

# ESG Rules: Will the UK Align With the EU?

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The focus on environmental, social and governance (ESG) issues grew considerably in 2020, in part due to significant regulatory developments. (See our 1 February 2021 client alert, "[ESG: Key Trends in 2020 and Expectations for 2021](#).")

## Takeaways

- Financial services businesses and other UK companies will still need to take into account EU rules relating to ESG.
- The UK government intends to start a "green industrial revolution" to stimulate recovery from the COVID-19 pandemic.
- The UK government will likely introduce legislation that places it on equal footing with the EU's sustainable finance regime.
- UK businesses which maintain access to the EU will likely opt to comply with the more onerous regime should the UK and EU frameworks diverge.

The European Union passed two significant ESG-related regulations: the Sustainability-Related Disclosure Regulation (SFDR) at the end of 2019 and the Taxonomy Regulation in 2020. However, neither the SFDR nor the detailed criteria set to supplement the high-level framework of the Taxonomy Regulation have been, or are expected to be, imported into UK law. (For directly effective EU law, such as the SFDR and the Taxonomy Regulation, to be onshored into UK law, it would have had to be in force and applicable to the UK on the "exit date" of 31 December 2020.) Nevertheless, financial services businesses and other UK companies will still need to take into account these and other ESG-focused regulatory developments. In this article, we explore the potential challenges that UK businesses will face in 2021 and beyond as a result of the changing regulatory landscape post-Brexit.

## EU Regulations

The SFDR has a phased implementation timetable, with the first obligations coming into force on 10 March 2021. These obligations apply to any financial market participant or financial adviser (whether in the European Economic Area (EEA) or not) that wishes to market a financial product to customers or investors in one or more EEA member states. Financial market participants include asset managers, fund managers, certain insurance undertakings, and pension product providers and manufacturers. As a result, financial market participants and financial advisers in the UK that wish to market their services in the EEA, or to provide products to their EEA-based clients, will need to comply with these requirements.



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Obligations under the SFDR are focused on disclosure, requiring entities that fall under its scope to explain how sustainability risks are integrated into their investment decisions or advice, as well as the likely impact of sustainability risks on the returns of the financial product being marketed or advised on. However, the intended effect of these obligations is to press in-scope entities to integrate ESG factors into their diligence and investment decision-making processes, to the extent they have not already done so. This is likely to have a knock-on effect for businesses that are outside the scope of the rules, for example private equity-owned businesses, because their owners will be required to have an increased focus on ESG factors.

## UK Rules

The UK government has [stated its intention](#) to bring about a “green industrial revolution” to stimulate recovery from the COVID-19 pandemic. This includes, in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), an intention to “introduce mandatory reporting of climate-related financial information across the economy by 2025, with a significant portion of mandatory requirements in place by 2023.” This policy was also covered in UK Chancellor Rishi Sunak’s statement to Parliament on 9 November 2020 (Chancellor’s Statement), and a [full road map for establishing these UK climate-related financial disclosures](#) was published on the same date (Report).

While certain public companies have been under an obligation to include nonfinancial reporting in their annual statements since 2018, the regulatory impact of these new initiatives is expected to apply to a broader range of companies. As a result of a new listing rule, commercial companies with a premium listing on the London Stock Exchange will be required to provide, on a comply-or-explain basis, disclosures within their annual financial report (for accounting periods beginning on or after 1 January 2021) on how they are managing climate-related risks and opportunities.

The Report covers seven categories of organisations: listed commercial companies; UK-registered companies; banks and building societies; insurance companies; UK-authorized asset managers; life insurers and pension schemes regulated by the Financial Conduct Authority (FCA); and occupational pension schemes.

There are differing timelines for the development and implementation of the new disclosure rules for each category.

By way of example, for UK-authorized asset managers, the development of the relevant disclosure rules is being handled by the FCA, with the intention to publish a consultation paper in the first half of 2021 and finalise the disclosure rules by the end of 2021. Those rules are expected to come into force for large asset managers (those with assets under management in excess of £50 billion) in 2022 before being expanded to cover remaining asset managers in 2023.

In addition to the mandatory reporting of climate-related financial information, the Chancellor’s Statement made clear the UK’s intention to implement its own “green taxonomy.” The chancellor went on to explain that this taxonomy will use the scientific metrics adopted in the EU taxonomy as its basis, subject to the review of a newly established UK Green Technical Advisory Group to assess the appropriateness of the EU’s scientific metrics to the UK market.

## Standardisation

One of the common themes of ESG commentary in 2020 was the need for standardised reporting. At present, there are still numerous reporting frameworks that investors and companies need to navigate and consider when seeking to comply with the existing and forthcoming disclosure obligations. The desire of the UK government to develop its own ESG framework reflects its post-Brexit push to tailor many areas of law, including ESG rules, to the UK market, and commentators have suggested that the UK will adopt a more “principles-based” regime. For example, rather than prescribing the content and form of disclosure related to sustainability risks as mandated by the SFDR, the UK may apply a standard that disclosure has to meet, like the “clear, fair and not misleading” standard applied to financial promotions. However, in order to reduce both complexity and the risk of competing compliance requirements, UK businesses may anticipate that the UK government will introduce legislation that places the UK on equal footing with the EU’s sustainable finance regime. UK businesses which maintain access to the EU will likely opt to comply with the more onerous regime should the UK and EU frameworks diverge. In a worst-case scenario, these businesses may have to determine disclosure on the basis of multiple sets of rules.

Of course, the EU is not the only market that UK businesses access, and alignment with the TCFD would optimally also align the UK with non-EEA jurisdictions. For instance, New Zealand and Switzerland have committed to making financial disclosures regarding climate change mandatory. Furthermore, it seems likely that the Biden administration in the U.S. will usher in increased regulatory action on climate change. (See our [2021 Insights](#) article “[Climate Change Should Drive Energy and Environmental Policy](#).”)



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### Conclusion

While the precise nature and scope of ESG regulation in the UK continues to develop, ESG is, and will remain, a critical consideration for all aspects of UK businesses' operations. The nature of the disclosure obligations stemming from regulation, coupled with the public scrutiny around this issue, means that business leaders will have to be watchful of ESG as they develop plans for 2021 and beyond. Investors will place higher expectations on companies in order to meet their own increased obligations. While UK businesses will lose the benefit of a harmonised regime putting them on equal footing with EU competitors, there is an industry expectation that the UK government will do what it can to balance its independent views with its interest in aligning regulations with global ESG standards.