dictate name changes for them. If so, they're the only ones that truly have this as a voluntary regime."

Head of ESG product, Asset Manager

The application of disclosures and reporting periods

Disclosures

The aim of disclosures mandated under SDR is to provide standardised key sustainability information for consumers to make better investment decisions. To ensure consistency, products that use a label, and non-labelled products with sustainability-related terms in their names, must produce the same types of disclosures with minor differences in the detail. These are:

- consumer-facing disclosures
- pre-contractual disclosures
- ongoing product-level disclosures

Firms that choose not to acquire a product label must still meet other related obligations, such as the publishing of respective statements on the relevant digital medium where the product is offered, to explain why such a product does not have a label.

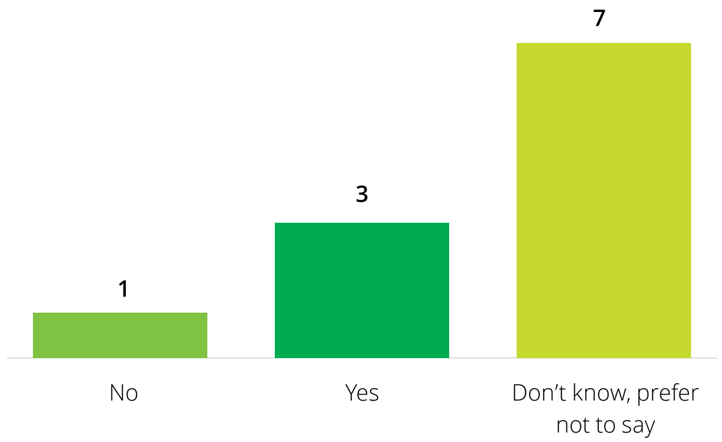
Our survey highlights several specific obstacles facing firms in complying with these disclosure requirements, specifically:

1. **Pre-contractual and ongoing product-level disclosure work to establish clear and accurate information** Firms have experienced difficulties in upgrading existing governance models that sit behind their key internal decision-making capabilities. Some examples of decisions that require key governance frameworks include decisions about which assets are appropriate for the product, and the criteria used to determine the sustainability characteristics of each asset, as well as the basis upon which an associated sustainability standard is deemed (and will remain) appropriate. Given the FCA's new Consumer Duty which came into force in July 2023, work should already have been completed to establish both what is, and is not, clear and accurate across all consumer-facing information. However, it seems some firms still have much work to do.
2. **Whether to be in-scope or not for the public consumer-facing disclosure requirements** Whether firms using exclusion criteria to meet the 'threshold' are required to produce a consumer-facing disclosure document is currently a matter for debate. Firms need to base their decisions on a factual assessment of the exclusions applied to the product (e.g., the disclosures, name and size of the exclusions) considering their impact on the eligible investments available to the fund, their performance relative to the fund's objectives and the materiality of any claims made. Defining clear criteria for this assessment is therefore crucial. Creating a clear and concise consumer-facing disclosure that is easily understood by retail investors is a key objective for firms subject to this requirement. However, as highlighted by some participants, effectively conveying the complexities of mixed-asset funds pursuing the mixed goals label within the two-page limit presents a significant challenge.

Reporting

Firms have mixed views on combining reporting requirements to comply fully with SDR. While just over a quarter of respondents saw potential in combining the SDR and existing Task Force on Climate-Related Financial Disclosures (TCFD) reporting obligations to streamline operations, others expressed concerns about potentially compromising optimal customer outcomes, preferring to prioritise investor clarity and avoid overwhelming them with data. Most respondents chose not to answer this question, indicating they are either undecided or prefer not to disclose.

Figure 8. Opinions on combining TCFD product reporting and Part B product level sustainability reporting



Question: 'Under ESG 5.4.4 requirement, firms are required to include the content of the TCFD product report in the Part B product level sustainability report or provide a hyperlink to it.
Are you in favour of combining these two reports (TCFD and Part B)?' (N = 11)
Source: Deloitte SDR Implementation survey, 2024

In this context, when determining the appropriate level of detail for SDR disclosures, the industry is also advised to keep in mind the underlying objectives of such disclosures, and the degree of control firms have over the data disclosed.

"There is a critical difference between a product report that reports on something you promised to do (such as SDR) and a report that is a release of data points that you may not be managing (such as TCFD). TCFD as a topic is also complex and so, if consumer clarity is our aim, why would we want a complex distraction in what could in its absence be a simpler articulation?"

