

Insights

ROADMAP TO SUSTAINABLE INVESTING: UK GOVERNMENT PROPOSALS FOR A GREEN FINANCE RULEBOOK – WITH AN INDUSTRY CALL TO ACTION TO HELP CEMENT THE UK AS THE GLOBAL LEADER IN GREEN INVESTMENT

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SUMMARY

Building on its ambition to develop the UK as an international centre for green finance, as first set out in its 2019 Green Finance Strategy, the Government has published its [Roadmap to Sustainable Investing](#). There are four key planks set out in the Roadmap: implementing Sustainability Disclosure Requirements across the economy; delivering a UK Green Taxonomy; setting expectations for the UK's investment community to act as effective and responsible investment stewards to support a market-led transition to a more sustainable future; and to highlight how the UK is leading international efforts to bring about global and systemic change in the financial system, including through the UK's G7 presidency and by rallying the international community ahead of COP26. Consultations on the details, including specific legislative and regulatory changes, are due to follow shortly, in November 2021.

The Roadmap pulls together various UK-specific sustainability initiatives and commitments, including: the FCA Guiding Principles on ESG and sustainable investment funds; the FCA's focus on investor stewardship and the Chancellor's July 2021 Mansion House speech proposal to implement integrated Sustainability Disclosures Requirements. It impacts corporates, asset managers and owners, creators of investment products and those giving investment advice.

Sustainability Disclosure Requirements

The Sustainability Disclosure Requirements (SDR) are a new standardised disclosure framework, initially focussed on climate risks. Built on, but going beyond the Task Force for Climate-related Financial Disclosures (TCFD) recommendations, SDR require wider information on how firms impact the environment. There are three types of disclosure:

- **Corporate disclosure.** Corporates (UK registered and UK listed companies) will have to make sustainability disclosures in their annual reports, using global baseline reporting standards and metrics, which are to be developed by the International Sustainability Standards Board (ISSB). In addition, to report against the UK Green Taxonomy - so that investors can also identify the investment products which are making a substantial contribution to environmental objectives. Scope, timing and detail (for UK companies and listed issuers) will be subject to consultation.
- **Asset manager and asset owner disclosure.** Asset managers/owners (including occupational pension schemes) will have to disclose, at entity level, how they take ESG-related matters into account in their governance arrangements, investment policies and strategies and be able to substantiate ESG claims in a user-friendly comparable way. Scope, timing and detail will be subject to consultation.
- **Investment product disclosure.** Firms will be required to disclose, at product level, the sustainability-related information that consumers need to make informed decisions about their investments, including the extent to which they are taxonomy-aligned. Disclosures will be consumer-friendly, with more detailed disclosures required for sophisticated investors. This will form the basis of the introduction of a new sustainable investment labelling regime, where products and funds are to be objectively classified against specified sustainability criteria. The details on these proposals (including the content, scope, format and location of the disclosures) will be subject to consultations based on discussion papers, and implementation of the labelling regime will be supported by an advisory forum.

Corporates and asset managers/owners will also have to disclose transition plans on a 'comply or explain' basis under SDR, initially following net zero commitments and (in due course when commonly-agreed approaches emerge) on a standardised basis. Sustainability-related disclosures for financial advisers will be separately considered and consulted on.

Government output is also expected next year on bringing ESG data and ratings providers within scope of FCA regulation and authorisation and on digital reporting infrastructure (including assessing the value of a centralised register for ESG data).

Whilst a streamlined approach is envisaged, the new proposals sit alongside implementation of the TCFD-based rules via FCA rules and DWP regulations (ie those impacting UK corporates, asset managers, life insurers providing investment products, FCA-regulated pension schemes, occupational pension schemes and financial advisers). An asset manager may not be within scope of the draft TCFD-aligned rules in the draft new ESG Sourcebook (as set out in the FCA consultation CP21/17) ie it will be exempt if it has less than £5 billion in assets under management on a three-year rolling average, to be assessed annually, but could still fall within scope of SDR when phased in.

UK Green Taxonomy

The UK Green Taxonomy (the Taxonomy) will set out the criteria that specific economic activities must meet to be considered environmentally sustainable and therefore 'Taxonomy-aligned'. It follows a similar structure to the EU Taxonomy, using the same six environmental objectives, to be underpinned by Technical Screening Criteria (TSC), and which are to apply on a sequenced basis. The three activity tests are also aligned with the EU's approach: that an economic activity is Taxonomy-aligned if it: (i) contributes substantially to one or more of the environmental objectives; (ii) does not significantly harm any other objective; and (iii) meets certain minimum safeguards (ie in alignment with the OECD's Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights).

Although the Taxonomy focus is on reporting rather than projections, transitional and enabling work is recognised. For instance, the TSCs will set the threshold for best-in-sector emissions levels where a particular activity cannot be aligned with net zero ambitions eg cement manufacture. Companies will report the proportion of their capital expenditure which is Taxonomy-aligned, to be able to demonstrate their investment in producing green activities in the future. Contributions to environmental objectives in other sectors which are not yet sustainable will also be recognised eg the manufacture of components for wind turbines.

The Taxonomy is to be road-tested to ensure it's robust and accessible, incorporating learning from other taxonomies developed internationally. The Government will consult on draft TSCs for the first two environmental objectives (climate change mitigation and climate change adaptation) in Q1 2022 and the remaining four in Q1 2023.

Being a responsible Steward of Capital

The Roadmap reiterates the importance of active investment stewardship and highlights the FCA priorities in this area. It expects the UK pensions and investment sectors to provide leadership, including to apply to become signatories of the UK Stewardship Code 2020; take into account information generated by SDR when allocating capital and to use their rights and influences to hold investee companies to account to promote long-term, sustainable value generation. SDR will ensure that investee companies disclose the necessary information, and government and industry's stewardship initiatives will lower the barriers to investors acting as effective stewards.

An initial practical step identified in the Roadmap is that the industry should seek to integrate ESG considerations into investment decision-making, monitoring and engagement strategies, escalation and collaboration and voting practices.

The Government will assess progress of the specified expectations at the end of 2023.

Conclusion

The Roadmap is welcome and provides much-awaited clarity and detail of the UK's approach in this area. We will be interested to find out the detail, legal and practical impacts and sector-specific requirements once the follow-up publications are produced. The Government is taking a long term comprehensive view, with the Green Finance Strategy due to be updated in 2022. An iterative and expansive approach with different sectoral pathways is therefore to be expected.

Whilst there is arguably little new substance in the Roadmap, it is helpful in drawing together different strands of the UK's sustainable investing initiatives. As the UK's initiatives are being driven by different groups and with differing terminology, producing this single Roadmap does allow firms to get a clearer picture of the overall approach. It would also appear that the UK's measures are becoming more closely aligned with the sustainable finance initiatives that are being pursued within the EU. This will be of great help to firms operating in both the UK and the EEA as it may reduce the need for dual reporting and monitoring – although we will need to wait to see the details before firms can fully relax on this front.

Please do not hesitate to get in touch with any of the BCLP Funds & Investment Management team or your usual BCLP contact if you would like to discuss any of the issues raised in this briefing in more detail.

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