Linklaters

Greening Finance: A Roadmap to Sustainable Investing

20 October 2021



On 18 October 2021, Rishi Sunak, the UK's Chancellor of the Exchequer, published Greening Finance: A Roadmap to Sustainable Investing. This roadmap outlines the legislative and regulatory changes that will be made in the UK to ensure that consumers and investors have the information they need to make investment decisions that drive a positive environmental impact.

The roadmap sets out a three-phase approach to greening the financial system:

> Phase 1: Informing investors and consumers
> Phase 2: Acting on the information
> Phase 3: Shifting financial flows

The roadmap sets out specific proposals for Phase 1, which consists of three key initiatives:

1. Sustainability Disclosure Requirements ("SDRs")
2. The UK Green Taxonomy
3. Setting out the government's expectations of investor stewardship

Sustainability Disclosure Requirements

The SDRs start from the observation that sustainability information is increasingly important to investment decision making, but voluntary disclosures are often inconsistent and non-comparable. Perhaps, unsaid in the roadmap, is also the fact that a lack of clear standards on sustainability reporting makes consumers and investors vulnerable to "greenwashing". In this sense, the SDRs are in many ways the UK's answer to the EU's Sustainable Finance Disclosure Regulation ("**EU SFDR**"). However, unlike SFDR, the UK's approach is intended to leverage international standards to be developed through the IFRS' sustainability offshoot, the International Sustainability Standards Board ("**ISSB**"), and apply beyond the asset management/owner sectors.

The roadmap does not contain draft rules on the SDRs but sets out the government's plans in detail. These involve building on the UK's implementation of mandatory reporting in line with the recommendations of the Task Force on Climate-Related Financial Disclosures ("**TCFD**") across the economy by 2025. This mandatory reporting is already being implemented in the UK, with premium listed companies already subject to Financial Conduct Authority ("**FCA**") rules requiring such reporting, and the FCA consulting on extending this to standard listed companies and regulated asset managers and owners in 2022. The government has also said that they will establish a mechanism to adopt and endorse forthcoming ISSB standards for use in the UK, which they expect to be broadly consistent with the approach of the TCFD.

However, the SDRs intend to go further than the TCFD and ISSB standards in two key areas:

> asset managers/owners and investment products will be required to substantiate the ESG claims they make in a way that is comparable between products and accessible to consumers, and explain how they take ESG-related matters into account in governance, investment policies and strategies; and

- the UK's Green Taxonomy will require sustainable investments to satisfy minimum safeguards relating to basic good governance practices, and the SDR will require disclosure against these minimum safeguards.

The SDRs intend to use the same framework and metrics across the economy, and comprise **three types of disclosures**:

1. **Corporate disclosure** – requirements for corporates (including financial services firms) to make sustainability disclosures under international standards and the UK Green Taxonomy. The roadmap also mentions certain firms will be required to publish transition plans that align with the UK's net zero commitment on a comply or explain basis, and the government will seek to incorporate standards for transition plans into UK regulation as these standards emerge. The government wants to see publication of transition plans become the norm across the economy.

2. **Asset manager and asset owner disclosure** – requirements for these firms to disclose how they take sustainability into account.

3. **Investment product disclosure** – requirements for the creators of investment products to report on the product's sustainability impact and relevant risks and opportunities. This would then form the basis for a new sustainable investment labelling regime to make it easier for consumers to navigate the investment products available. The roadmap says this will be based on objective criteria considering: (a) the products' objectives, policies and strategies; and (b) how investments are allocated.

The intention is that these would form a "fully integrated" regime that works smoothly across the economy.

To implement this, the government has set out a number of not yet implemented future plans for the next few years:

- November 2021:
  - FCA Discussion Paper on **SDR Disclosures for asset managers/owners**.
  - FCA Discussion Paper on **consumer-facing product-level SDR disclosures**.
  - FCA Discussion Paper on **sustainable investment labelling regime**.
- By 2022:
  - As previously announced/consulted on, TCFD reporting will be implemented for premium and standard listed issuers, asset managers/owners, occupational pension schemes and investment products.
  - TCFD reporting extended to certain UK-registered financial services firms in the UK.
  - Consultation on the **SDR framework for corporates**.
- During 2022: Further detail on government thoughts on bringing **ESG data and ratings firms** into the scope of FCA authorisation and regulation.
- In 1-2 years following Royal Assent of primary legislation:
  - Mandatory disclosure requirements in Annual Reports incorporating UK Green Taxonomy and ISSB standards for "**most economically significant" UK-registered companies** (with voluntary disclosure for other companies). Consultation on mandatory disclosure requirements for **UK-listed companies**.
  - Consultation on mandatory sustainability-related disclosures for **asset managers/owners**.
  - Consultation on potential mandatory consumer-facing and product-level sustainability related disclosures in **investment products**.
  - Consultation on potential mandatory sustainability-related labels for **investment products**.
  - Subject to consultation, potential disclosure requirements on how **investment advisers** take sustainability matters into account.

- In 2-3 years following Royal Assent of primary legislation:
    - Extending mandatory disclosure requirements in Annual Reports on UK Green Taxonomy and ISSB standards to **other companies**.
    - Potential implementation of mandatory sustainability-related disclosures for **asset managers/owners**.
    - Mandatory disclosure requirements incorporating taxonomy disclosures to be presented in **sustainability report for asset managers/owners**.
    - Potential **implementation of mandatory consumer-facing and product-level sustainability related disclosures** in **investment products**.
    - Potential implementation of mandatory sustainability-related labels for **investment products**.