Head of ESG product, Asset Manager

While the FCA allows flexibility on the timing of certain reporting obligations, such as those for products and entities, it stresses that interim reports may be required to cover any transition periods and prevent gaps in the reported data.

Recommendations

So where do we go from here?

Sustainable investments are no longer niche products. They are instead growing into a significant part in the investment universe. This shift, together with changing investor priorities, reflects a broader transformation of the investment management landscape. Growing exposure and awareness of climate change mean that investors are increasingly aware of the risks that the transition poses to their investments and, in turn, how their own investment choices can play a role in delivering positive environmental and social outcomes.

The industry is working with trade bodies and other stakeholders to find resolutions to many of the challenges discussed in this report. Here is a list of recommendations that firms may wish to consider actioning:

1. Undertake a full product-set assessment against the SDR rules

Firms face a dilemma in deciding the best next step in pursuing a sustainability-related firm-wide and product-level strategy. Firms need to balance regulatory compliance with commercial objectives, particularly in light of Consumer Duty principles that emphasise meeting the needs of customers. Achieving this balance is crucial, and a product-set assessment mapped to the SDR, which includes all associated infrastructure and operational costs to implement the changes necessary to use a label, or sustainability-related terminology in product names, is an important action for firms to take. Achieving this will likely require strategic capital allocation and a focus on scalability to ensure any compliance-driven changes also support broader business objectives as well as positive outcomes for investors.

2. Roll out comprehensive SDR training to ensure a consistent understanding of the rules and associated sustainability language

The sector faces some critical challenges relating to the management of greenwashing risks, ensuring clarity across all sustainability-related information that may be useful to customers when they are looking at potential investments options. However, firms must do this in the absence of standardised sustainability terminology, leading to varied interpretations across firms and their respective internal teams. This has been further exacerbated by the speed at which regulation has been introduced to market. Key members of staff may therefore have different understandings of sustainability-related terms, impacting a firm's approach to product design, marketing and communications, right across the product value chain.

Firms may therefore wish to consider producing an internal sustainability glossary describing the various internal sustainability-related terminology used as well as defining key sustainability terms and concepts. This will ensure that all staff members have a consistent reference point. Likewise, training sessions and workshops will keep employees up-to-date on the latest sustainability developments, terminology, and application to products, ensuring that shared level of understanding is maintained over the long term. Cross-departmental collaboration should also be encouraged, across marketing, product development, compliance, internal audit and other areas of the business. This may help to promote a shared understanding of sustainability concepts and their application.

3. Carry out product lifecycle and client touchpoint reviews of all sustainability-related information, including claims made about the performance (financial or otherwise) of sustainable investment products

Greenwashing risks can occur at multiple junctures across the product lifecycle. It is often difficult to track and manage such risks in a comprehensive manner. Firms should therefore consider end-to-end sustainability audits, introducing sustainability checkpoints throughout the product lifecycle, from initial design to marketing and client engagement. This could involve reviews at each stage to ensure that sustainability claims being made are accurate. Firms will also need to ensure that consumer-facing disclosures are a clear and accurate representation of the fund's investment objectives, policies and strategy.

They must also ensure that messaging is unified across all channels, including their consumer-facing materials, a task that will hopefully have already been accomplished as part of the process for implementing the FCA's Consumer Duty rules. This should include establishing feedback mechanisms to handle any complaints or inquiries that may arise regarding sustainability claims, allowing firms to identify and remediate any misleading or unclear messaging, promptly. It may also be worth considering whether to launch consumer education campaigns to increase awareness of sustainability concepts amongst customers and the wider public as a way of improving the broad understanding of your firm's sustainability efforts.

4. If considering whether to opt out of the labelling regime, review what each fund seeks to achieve and the characteristics of the underlying assets within them

The use of sustainability-related terms within a product name in the absence of a product label still has significant implications, since it shapes investors' expectations and can influence how the fund is perceived in the market. Firms should therefore provide clarity at all times, marrying the purpose and objectives of the fund in question with the characteristics of its underlying assets. Firms may consider assembling and rolling out tests designed to probe a sample of underlying assets and their characteristics against the fund's purpose, including how performance in areas such as 'impact' is monitored.

