

Accelerate ESG Alert

The Roadmap to Sustainable Investing—UK to be the first Net Zero-Aligned Financial Center

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As we reflect on the 2021 United Nations Climate Change Conference (COP26), it would be remiss not to note that the United Kingdom government announced its intention for the U.K. to be the world's "first net zero-aligned financial centre". Building upon the 2019 Green Strategy, and as a precursor to this announcement, in October the government published its roadmap to sustainable investing (the "Roadmap"), which has a number of overarching themes:

- Implementing Sustainability Disclosure Requirements (SDRs).
- Developing a U.K. Green Taxonomy (the "Taxonomy").
- Focussing on responsible investment to support a sustainable future.
- Generally, highlighting how the U.K. is seeking to change global financial systems for the better.

Sustainable Disclosure Requirements

The Roadmap sets out a desire to narrow the information gap between institutions and market participants, and proposes that this will be achieved through mandatory sustainability related risk disclosures (the SDRs) and effective product labelling. This level of disclosure is aimed at increasing transparency and accountability in respect of an institution's environmental impact, driving competition and market pressure for a more sustainable economy in both public and private sectors.

It is expected that the SDRs will build on existing and forthcoming national and international standards introduced by, among others, the Task Force on Climate-Related Financial Disclosures (TCFD), the International Financial Reporting Standards Foundation (IFRS) and the International Sustainability Standards Board (ISSB), and will entail disclosure against the Taxonomy. They will encompass three types of disclosure: corporate; asset manager and asset owner; and investment products, each with a distinct scope and implementation period under the Roadmap. The U.K.'s Financial Conduct Authority is also considering related obligations on financial advisors, and the treatment of offshore funds marketing into the U.K.

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Taxonomy

The Taxonomy aims to address concerns of “greenwashing” by setting out objective standards and metrics for firms to disclose against. These metrics (“technical screening criteria”) will be in respect of six environmental objectives, and will seek to identify how economic activities can contribute to relevant environmental objectives.

The Taxonomy will draw on its European Union equivalent and, while its implementation will be in accordance with government policy for the U.K. market, the government intends for it to remain compatible with international reporting frameworks. Technical screening criteria for the first set of environmental objectives (to be largely based on the EU taxonomy) are expected to be consulted on in draft form in the first quarter of 2022. These objectives mirror those under the EU taxonomy, being climate change mitigation and climate change adaptation. No specific timeline has been set for the remaining environmental objectives.

Transition Plans

In addition, as a means of facilitating the transition to a sustainable economy, and as a component of corporate disclosures, the government’s announcement at COP26 also emphasised the role of firm-level transition plans, with an intention to legislate compulsory publication of the plans on a comply-or-explain basis by 2023.

Transition plans set out a firm’s commitment to decarbonize. Current guidelines suggest that plans should combine high-level targets such as greenhouse gas reductions with interim milestones and clear actions the organization will be taking. How a business will best transition towards “low-carbon” is at the firm’s discretion, and the Roadmap notes that there is no intention to make net-zero commitments mandatory. Instead, as with the technical screening criteria, firms should utilize the “best practice” options available in their industry, with the onus on market participants to determine if published plans are adequate or credible.

Labeling

The Roadmap also proposes to introduce sustainable investment labels (SILs), by which investment products will be “classified” according to their sustainability characteristics. While this is seen to an extent under the EU Sustainable Finance Disclosure Regulation by the classification of products under the Articles, the objective of the SILs is to make these classifications accessible to consumers, rather than solely to sophisticated investors and industry professionals. The SILs would be supported by detailed disclosures under the SDRs, enabling consumers to make informed decisions relating to a product’s sustainability. This should mean that consumers may participate, with confidence that they are doing so on an informed basis, in driving market change towards net zero.

Looking Ahead

The government’s plans are ambitious in scope, but are of limited utility without guidance as to how the various plans and commitments will be truly implemented. We will be tracking developments going forwards, particularly as responses to the proposals are published and a clear “transition pathway” evolves.

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