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Insights

CLIMATE CHANGE RISK AND INNOVATION IN FINANCIAL PRODUCTS AND SERVICES

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The current investment landscape presents an opportunity to align operating, legal and governance approaches to ensure long-term value through sustainable business conduct. Firms who implement their commitment to sustainability with scale and depth and who hold consultants, managers and advisors to account, are likely to create a competitive advantage for themselves – and a 'sustainability multiplier effect' in the market.

A central limb of the FCA's work plan on climate change and green finance is set out in its Consultation Paper on new climate-related disclosures for large asset owners and listed issuers. Open for comment until 1 October 2020 (extended from the original closing date of 5 June 2020 as part of the FCA's COVID-19 response), the proposals are aligned with the Taskforce for Climate-related Financial Disclosures' (TCFD) recommendations, to be implemented for accounting periods beginning on or after 1 January 2021 (therefore applying to reports published in 2022) on a 'comply or explain' basis. The FCA is separately considering how best to enhance climate-related disclosures by regulated financial services firms. In the meantime, the FCA encourages in-scope asset managers and life insurers to voluntarily make disclosures in line with the TCFD's framework for asset managers, alongside their disclosure and reporting obligations in their capacity as issuers.

Regulatory consistency across similar initiatives is key, to avoid duplication or divergence. The FCA supports the EU's sustainable finance legislative package (benchmarks, disclosures and taxonomy) coming into force from 10 March 2021, with affected firms only having 15 months to become compliant. This is less than the more usual two year implementation period for EU financial regulation. As the detailed technical provisions are yet to be finalised, affected firms will in fact have even less time to become fully compliant. Sustainability risks will also need to be taken into account under other EU financial regulation, such as for MiFID II and IDD client suitability assessments.

Policymakers are keen to provide clarity on what sustainable investments are by creating an EU-wide classification system, pursuant to the Taxonomy Regulation, to provide a common language to identify economic activities that can be considered environmentally-sustainable. The Regulation is expected to be adopted no later than 31 December 2020 (including delegated acts establishing

the technical screening criteria for each environmental objective), with a view of ensuring their application from 1 January 2022. Whilst the rules do not themselves establish a label for sustainable finance products, they set out criteria in relation to public measures or standards concerning financial products or corporate bonds offered by issuers and other financial market participants which are to be considered environmentally sustainable. This will help give greater transparency for end-investors and allow better comparison between products and reduce opportunities for “green-washing”. The Council of the EU recently published its Position on this Regulation, concluding that the proposals will play a key role in reorienting capital flows towards sustainable investment, and represents a key step towards the overall objective of achieving a climate-neutral EU by 2050.

Although other frameworks are in play, we expect this EU-centric taxonomy to become the global language of mainstream impact investment. However, there is scope for it to be expanded and developed beyond environmentally sustainable activities, to cover other sustainability objectives, such as social and governance issues. In our view it is still important to be able to differentiate between fund products, in order that investors can better understand and compare them and therefore use the information available to them to make a more informed investment decision. An approach that is overly-standardised or adopts a “one size fits all” label may not create the clarity and distinction designed to help investors and advisers navigate the responsible investment fund universe more easily. For instance, the rigid and prescriptive approach for the content of structure of ‘Key Information Documents’ to be made available to retail investors under the PRIIPS Regulation has caused consternation and confusion in the market. The precise way in which ESG considerations are to be taken into account in investment analysis and decision-making processes will differ between funds, mandates and strategies. This needs to be balanced against the use of a set of definitions of what is or isn’t “sustainable” at an economic level.

Firms face significant implementation challenges, as they look holistically across different business areas and processes. These timing and logistical challenges mean that firms should get started now on identifying and embedding those measures that are sufficiently final whilst waiting for clarity on the outstanding aspects.

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Matthew Baker

Co-Author, London

matthew.baker@bclplaw.com
+44 (0) 20 3400 4902

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