Newsflash

Greening Finance – A Roadmap to Sustainable Investing

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Following the UK Government raising £10 billion for green projects through the sale of its first green gilt, the government released their plans for the coming years in [Greening Finance – A Roadmap to Sustainable Investing](#).

The roadmap aims to:

1. Get the right information to investors and businesses, helping them to understand the full range of environmental risks they face and create.
2. Help tackle 'greenwashing'. A UK Green Taxonomy will set out criteria that specific economic activities must meet to be considered environmentally sustainable.
3. Lower the barriers to investors acting as effective and responsible stewards of capital.
4. Lead international efforts to bring about global and systemic change in the financial system.

Sustainability Disclosure Requirements

In recent years there has been an increasing focus from governments and organisations on producing sustainability disclosures for customers, investors, and other stakeholders. The government is keen for this information to become a key component of every investment decision and be incorporated into the strategy of every business. However, organisations' disclosures are often inconsistent, limiting the usefulness of disclosures for investors and stakeholders. To address this the Chancellor announced new Sustainability Disclosure Requirements (SDR) in July 2021.

The SDR builds on the UK's TCFD implementation and will adopt the four pillars recommended by the TCFD: Strategy, Governance, Risk Management, and Metrics and Targets.

The SDR will create an integrated economy-wide framework for comparable decision-useful sustainability disclosures. To ensure international comparability and compatibility, the government will incorporate the International Sustainability Standards Board (ISSB) standards into the SDR framework once they have been developed.

Corporate disclosure

All UK-registered and UK-listed companies will be required to publish sustainability disclosures in Annual Reports. We expect that this will come into force by 2025, with timelines varying by the scope of any consultations. These disclosures will incorporate the ISSBs proposed international standards and report environmental impact using the UK Green Taxonomy (see below).

Under SDR, companies will be required to disclose their transition plans aligned with the UK's own net zero commitment on a comply or explain basis. Transition plan disclosure requirements will be strengthened as standards emerge to encourage consistency and comparability. All transition plans should include interim milestones and targets to enable stakeholders and regulators to monitor how the transition is progressing.

Asset managers/owners

Building on the FCA's existing expectations, asset managers/owners will be required to disclose how they factor sustainability considerations into their investments. There will be a discussion paper launched this month on SDR requirements, and subject to a consultation next year, we expect mandatory SDR requirements will be in place by 2025.

Investment product providers

Subject to consultation next year, investment product providers will be required to report on products' climate impact, and related risks and opportunities in detailed product-level SDR disclosures. Depending on the detail required in these product-level SDR disclosures, this is likely to be resource-intensive for many providers but vital in enabling consumers to select investment products based on their sustainability characteristics. These disclosures will help support a sustainable investment-labelling regime covering all investment products and classifying them against sustainability criteria. These criteria will consider investment allocation, as well as the overall objectives, policies, and strategies of the product.

ESG Data

To inform these sustainability disclosures, a vast quantity of ESG data will be required. However, inconsistency of ESG data and scoring between providers is currently a barrier to both assessing the sustainability performance of investments and in ensuring comparability between different organisations' disclosures. There are typically more data gaps, greater assumptions, and therefore greater subjectivity in producing ESG ratings than, for example, credit ratings.

To ensure that providers deliver ESG data and ratings transparently, the government is considering bringing these firms into the scope of FCA authorisation and regulation. They are also considering how to deliver an approach to digitisation of sustainability data, in response to requests from asset managers for enhanced digitisation and storage of sustainability information. The government will set out further detail next year.

UK Green Taxonomy

The number of products marketed as green, sustainable or ESG-friendly has grown considerably over the past few years. At Hymans Robertson, we believe the true greenness of these products varies due to a lack of definitions and regulation around when these labels can be used. Many firms view reputational risk as one of the most material sources of climate related risk they face, so may be keen to highlight, or potentially overstate, sustainable business practices. 'Greenwashing' refers to firms making misleading or exaggerated sustainability claims. These practices risk damaging investor trust, limiting the flow of capital into sustainable investments, and hence threatening the UK's progress towards net zero.

Firms should be held accountable to their marketing material and the reasonable expectations of their customers. To do this, certain companies will be required to disclose the proportion of their activities which are aligned with a well-defined taxonomy of environmental objectives. In July 2020 the EU published a Sustainable Finance Taxonomy. Taking a similar approach, the UK government will develop and implement its own Green Taxonomy.

Certain companies will be required to disclose the proportion of their activities that correspond to Taxonomy-aligned activities. Disclosure requirements for corporates will come into force prior to those for investment products, enabling the former to feed into the latter. To be considered Taxonomy-aligned, an activity must meet three tests.

Taxonomy alignment

Three tests	Six objectives	
Make a substantial contribution to one of the six objectives	Climate change mitigation	Climate change adaptation
Do no significant harm to the other objectives	Sustainable use and protection of water and marine resources	Protection and restoration of biodiversity and ecosystems
Meet a minimum set of safeguards	Pollution prevention and control	Transition to a circular economy

The criteria for making a substantial contribution to an environmental objective will be set out in detailed standards, known as Technical Screening Criteria (TSC). Taxonomy-alignment will be based on reported data, rather than projections, to provide investors and consumers with an accurate indicator of a company's environmental performance. Firms will also be rewarded for investing in producing future green activities and enabling other sectors to make substantial contributions to environmental objectives.

The draft TSCs for climate change mitigation and climate change adaptation will be subject to a public consultation in Q1 2022 and come into law by the end of 2022.

Investor Stewardship

The SDR is intended to lower the barriers to investors acting as effective stewards. The government expects that, as disclosures become more consistent, readily available and develop over time, the UK's pensions and investment sectors should demonstrate and disclose on increasing levels of stewardship. Whilst not explicitly setting a date on when this will be required, pensions and investment firms (asset managers, asset owners and the service providers that support them) will be expected to apply to become signatories of the UK Stewardship Code 2020 and encourage or require their service providers to sign up too.

> Stewardship is the responsible allocation, management and oversight of capital to create long term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society *Financial Reporting Council (FRC) 'The UK Stewardship Code 2020*

Investor stewardship is a powerful vehicle to hold companies to account for the feasibility and credibility of their net-zero commitments and build incentives for developing transition strategies. In practice, investors can use the increased information to:

- Decide which companies are allocated capital, helping to transition the economy to net-zero.
- Challenge companies' boards and management on their strategies or set clear expectations of investment managers and intermediaries operating on their behalf.
- Collaborate with other investors to amplify their stewardship.
- Exercise shareholder rights by voting against directors, corporate actions, or other resolutions.

From speaking to our clients, we understand that a number are using "stewardship with teeth", which combines stewardship and divestment. Firms are actively looking to engage with their invested companies, but where there is a lack of progress towards targets or response to the engagement, firms will take steps to reduce or eliminate their exposure to those companies.

At Hymans Robertson we are supporting our clients to navigate the ever-changing regulatory landscape.

Climate change is just one element in a broader set of Responsible Investment considerations. Hymans Robertson has a wealth of experience assisting financial firms with their climate-related disclosures, transition plans, scenario analysis and many other broader Responsible Investment considerations. We are happy to discuss any aspect of climate change and Responsible Investment with you.

If you would like to discuss with one of our specialists, please get in touch.