

Greening Finance: A Roadmap to Sustainable Investing

The Roadmap outlines HM Treasury's ambitious plan to transform the UK's financial system – aiming to align it with the Government's net zero commitment and making the UK a world leader in green finance and sustainable investing.

What is the Roadmap?

On 18 October 2021, the UK Government released its Roadmap to Sustainable Investing (the **Roadmap**), as part of a series of announcements in the lead up to COP26. The Roadmap sets out the Government's proposed approach to tackling climate-related financial risks, encouraging UK investors and businesses to consider environmental, social and governance (ESG) risks in their decision-making processes.

In particular, it is a call to action for the investment and pension sectors – the first step in helping shift investment focus and financial flows to a net-zero and nature positive economy.

The Roadmap builds on a number of other UK initiatives impacting the investment sector, including the 2019 Green Finance Strategy and the FCA's consultation paper CP21/17 on enhancing climate related disclosure by asset managers, life insurers and FCA regulated pension providers.

This paper summarises the main elements of the Roadmap. We will be publishing detailed analysis of each of the Government's proposals and their likely impact on our clients.

How will the Roadmap be implemented?

The Roadmap includes the outline of significant, whole economy change and the implications for the investment sector. However, it is the starting point only. Further details will be set out in a discussion paper expected to be published in November 2021, and the Green Finance Strategy will be updated in 2022.

The Government intends that its ambition to green the financial system will happen in three phases:

Phase	1	Informing investors and consumers: addressing the information gap for market participants, ensuring a flow of decision-useful information on environmental sustainability from corporates to financial market participants.
	2	Acting on the information: creating expectations and requirements that this sustainability information is mainstreamed into business and financial decisions, for example in risk management and investor stewardship.
	3	Shifting financial flows: ensuring that financial flows across the economy shift to align with the UK's net zero commitment and wider environmental goals.



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The Roadmap addresses only Phase 1 – introducing the Government's plan for entities to provide detailed and meaningful sustainability related information.

Phase One: Informing

There are 3 key elements to Phase One:

1. Sustainability Disclosure Requirements

The Sustainability Disclosure Requirements (**SDR**) will create economy-wide decision-useful disclosures, bringing together existing sustainability-related disclosure requirements into one integrated framework. The Government's intention is to build on leading global standards and best practice, while introducing several new requirements.

There will be 3 types of disclosure, impacting both entities and products:

Corporate disclosure: Companies (including those in the financial services sector) will be required to: (1) make sustainability disclosures in line with international standards to be developed by the International Sustainability Standards Board (**ISSB**) and (2) report on environmental impacts in line with the UK Taxonomy. Both of these elements are considered further below.

Impact on: UK registered companies and UK listed companies. Further clarity on exact scope is needed.

Asset manager and asset owner disclosure: Asset managers and asset owners (including occupational pension schemes) will be required to disclose how they take sustainability into account in their decision making, to help consumers determine if their assets are being managed in line with their sustainability preferences.

Impact on: asset managers, life insurers providing investment products and FCA-regulated pension schemes. Further clarity on exact scope is needed.

Investment product disclosure: Creators of investment products will be required to report on the product's sustainability impact as well as relevant risks and opportunities. This reporting will form the basis of a new sustainable investment labelling regime, allowing consumers to understand the range of sustainable investment products available to them.

Impact on: investment products, and the introduction of the new sustainable investment labels. Further clarity on exact scope is needed.

Timing: A discussion paper on the various elements of SDR is expected in November 2021. The requirements are not expected to take effect for at least 2 years. It is expected that, for entities in scope of the new TCFD reporting proposals (including those under the FCA's recent CP 21/17), the TCFD reporting obligations will take effect sooner.

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Other points to note:

Financial advisers: Related to the investment disclosures set out above, the Government also intends to consult on potential requirements for financial advisers, including how sustainability considerations are considered in the provision of investment advice.

Transition plans – comply or explain: SDR will also require firms to make disclosures on their net zero transition plans, with (initially) certain firms required to publish a plan that aligns with the Government's net zero commitment, or to explain why they have not done so.