Annex A of the roadmap summarises the overall approach (in light of the above) to each type of entity and product.

UK Green Taxonomy

This UK's Green Taxonomy starts from the observation that the lack of common definitions regarding environmental sustainability makes it hard for companies and investors to assess the environmental impact of their decisions and increases the risk of "greenwashing". The UK's Green Taxonomy will set out the criteria that economic activities must meet to be considered "environmentally sustainable" and "Taxonomy-aligned". In this regard, the UK's Green Taxonomy is essentially aiming to do the same thing as the EU's Green Taxonomy.

The roadmap sets out the objectives and approach of the UK's Green Taxonomy, and it is notable that in principle the approach will be the same as the EU's. So, in order to be "Taxonomy-aligned", an activity must:

- substantially contribute to one of 6 environmental objectives, being:
    - climate change mitigation;
    - climate change adaptation;
    - the sustainable use and protection of water and marine resources;
    - the transition to a circular economy;
    - pollution prevention and control;
    - the protection and restoration of biodiversity and ecosystems,

  with details of what this means being set out in Technical Screening Criteria ("**TSC**");
- "do no significant harm" to the other environmental objectives (with this again being defined by TSC); and
- meet minimum standards being alignment to OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.

As with the EU Taxonomy, there will also be consideration of transitional and enabling activities.

Firms/products would then be able to produce an overall alignment percentage based on the proportion of their activities meeting the criteria above.

Hence, it seems clear that firms operating both in the UK and EU who are preparing for compliance with the EU's Taxonomy will, to a certain extent at least, be able to leverage this for compliance with the upcoming UK Taxonomy. Certainly, while there may be differences in the TSCs the expectation is that the inputs required to assess taxonomy eligibility should be the same.

As with the EU Taxonomy, the climate change mitigation and adaptation objectives will be implemented first, with the TSC subject to consultation in **Q1 2022** ahead of legislation by the **end of 2022**.

In terms of process, the roadmap highlights that TSCs will be subject to public consultation and then made through statutory instruments, with regulatory guidance and presentational tools intended to increase the ease of application.

Unlike the EU Taxonomy, the UK has committed to its Taxonomy disclosures being implemented for corporates before those for investment products, so that the former can feed into the latter. This was a key ask of financial institutions and the Treasury has heard this loud and clear.

Investor stewardship

This part of the roadmap starts with the observation that effective stewardship by asset owners and managers is crucial to the successful management of risks, opportunities and impacts presented by climate and environment change, and it can be a powerful vehicle for holding companies to account on net-zero commitments and transition strategies.

The roadmap notes the initiatives that have already been implemented in the UK, such as the UK Stewardship Code and the FCA's implementation of the EU Shareholder Rights Directive II. It also notes that the new SDR regime should help to improve disclosure and lower the barriers to investors acting as effective stewards.

However, on top of that, the government has set out its expectations in this area for the pensions and investment sectors:

1. Progress work on stewardship within their organisation; apply to become a signatory of the UK Stewardship Code 2020; and encourage or require their service providers to sign up to the Code.

2. Take into account information generated by SDR when allocating capital.

3. Actively monitor, encourage, and challenge companies by using their rights and direct/indirect influence to promote long-term, sustainable value generation. In some cases, the exercise of stewardship discipline may eventually escalate to withholding capital or divestment. For example, where a company is not taking appropriate action to transition to net zero.

4. Be transparent about their own and their service providers' engagement and voting, including by publishing easily accessible, high-quality quantitative and narrative reporting.

5. Provide leadership, for example by joining a Race to Zero-accredited net zero initiative for the financial sector, and thereby joining GFANZ. They should back up this commitment by publishing by the end of 2022 a high-quality transition plan. This should include near term science-based targets and set out their organisation's pathway to net zero financed emissions.

The government will assess progress on these points at the **end of 2023**.

The government has also said that it will update the Green Finance Strategy in 2022, which will cover the period out of 2050 and therefore go beyond the timescales in the roadmap.

For more information on the EU SFDR and EU Taxonomy, see the Linklaters Sustainable Finance Survival Guide.

Linklaters

Key Contacts

Vanessa Havard-Williams
Partner, London
+442074564280
vanessa.havard-williams@linklaters.com

Peter Bevan
Partner, London
+442074563776
peter.bevan@linklaters.com

Sebastian Barling
Partner, London
+442074565352
sebastian.barling@linklaters.com

Rachel Barrett
Partner, London
+442074565414
rachel.barrett@linklaters.com

Raza Naeem
Counsel, London
+442074565272
raza.naeem@linklaters.com

Benjamin Maconick
Managing Associate, London
+442074564940
benjamin.maconick@linklaters.com

Terry Yiangou
Managing Associate, London
+442074564922
terry.yiangou@linklaters.com

Julia Vergauwen
Managing Associate, London
+442074565775
julia.vergauwen@linklaters.com

Iyesogie Igiehon
Managing Associate, London
+442074562845
iyesogie.igiehon@linklaters.com

linklaters.com