5. Review the basis on which a sustainability standard is set, and establish how it will be monitored to ensure it remains appropriate and is accurately reflected in any future label application

Firms wanting to apply for the use of a label may wish to consider how much detail is provided concerning the sustainability standard for each product, as well as the respective label within their FCA application or working programme prior to application. It will be important to evidence the basis on which this has been set and how this will be monitored moving forward. Simply articulating what the standard is will likely not be enough.

It is therefore important for firms to outline clearly what the focus of each fund is (such as carbon reduction, social impact) and reference any guidelines or standards that underpin the approach used, for example the UN Principles for Responsible Investment (PRI), SDGs, the Paris Climate Agreement, or GRI. A full and frank justification of why a firm believes the standard is appropriate will be important. As part of this process, the criteria driving any 'exclusionary screens' that prevent specific sectors, industries or companies from being included in a given investment portfolio may also need to be explained and justified as they relate to specific sustainability outcomes.

Likewise, clarification concerning how the materiality of environmental and/or social factors across different sectors or industries is determined may be helpful. For example, environmental factors like carbon emissions may be more material for more energy-intensive industries, while social factors might be prioritised in service-related sectors. It would therefore be worth providing examples of how the assets in the fund came to be included, using real world examples, with multiple options for mixed-asset portfolios. Firms should also move beyond surface-level disclosures to provide much clearer and better-articulated justification of the standards they deem appropriate for a specified fund, and why it will continue to be appropriate over time.

6. Review the asset selection for applicable funds when applying for the use of a label, and think about how that judgement has been arrived at, including how the process has been defined

In much the same way, it will also be important for firms to consider the role of both quantitative and qualitative judgements in their asset selection processes. Transparency is important and defining the standards against which any judgement is being made should be carefully documented. For example, if a firm is using qualitative methods to assess its sustainability credentials or governance practices, it should consider outlining the specific criteria it uses to make this judgement. Firms can increase the objectivity of qualitative judgements by establishing frameworks and/or checklists to guide decision-making, ensuring they are grounded in applicable standards such as the UN's PRI or SASB standards.

Firms should also take time to explain the inputs informing these judgements, accumulating evidence to back them up. This may include management interviews and on-site visits as well as sector analysis. The more detail, the better, as this will help customers as well as the regulator understand how the firm is making an informed decision. Indeed, as would be expected for any new process or piece of governance, evidence of robust internal validation, quality assurance and continuous monitoring of effectiveness is vital.

7. Firms considering the use of impact labels should consider the contribution made and how this aligns with the 'theory of change' in terms of achieving expected outcomes for the product

Firms considering the use of an impact label should reflect on how the product genuinely contributes to positive social and/or environmental outcomes, and how this aligns with the firm's 'theory of change'. This should explain comprehensively how and why a particular investment strategy will lead to a desired environmental and/or social outcome, clearly evidencing what the impact goals are that the fund aims to achieve. Examples would include reducing carbon emissions, promoting gender equality, or improving access to clean water. They should also describe how, and to what extent, investment inputs like capital allocation and green technologies can create specific investment outputs, for instance renewable energy production as well as desired outcomes, for example reducing GHG emissions.

Firms need to be able to prove how a given fund and its underlying assets contribute to positive environmental and social outcomes over-and-above what would have occurred without such interventions. All stages of the investment process – from asset selection to portfolio management – should be driven by the core objective of creating a measurable positive impact. Hence, firms should also consider how this is evidenced at the outset of the process.

8. Carry out due diligence on ESG data providers and internal ESG metrics, including undertaking third-party ESG data reviews

Inconsistent or unreliable ESG data from third-party providers can introduce greenwashing risk, especially where firms turn to alternative data sources to support their own sustainability claims. Varying methodologies and metrics used by rating agencies can also create confusion about true sustainability performance. Part of the solution here might be for firms to carry out periodic due diligence on ESG data providers, as well as prioritising work with reputable ESG data providers and rating agencies with transparent methodologies.[20] Firms must therefore carry out robust due diligence to ensure the data they are using is both accurate and reliable.

It will also be important for firms to develop proprietary environmental and/or social benchmarks based on industry standards (for example, GRI, SASB, TCFD) to monitor sustainability performance, ensuring that claims can be verified and communicated confidently. This could potentially be achieved collaboratively by pooling data as a shared service to control costs and boost data quality. In addition, firms should consider the use of independent audits to verify sustainability-related claims based on their internal benchmarks, to reduce reliance on potentially inconsistent external data points.