ISSB: The Government propose to align the SDR with the standards of the ISSB. However, this is an organisation that is still being formed and draft standards are not expected until next year. It is expected that the ISSB standards will build on TCFD and other international reporting standards. As such, we do not at this stage have clarity on what specifically will be required and this is an area to watch with interest.

Economy-wide disclosure: There are encouraging signs that the Government is learning some lessons from the implementation of the EU's Sustainable Finance Disclosure Regulation (**SFDR**) by introducing the SDR in a harmonised way, using the same framework and metrics, across all sectors of the economy. For investment managers, this should help to avoid the fragmented and difficult implementation we have seen with SFDR, hopefully reducing the data gaps and allowing for a more efficient and consistent change across the industry.

However, there are a number of strands to the Government's extremely ambitious proposals, and it is crucial that the industry keep on top of both the timing of these and the way they interact with each other. Involvement at every stage of the discussion as the proposed policy forms is key.

2. UK Green Taxonomy

The UK Green Taxonomy (the **UK Taxonomy**) will be a framework to clearly set out the criteria which specific economic activities must meet to be considered environmentally sustainable (ie, "taxonomy aligned"). Reporting against the UK Taxonomy will form part of the SDR.

The UK Taxonomy will, at least initially, be similar to the EU Taxonomy. It will use the same 6 environmental objectives (set out below), each underpinned by a set of Technical Screening Criteria (**TSC**), with the objectives and their TSC to be developed over time. The first objectives to be implemented are – as with the EU Taxonomy – climate adaptation and climate mitigation and the Government will use the EU's TSC for both.

6 Environmental objectives

Climate change mitigation

Stabilisation of greenhouse gas emissions consistent with the Paris Agreement and net zero by 2050

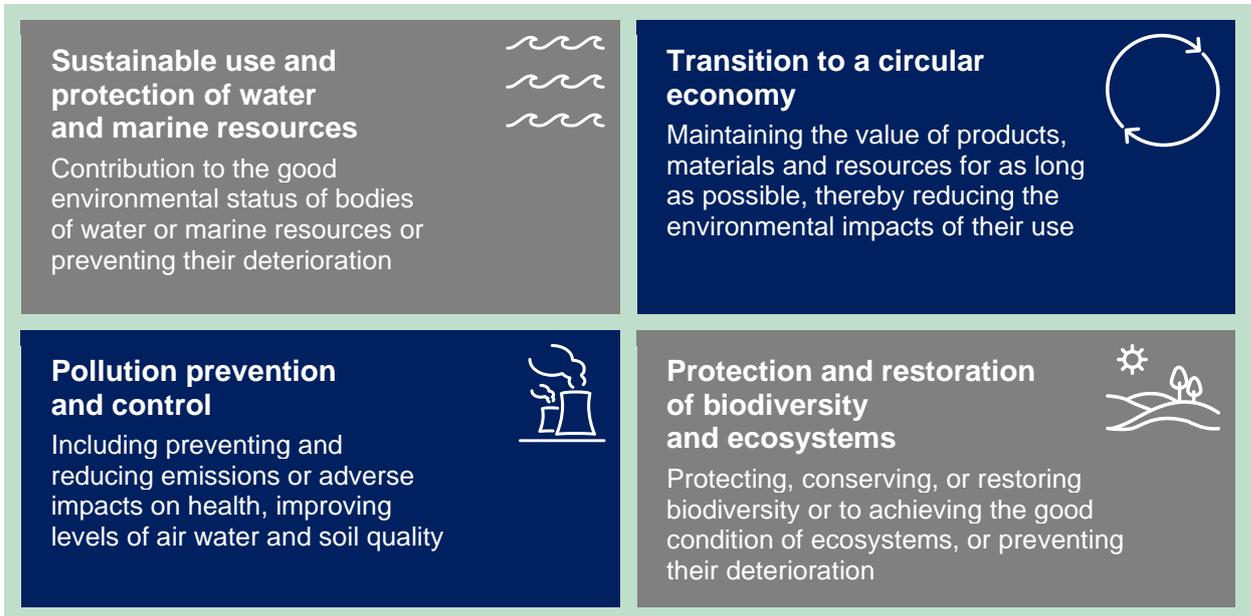


Climate change adaptation

Reducing the risk of adverse impact of current or future climate change on economic activity, people, nature, or assets



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In order to be taxonomy aligned, an activity will need to meet three tests, which are also in line with those set at the EU level. These are:

Substantial contribution to the relevant objective: the criteria for making a substantial contribution will be set out in the TSC.

