In anticipation of UK SDRs... What you should know

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While the Environmental, Social and Governance **(ESG)** sourcebook in the FCA Handbook, came into effect on 1 January 2022, the UK's Sustainability Disclosure Requirements **(SDRs)** will have a much longer wait for legislative approval.

Purpose & Timelines

SDRs are intended to create an integrated and streamlined framework that brings together sustainability-related reporting requirements under one roof for corporates and financial institutions.

As announced in November 2020, **all major UK corporates and financial institutions will be subject to climate reporting** in alignment with TCFD recommendations.

With effect from 1 January 2022, investors regulated by the FCA have **new rules around climate disclosure** obligations, based on the recommendations of the TCFD. ~(Large occupational pension schemes have been obliged to report in line with TCFD-based rules since October 2021.)

Climate-related and other sustainability disclosure requirements for listed and large corporates, and regulated asset managers and owners will evolve with the introduction of SDRs, although the process for doing so is not yet clear but is trialled as Q3-Q4 2022.

Reporting impact of SDR

The SDRs appear likely to change the nature of reporting requirements if, as expected, they herald the introduction of "double materiality".

In reporting terms, this means that disclosures should both

(i) outline how sustainability issues impact companies; and

(ii) set out how companies' activities impact sustainable development in the society and environment beyond their immediate operations.

Although the emphasis on double materiality is wanted by many, implementation and impact are harder to predict.

Those operating in the EU will already be working with the EU's reporting framework for sustainable investment which is based on double materiality. However, the extent of the UK's commitment to it is less certain, and there is a lot of industry debate around the need for it.

Consistency is key between SFDR and SDR

What is imperative, and agreed across the industry, is that consistency is needed between the EU Sustainable Finance Disclosure Regulation (SFDR), which outlines reporting requirements for 'green funds', and SDR while avoiding some of the flaws of the former.

This is because the SDR regime entails the introduction of new labelling requirements for UK-registered funds as well as new reporting requirements for companies whose stocks and bonds are contained in their portfolios.

This means that a more formal framework is needed around sustainable investments which has led to the UK FCA deciding that there needs to be specific labels and detailed layers of regulatory disclosure, all of which must be clear and understandable.

Current requirements

Two new sets of regulation were introduced in the UK in early 2022:

(i) the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022; and

(ii) the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022.

The new regulations require

- certain companies to provide **a "sustainability" information statement** on climate-related disclosures in their annual strategic report.

- specified LLPs to provide **a similar sustainability information statement** on climate-related disclosures in their annual strategic report or their energy and carbon report.

- a 'sustainability information statement' which is a description of...

- the company's governance arrangements in relation to assessing and managing climate-related risks and opportunities;
- how the company identifies, assesses, and manages climate-related risks and opportunities; and
- how processes for identifying, assessing, and managing climate-related risks are integrated into the company's overall risk management process.

The regulations also require a description of

- the principal climate-related risks and opportunities arising in connection with the company’s operations, and
- the time periods by reference to which those risks and opportunities are assessed;
- a description of the actual and potential impacts of the principal climate-related risks and opportunities on the company’s business model and strategy;
- an analysis of the resilience of the company’s business model and strategy, taking into consideration different climate-related scenarios;
- a description of the targets used by the company to manage climate-related risks and to realise climate-related opportunities and of performance against those targets; and
- a description of the key performance indicators used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities and of the calculations on which those key performance indicators are based.

As a result these new statutory instruments set out how companies, across sectors and geographic areas, will support the UK’s transition toward net zero, can assess and disclose their governance, strategy, risk management and metrics and targets related to sustainability including climate change. The aim is to require these disclosures to promote the management of climate-related financial risk and opportunities across the British economy.

Leading the way via a clear road map

The UK has done much more than merely be the first EU country to enact mandatory ESG disclosure laws; it has set the scene for mandatory ESG regulation in the Western world whilst driving a London double decker bus toward repairing the world.

And significantly, beyond the prescriptive mandate, these new laws provide a road map for businesses believing that profit should come not from creating the world’s problems, but from solving them.

👀**Need help** to better understand or implement your reporting requirements? Merlys has consultant-experts and expertise at the ready. Here's an example of some of the ways we can help:

- Gap Analysis
- Legal Interpretation
- Reviewing/analysing/advising on your actions or proposed actions - ensuring they're fit for purpose
- General legal advice on the stance you want to take
- Supporting you in ensuring you've recorded your decision-making process accurately
- Implementation

We're always happy to discuss your needs: call us now to talk through your challenges and the solutions available: +44(0)20 7821 0191 or email us to book a time to talk or to ask a question: charles@merlys.uk

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