9. Undertake a scenario-based cost-benefit analysis for funds that may be brought into scope over the next 12-24 months

It would be prudent for firms to undertake a cost-benefit analysis for funds that may be brought into scope over the next 12-24 months, such as overseas-domiciled funds and portfolio management services. Key scenarios to consider might be where firms want to access a growing sustainable investment market and take advantage of an uptake in investor demand, or when to branch out further into the sustainability space for reputational purposes. Pre-emptive moves to comply with SDR may also be a source of future competitive advantage, even if this activity is constrained to considering the actions needed to achieve SDR compliance in a future scenario, or to put in place a framework for implementation should things move faster than anticipated. Being an early adopter would also put a firm in a stronger position when any new services are brought into scope, especially if market demand for labelled products is high, enabling it to move sooner on new label applications.

As part of this assessment, firms may also wish to consider conducting sensitivity analysis to understand precisely how different variables like regulatory stringency, market uptake and investor demand could influence future costs and benefits. Adjusting these assumptions can help firms evaluate a range of potential outcomes, equipping them to adapt and respond more effectively to future changes.

Conclusion

Our research highlights a clear divide in expected investor demand for sustainable investment products. While some firms take a cautious 'wait and see' stance due to perceived limited retail interest, others are actively pursuing sustainability labels in anticipation of strong demand. This contrast underscores the need to adapt strategies in line with evolving investor sentiment. Firms seeking to integrate SDR labelling face practical challenges in meeting the requirements of the rules. **Nevertheless, the firms we surveyed remain committed to the success of the regime, buoyed by the promise of future demand, greater transparency and standardised data**.

The intention of SDR is to safeguard investors and ensure that underlying assets align with the sustainability-related claims that funds are making. **However, firms are concerned that complexity and a lack of clarity could unintentionally hinder capital flows to sustainable investments, and so undermine SDR's role in the transition**. As an unintended consequence, firms may indeed refrain from disclosing their ESG efforts at the fund level out of fear of inadvertently breaching the SDR requirements, leading to the perverse outcome of there being less transparency (i.e. 'greenhushing').

To this end, firms should consider further engagement with the FCA, the Investment Association, and other relevant industry bodies and consultants to seek clearer guidance on balancing greenwashing prevention with transparent ESG disclosure. **In addition, investing in the upskilling and training of staff will help equip firms with the knowledge necessary to navigate SDR's complexities in the most effective way**, while investment in education will help to 'lift the boat' more widely, raising awareness of sustainable investments.

To unlock the SDR's full potential and combat greenwashing, collaboration is essential. Clarifying interoperability with SFDR and offering practical guidance will ease the transition. Together, the FCA and the investment management industry can build a transparent, trusted, and thriving sustainable investment market for the future.

Glossary

Anti-greenwashing rule	Requires all FCA authorised firms to ensure that any sustainability-related claims about products and services are clear, fair and not misleading.
Authorised contractual scheme	A co-ownership scheme or a limited partnership scheme.
Authorised unit trust	A unit trust scheme that is authorised for the purposes of the Financial Services and Markets Act 2000 by an authorisation order.
Climate transition plan	A time-bound action plan that clearly outlines how an organisation will pivot or adapt its existing operations, assets and business models towards a trajectory that aligns with the latest climate science recommendations of reaching net zero by 2050 and thereby limiting global warming to 1.5 degrees Celsius.
Distributor responsibilities	Distributors must communicate labels and disclosures to retail investors and add a notice on overseas funds, clarifying that they are not subject to the UK regime.
Feeder funds	Feeder AIF (Alternative Investment Funds), feeder LTAF (Long-Term Asset Funds), feeder NURS (Non-UCITS Retail Schemes) or feeder UCITs (Undertakings for the Collective Investment in Transferable Securities).
Full-scope UK alternative investment funds (AIFs)	UK-based investment funds that invest in alternative assets, including private equity, private debt, real estate, hedge funds, infrastructure, and commodities and are subject to the full scope of the UK's Alternative Investment Fund Managers Directive (AIFMD).
Greenwashing	Misleading or unsubstantiated claims about environmental performance made by firms about their products or activities.
Investment labels ('The four labels')	Sustainability Focus, Sustainability Improvers, Sustainability Impact and Sustainability Mixed Goals that help consumers identify the key sustainability-related characteristics and objectives of products.
Naming and marketing rules	Non-labelled products that use sustainability-related terms in their names or marketing have to make the same disclosures as those that use labels and cannot use any variation of the terms 'sustainability' or 'impact'. For these products a statement should be put in a prominent place in the relevant digital medium explaining why the product does not have a label.
Open-ended investment companies (OEIC) and/or investment companies	For a body corporate to be an open-ended investment company, as defined in section 236(1) of the Financial Services and Markets Act 2000: (1) it must be a collective investment scheme (2) it must satisfy the property condition in section 236(2) (3) it must satisfy the investment condition in section 236(3).