Do no significant harm to the other objectives: these criteria will also be set out in the TSC. The purpose of the “do no significant harm” principle is to ensure that, in contributing to one objective – e.g., climate adaptation – the activity in question is not at the same time having a negative impact elsewhere – e.g. biodiversity.

Minimum safeguards: each activity will need to meet a set of minimum safeguards, including alignment with the OECD Guidelines for Multinational Enterprises, and the UN Guiding Principles on Business and Human Rights.

Impact: Companies will be required to disclose the percentage of their capital expenditure, operational expenditure and turnover that relates to Taxonomy-aligned activities. Using corporate disclosures, providers of investment products will then disclose the extent to which their products are Taxonomy-aligned.

Timing: The TSC for climate adaptation and climate mitigation will be subject to consultation in Q1 2022, with the remaining objectives scheduled for consultation in Q1 2023.

The Government is clear that they view the UK Taxonomy as a long term tool for sustainable reporting, focussing on intended outcomes as a way of limiting revisions. However, the timeline for full implementation will be protracted and, given the pace of change in sustainable activities, the Government expects to review the Taxonomy’s effectiveness every 3 years.

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3. Responsible Stewardship

The Government also seeks to build on the existing frameworks on stewardship, through the implementation of SDR, expecting that the pensions and investment sector will each use the information obtained as a result of SDR to deliver on their responsibilities as stewards of capital.

The Government's expectations are that the pensions and investment sector will:

Progress work on stewardship, including applying to become a signatory to the UK Stewardship Code 2020.

We know that the new Code has been a challenge for even some of the biggest asset managers, so this will be a big undertaking for many firms.

Use the information they obtain through SDR when making capital allocation decisions.

Actively engage with companies to influence positive change and promote long-term value creation (as is in any event required under the UK Stewardship Code).

Increase transparency through the publication of accessible and high quality engagement and voting reports.

Demonstrate leadership by engaging in international initiatives and by publishing comprehensive net zero transition plans by the end of 2022.

Next steps

The Roadmap is a very ambitious, but very welcome, plan by the Government. As we have explained, it will be followed by a number of discussion and consultation papers, before legislation is enacted. Following each element of the Roadmap will be crucial, as will engaging with consultations to ensure that the proposals presented work for the industry.

As well as SDR and the SDR related changes noted in this update, the Government will also be seeking to:

- Build its engagement at an international level to further the UK green finance agenda and meet its aim of the UK being a global leader in this area.
- Examine the services of ESG data and ratings providers and considering whether or not to bring them within the scope of FCA authorisation and regulation. Further information on this will be provided in 2022.

How can we help

We have a market leading sustainability team with dedicated experts across all sectors who can help you understand and navigate all upcoming changes.

Our UK and international sustainable investment team is deeply involved in all aspects of the implementation of the similar EU requirements, helping investment houses all over the world understand and implement the regulatory requirements, while advising on wider sustainability issues at a business strategic level. We can help you understand how these requirements will align – or not – with the similar EU requirements and work with you from the outset to ensure the business is prepared at every level.

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The Roadmap goes far beyond proposed TFCF reporting standards and, once again, places the UK financial sector in the spotlight as a critical medium to achieve net-zero and protect our natural environment. It is crucial that clients are prepared to adapt to meet the various standards and requirements and, to assist you, we will be issuing a series of updates setting out further guidance on each element of Phase 1, while continuing to monitor developments in this area.

Contact **Laura Houët** for more information and to help you navigate these developments.



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