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2022 and Beyond – The Rise of ESG in the UK and Europe

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ESG considerations is a key theme that has heavily influenced investments over the past few years and which will no doubt play an even more prominent role in the 2020s. We touched on this briefly in our 2021 closing **article** in *REF News and Views* with respect to de-carbonisation of existing buildings, as the world is more focused on climate change initiatives. With all market participants increasingly adopting and adjusting to the need to comply with the ever-increasing appetite for ESG investments, we look here at some of the key recent developments in Europe and the UK regarding ESG in the financing market.

Call for regulation as to standardised ESG assessment

With increasing appetite for corporates and the financial sector to invest in ESG products, there are concerns about the labelling and regulation around what would constitute an ESG investment, along with standards in assessing the ESG rating of such companies. At this point in time, the standards around ESG labelling, disclosures and marketing are largely unregulated, leading to greenwashing concerns. Although ESG certification/ratings can be conducted by various agencies, and some companies do go through the process to certify or obtain an independent opinion/rating on their ESG compliance, this is not compulsory as part of the marketing/disclosures with respect to financial products. Furthermore, there is no prescribed standard by regulators as to ESG assessments, and so often how ESG is assessed can differ. Regulators are increasingly aware of this issue, and ESG regulation is an area of focus as we head into 2022.

In the UK, the FCA published a consultation paper on climate disclosures by listed companies. This paper also addressed ESG rating providers, with respect to general guidance on using ESG data and ratings, and also consideration of a Best Practice Code to encourage voluntary, industry-led adherence to a minimum standard of conduct so as to ensure consistency across the industry. It is expected that the FCA's final policy on the consultation will be published in the first half of 2022.

In Europe, the European Commission is expected to commence consultation in 2022 with respect to ESG ratings and the impact of these ratings and the players in the market. One of the key focuses is to look at the reliability and comparability of ESG ratings by different providers, and whether introduction of regulations would be appropriate.

ESG bonds

Green, social, sustainable and sustainability linked bond issuances continue to increase with full steam as we head into 2022. The year 2021 was a big year for ESG linked bonds, which includes green, social and sustainable bonds, and also transition bonds and sustainability-linked bonds. One of the key criteria in being classified as an "ESG bond," in addition to ESG rating, is the use of proceeds from the bond issuance towards an "ESG purpose." This sector of the market continues to evolve, with regulators such as the European Commission publishing a proposal for EU Green Bond Standard to prescribe the use of proceeds of such bonds towards "green" purposes, and the International Capital Market Association adopting key recommendations to increase transparency with respect to the use of proceeds.

Furthermore, the EU Commission published a proposal for the regulation of Green Bonds in 2021, and this proposal requires all green bonds issued to European investors and marketed as a "European Green Bond" to comply with the European Green Bond Standard. The standard prescribes a set of common rules for issuers to use the designation of "European Green Bond," and the proceeds from the issue must be used exclusively towards activities that meet the EU Taxonomy Regulation. Issuers will also have to publish on their website (in accordance with a prescribed template) a European green bond fact sheet, and their annual reports confirming the use of the proceeds, along with an environmental impact report from the use of such proceeds.

The Task Force on Climate-related Financial Disclosures (TCFD)

Various countries are taking steps to encourage or mandate TCFD implementation. In the UK, the FCA has mandated that from 1 January 2021, all UK premium-listed companies must state, in their annual report, whether their disclosures are consistent with TCFD recommendations or, if not, explanations as to the reasons. The FCA is going to apply this to standard listed companies for financial years from 1 January 2022, and large companies and LLPs will also become subject to this reporting.

For asset managers and asset owners, the FCA published a policy statement in December 2021 which requires that they disclose how they take climate-related risks and opportunities into account in managing their investments, as well as climate-related characteristics of their products. This requirement is implemented in stages, depending on the amount of assets under management.

Sustainability Disclosure Requirements (SDR)

In November 2021, the FCA published a discussion paper on SDR and investment labelling. The discussion paper include two key topics:

(i) the need for real economy companies (which includes listed issuers, asset managers and asset owners) to report on their sustainability risks, opportunities and impacts. The regime will be largely built on the existing measures under TCFD, but expanding the scope to cover wider sustainability topics beyond climate change.

(ii) sustainable investment labels – certain investment products will be required to display a label reflecting their sustainability characteristics, which will be developed and implemented by the FCA.

The consultation is expected in Q2 2022. The full text of the discussion paper can be accessed **here**.