Phased implementation	The rules come into force on a staggered timeline, allowing firms time to adapt. The anti-greenwashing rule alongside its finalised guidance went live in May 2024. The first date SDR labels became available was July 2024. In July 2024, the naming and marketing rules went live for labelled products. For non-labelled products with sustainability-related terms in their names, the naming and marketing rule will go live in December 2024.
Stringent criteria	Funds using labels must meet specific criteria, including having a clear sustainability objective, a robust investment strategy and demonstrable progress towards their goals.
Sustainability focus label (‘focus label’)	Must have a sustainability objective that is consistent with an aim to invest in assets that are environmentally and/or socially sustainable. The objective must be determined using a robust evidence-based standard that is an absolute measure of sustainability. A minimum of 70% of the Sustainability Focus product’s assets must meet the objective, and the remaining assets must not conflict with it. An independent assessment is required to confirm that the standard is fit for purpose – the verifier can be an internal or external party.
Sustainability Impact label (‘impact label’)	Must have a sustainability objective that aims to achieve a pre-defined positive measurable impact in relation to an environmental and/or social outcome. Firms must specify a theory of change setting out how they expect their investment activities and the product’s assets to achieve a positive impact. Firms must specify a robust method for measuring and demonstrating impact of both the assets the product invests in and the firms’ investment activities.
Sustainability Improvers label (‘improvers label’)	Must have a sustainability objective that should aim to invest in assets that have the potential to improve environmental and/or social sustainability over time. The objective must be determined using a robust evidence-based standard that is an absolute measure of sustainability – an independent assessment is required to confirm the standard is fit for purpose. The verifier can be an internal or external party. A minimum of 70% of assets should meet the objective and the remaining assets should not conflict with it. Firms will need to identify the period of time by which the product and/or its assets are expected to meet the objective, including short- and medium-term targets. The firm’s stewardship strategy should support delivery of the objective.
Sustainability mixed goals label (‘mixed goals label’)	This is for products with a sustainability objective to invest at least 70% in accordance with a combination of the sustainability objective for the other labels. The objective must be determined using a robust evidence-based standard that is an absolute measure of sustainability – an independent assessment is required to confirm the standard is fit for purpose. Firms must identify (and disclose) the proportion of assets invested in accordance with any combination of the other labels. Requirements for each of the other labels must be met.
Transparency	Detailed disclosures are required for both labelled products and non-labelled products that use sustainability-related terms in their names. The objective is to provide consumers with comprehensive information.
Value chain	A series of consecutive steps that a business performs to deliver goods and/or services to an end customer, including interaction with third parties.

Endnotes

1 Sustainability Disclosure Requirements (SDR) and investment labels, Policy Statement, PS23/16, FCA, November 2023.

2 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, European Union, November 2019.

3 See ESG 4.3.2R to ESG 4.3.8R of the FCA's ESG Sourcebook

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6 Dear AFM chair letter, FCA, July 2021.

7 Summary report of the open and targeted consultations on the Sustainable Finance Disclosures Regulation (SFDR) assessment, European Commission, 2023

8 2023 Future Focus Survey - ESG and sustainable investing trends in Europe, JP Morgan Asset Management, 2023.

9 Global ESG assets predicted to hit $40 trillion by 2030, despite challenging environment, forecasts Bloomberg Intelligence, Bloomberg LP, February 2024.

10 The FCA has applied the 70% minimum threshold to all labels. Although the sustainability objective should represent the aims of the overall product, the product may invest in other assets for liquidity and risk management purposes, as long as at least 70% of the gross value of the product's assets are invested in line with the sustainability objective.

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13 Disclosures and Labels Advisory Group, FCA.

14 For clarity, firms will not be required to report the names of individuals, just the names of the firms engaged in this work.

15 As noted above, the SDR requires at least 70% of an investment products' holdings be in assets that meet defined sustainability criteria to qualify for certain sustainability labels, such as 'sustainable focus' or 'sustainable impact'.

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19 FCA gives firms 4-month extension for SDR naming rules, FT Adviser, September 2024

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