ESG ACCORD

Your compliance, ESG and Sustainability, in accord

Regulations Overview

Introduction

Factoring ESG (Environmental, Social and Governance) has become critical to the success of companies and business across all sectors. Society, customers, management, employees, shareholders, lenders and rating agencies are now demanding that we consider how our companies impact the world, any contribution they make to society and how the business conducts itself.

Simply put, companies not taking ESG seriously will lose their customers, employee relations will suffer and financing become unstable or unviable.

ESG factors are first embedded at Board level. Accountability and responsibility for the transition focuses not only on financial materiality (impact on company accounts), but also to the socio-environmental materiality (impact of company activity on environment or society). The 'best' companies develop a strategic response and are changing services and products, their processes and operations, and this filters right through to supply chains.

For these reasons, ESG metrics & sustainability outcomes are now are considered critical by the Government, Bank of England and Financial Regulators.

Regulations overview

UK Business first

The UK generally prefers a private sector emphasis, a bottom-up, business-first approach.

This private sector emphasis, particularly with upcoming COP26 meetings, COVID-19 recovery and Brexit, is considered likely by many to have a deeper long lasting impact than governmental agreements.

Consider the forward thinking steps to mandatory TCFD- aligned climate reporting for corporates and the financial sector by 2025 put in place in the UK at the Green Horizon Summit in November 2020. COP26 is seen as a chance to accelerate the UK globally as a leader in green finance.

From 1 January 2021 UK premium listed companies are required to make better disclosures on how climate change affects their business, consistent with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).

FCA Policy Statement PS20/17 looks to enhance climate- related disclosures by listed issuers and clarification of existing disclosure obligations https://www.fca.org.uk/publication/policy/ps20-17.pdf

Further to this the FCA will next consult (first half 2021) to introduce TCFD obligations for asset managers, life insurers and pension providers. The FCA has said it aims to bring in those rules for the largest firms by 2022.

These new reporting and disclosure rules, before becoming mandatory, will be introduced first on a "comply or explain" basis. Read as; the FCA generally expects companies to be able to comply.

Let's look at what the EU has already implemented.

EU top-down government approach

Three sets of rules for funds and advisers considering ESG factors when making investments and managing portfolios.

Disclosure Regulations (SFDR) - From 10 March 2021

This is all about transparency obligations. It requires; website disclosures, pre-contractual disclosures, periodic reporting, consistent marketing,

What does this mean? Disclosure of ESG policy, your approach to due diligence, how sustainability risks are considered for and in investment decisions, if remuneration policy is consistent with the integration of sustainability risks. It is the policy, procedures and compliance systems relating to the disclosures.

Categories for promotions; Article 8 and 9 respectively "products promoting environmental or social characteristics" and "products with a sustainable investment objective" (refer to the taxonomy section later for what is and isn't considered sustainable finance).

Suitability Preferences / MiFID II - In effect by end of 2021

Asking clients for sustainability preferences will become mandatory, as will the associated processes and reporting, likely to be linked to Articles 8 and 9

Benchmark Regulations,

These are standardised benchmarks for reporting carbon impact. Methodology in force based on the Paris Agreement goals and the EU Climate Transition benchmarks. Other benchmarks to follow from end of 2021

These consider how benchmarks and indexes indirectly affect investment considerations. Harmonised rules for decarbonisation include two benchmarks aligned to the Paris Agreement goals and to the EU Climate Transition (low carbon). These standards play a role in removing greenwashing and have been designed to give a clear picture to investors of a fund's sustainability credentials. Benchmarks will have to explain how the (ESG) factors are included and how they align with The Paris Agreement - and explain why not if they are not included.

Sustainable Finance Taxonomy; the language for what is and what isn't "sustainable finance".

From the end of 2021, all products labelled as "sustainable" (see Articles 8 and 9, promotions) will have to disclose in relation to the agreed taxonomy. This is covers products including E & S objectives BUT not qualifying as "sustainable".

Within this there are six environmental objectives, and an overarching requirement of doing no significant harm to any of the other objectives;

- Climate change mitigation
- Climate change adaptation
- Sustainable use and protection of water and marine resources
- Transition to a circular economy
- Pollution prevention and control
- Protection and restoration of biodiversity and ecosystems.

In the Taxonomy;

Solid Fuels are excluded, meaning not eligible as sustainable finance.

Gas & Nuclear are included in so far as they are transition activities (additional requirements "do no significant harm" with technical standards and guidance over coming 12 months). Brown & Transition Activities to deliver sustainable objectives,

Technical standards for climate mitigation and adaptation in draft.

Other EU Directives. End 2021

UCITS, MiFID, IDD, Solvency II.

Governance, organisation and investment processes will have requirements on integration of sustainability risk.

And back in the UK....

- Climate is now viewed as macro-critical
- The BoE, from June 2021, will be utilising it's stress testing framework to assess the impact of climate-related risks on the UK financial system.
- UK City has aspirations to lead globally in green finance https://www.gov.uk/government/news/chancellor-sets-out- ambition-for-future-of-uk-financial- services#:~:text=The%20UK%20will%20also%20implement,tran sition%20to%20a%20sustainable%20economy
- UK's first ever Sovereign Green Bond launched
- The government has a strong commitment to a Green Economy
- Pivotal COP26 in Glasgow, November 2021
- UK hosting presidency of G7 in 2021 has the power to shift direction of economic growth and how this incorporates green economy principles
- The FCA PS20/17 gives us 'comply or explain' in the interim before mandatory TCFD (read as comply), the UK being the first country in the world for mandatory disclosures by 2025
- FCA coming into alignment with TPR. TPR's Corporate Plan 20/21 states "continuing our work to improve the knowledge and understanding of Trustee Boards on environmental, social and governance (ESG) and climate change factors, and improving our oversight of the governance and disclosure of the risks that schemes face from climate change"
- Since October 2020 UK pension schemes must set out how they consider ESG factors in the investment policy. TCFD disclosures inline with companies accounting is in government consultation. The Pensions Bill includes alignment for reporting with the Paris Climate Agreement.
- Fiduciary duty now means delivering on promise to pay-out to members at market rates as well as the ability to have positive impact/do good
- Taxonomy; taking the EU taxonomy as its base, a UK Green Technical Advisory Group will review the metrics for the UK market.
- The UK has joined the International Platform on Sustainable Finance to support and benefit from the development of common international standards on taxonomies
- The UK Government has announced funding of £10M for a Green Finance & Investment Centre

What we think all this means for UK financial advice firms:

We see equivalence at least to the EU regulations, given the number of cross border financial services companies looking for some continuity post Brexit. The UK will, of course, produce a UK version of the EU rules, but should follow the principle of "comply or explain".

The new regulations involving changes to existing MIFID II/PROD and COBs are likely to arrive in the UK Q2 2022. Given the changes needed in compliance and advice processes firms should be starting the transition process now

ESG Accord aims to bring you expertise to help your firm get ahead, de-risk and integrate ESG and Sustainability systems, processes and training.

ESG Accord. Your compliance, ESG & Sustainability in Accord.

admin@esgaccord.co.uk   www.esgaccord.co.uk

This publication is intended to highlight issues, it is not meant to be comprehensive, nor is it regulatory advice. Should you have any questions on issues raised here or on other areas of ESG or Sustainability, please contact us: admin@esgaccord.co.uk
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