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U.K. and EU Regulators Move Ahead on ESG Disclosures and Benchmarks

Amid the ongoing push for standardized, comparable and decision-useful ESG disclosures, regulators in the United Kingdom and the European Union have proposed additional disclosures and benchmarks to promote sustainable economic activity. The United Kingdom's Financial Conduct Authority (FCA) has published a consultation paper proposing that certain U.K. issuers make climate change disclosures consistent with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) or explain why they have not. The European Commission's Technical Expert Group on Sustainable Finance has published its final Taxonomy report for screening environmentally sustainable activities.

FCA Climate Change Disclosure Proposal

Under the FCA proposal, all commercial companies with a U.K. premium listing (*i.e.*, companies subject to the U.K.'s highest regulation and corporate governance standards) would be required to include a statement in their annual financial report setting out (1) whether they have made disclosures consistent with the TCFD's recommendations, (2) instances where they have not followed the TCFD's recommendations, and why, (3) instances where they have included disclosures in a document other than their annual financial report, and why, and (4) where in their annual report (or other relevant documents) the various disclosures can be found. The FCA places particular emphasis on the TCFD's recommended disclosures on risk management and governance, stating that only "on an exceptional basis" should companies not disclose these items.

The FCA's proposal applies to 480 commercial companies with a U.K. premium listing and includes all companies on the FTSE 100 index. For premium-listed financial firms, the proposal would require disclosure in their capacity as issuers, so "materiality" decisions for those firms would be assessed in a manner similar to other industries, rather than from the lens of the investment firms' clients (although client-focused disclosure contemplated by TCFD is separately encouraged). The proposal does not apply to open-ended or closed-ended investment companies.

EU Taxonomy on Sustainable Finance

The EU Taxonomy on Sustainable Finance provides performance thresholds for identifying environmentally sustainable economic activities. To qualify, a project or business activity must (1) make a substantial contribution towards one of six climate change and environmental goals, (2) avoid significant harm to other environmental

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objectives, and (3) meet certain social and governance safeguards related to responsible business practices, including those set forth in the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights.

The Taxonomy advances different disclosure requirements for "large companies" (listed companies, banks, and insurers with over 500 employees) and "financial market participants" (entities which offer financial products in the EU). Large companies must disclose the percentage of turnover (revenue), capital expenditure and operating expenses qualifying as environmentally sustainable. Financial market participants must disclose, for each financial product, (1) how and to what extent they have used the Taxonomy in determining the sustainability of the underlying investments, (2) to what environmental objectives the investments contribute, and (3) the proportion of the underlying investments that are Taxonomy-aligned (*e.g.*, for an equity fund, the percentage of its portfolio companies' activities that are environmentally sustainable). Certain financial products, such as pension offerings, are required to include the disclosures, while disclosures for other financial products are required on a comply-or-explain basis. Financial market participants will be required to complete their first set of disclosures by December 31, 2021, while large companies will be required to disclose in 2022.

The disclosure and benchmarking initiatives in the U.K. and EU provide investors, shareholders and other stakeholders additional tools for assessing company performance on sustainability and climate-change related matters. The European Commission's Technical Expert Group considers the Taxonomy to be "one of the most significant developments in sustainable finance" and expects it to "help companies, project promoters and issuers access green financing to improve their environmental performance . . . identify which activities are already environmentally friendly [and] . . . grow low-carbon sectors and decarbonise high-carbon ones."

The consultation period for the FCA's proposed rules closes on June 5, 2020, with expected implementation for accounting periods beginning on January 1, 2021. The European Commission is expected to pass the first series of legislation adopting the standards in the Taxonomy report by the end of 2020. Forward-looking U.S. issuers should view these developments, particularly the adoption of the TCFD's recommendations, as harbingers of future voluntary or mandatory disclosure expectations.

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