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Directorate-General for Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Bruxelles/Brussels
Belgium

Sent via online submission

Dear Sirs

European Commission (the Commission) Consultation on the Renewed Sustainable Finance Strategy (the Consultation)

The Loan Market Association (the LMA) welcomes this opportunity to inform the Commission's renewed strategy on sustainable finance.

The LMA is the trade body for the EMEA syndicated loan market and was founded in December 1996 by banks operating in that market. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 740 organisations across over 65 jurisdictions and consists of banks, non-bank investors, law firms, rating agencies and service providers. The LMA's overall mission is to act as the authoritative voice of the EMEA loan market vis à vis lenders, borrowers, regulators and other interested parties.

The LMA is strongly committed to supporting the development of green and sustainable finance markets throughout EMEA. The LMA's recent work in green and sustainable finance has focused on developing consistent market standards and guidelines. Through its Green Loan Principles and the Sustainability Linked Loan Principles, the LMA has sought to provide its members with a high-level framework with which to align their loan products and through which it is hoped that the integrity of these loan products will be preserved.

We wholly support the Commission's objective of achieving a climate-neutral European Union by 2050 and have set out our responses to a number of the questions posed by the Consultation below:

Question 6: What do you see as the three main challenges and three main opportunities for mainstreaming sustainability in the financial sector over the coming 10 years?

Challenges:

1. Lack of consensus – Introducing the holistic concept of sustainability into established credit and risk management processes is hugely challenging. A lack of consensus as to what is sustainable has led, in particular, to a fear of greenwashing. Fear of greenwashing both undermines the credible work that the vast majority of institutions are doing around sustainability and discourages engagement with sustainable finance options due to potential reputational damage.

2. Data and disclosures – There is a shortage of available environmental, social and governance (ESG) data, which means financial institutions cannot always make informed judgements on sustainability issues. Furthermore, available data often contains significant disparities meaning financial institutions cannot trust or rely on this data.

3. Cost – Additional time, reporting and verification costs have limited customer demand for sustainable finance products.

Opportunities:

1. Economic recovery – The economic recovery efforts post-COVID-19 provide a real opportunity to re-build economies around core sustainability targets, including climate change targets.

2. Data and disclosures – Improvements in the availability and reliability of ESG data and disclosures over the coming years will provide a real opportunity for financial institutions to fully integrate ESG issues into risk management and decision making frameworks. We support efforts from policymakers and global initiatives to make reliable ESG data more broadly available.

3. Stakeholder engagement – We have also seen a huge increase in stakeholder engagement on sustainability issues in recent years. Financial institutions have already found, and will continue to find, innovative ways of integrating sustainability into their core business, but require flexibility to do so. Accordingly, policymakers should avoid setting overly-prescriptive regulations which may stifle innovation.

Question 9: As a corporate or a financial institution, how important is it for you that policy-makers create a predictable and well-communicated policy framework that provides a clear EU-wide trajectory on greenhouse gas emission reductions, based on the climate objectives set out in the European Green Deal, including policy signals on the appropriate pace of phasing out certain assets that are likely to be stranded in the future?

5 – Very Important

What are, in your view, the mechanisms necessary to be put in place by policy-makers to best give the right signals to you as a corporate or a financial institution?

Clarity with regards to policy framework is essential for the development of this market. It will aid the development of a single level playing field, with corporates and institutions able to innovate and make sound sustainable decisions based on certainty as to EU policy.

We would welcome a framework based on clear science-based targets, enabling the market to make decisions based on objective measures, as opposed to subjective assessments. In addition, we would specifically welcome more definitive guidance as to what assets are likely to be stranded in the future. Using events such as COP26 to send key signals to the market in a coordinated fashion would also help. This will allow lenders and investors to develop a clear strategy in relation to the financing of those assets at risk of becoming stranded going forward, with a view to minimising these to the greatest extent possible and helping corporates transition to a more sustainable world.

Question 30: The market has recently seen the development of sustainability-linked bonds and loans, whose interest rates or returns are dependent on the company meeting pre-determined sustainability targets. This approach is different from regular green bonds, which have a green use-of-proceeds approach. Should the EU develop standards for these types of sustainability-linked bonds or loans?

3 – Neutral

If necessary, please explain your answer to question 30.

These innovative finance products have opened up access to the sustainable finance market to a wide range of borrowers and issuers across different sectors and geographies. Both sustainability linked bonds and sustainability linked loans have huge potential to finance the transition of companies, particularly in brown industries, to align with global climate targets and broader sustainability goals.

The rise of sustainability linked loans and sustainability linked bonds has been accompanied by the development of voluntary market standards, namely the Sustainability Linked Loan Principles (SLLP) and the Sustainability Linked Bond Principles (SLBP). Whilst these high-level frameworks are voluntary standards, there has been widespread alignment in the loan market with the SLLP and we would expect the same alignment in the bond market in relation to the recently published SLBP.

Given that the market is already aligning to these standards, and there is work from the EU in developing guidelines around sustainability and other metrics under a number of other banners, we do not see any need for prescriptive regulations to be set in relation to these products as this may make access to these products more onerous for borrowers, especially SMEs. If any standards were to be developed, we would advocate that these take the form of a voluntary EU label for sustainability linked loans akin to the EU Green Bond Standard.

Question 31: Should such a potential standard for target-setting sustainability-linked bonds or loans make use of the EU Taxonomy as one of the key performance indicators?

4 – Agree

If necessary, please explain your answer to question 31.

The thresholds and metrics under the EU Taxonomy technical screening criteria may be used as sustainability performance targets (SPTs) which set the level of ambition which borrowers or issuers commit to meet under the relevant finance product. Adherence to the SPTs is measured through key performance indicators (KPIs), which measure the improvement in the borrower's or issuer's sustainability performance over time. We do not, however, believe that there should be a rigid requirement for KPIs, or indeed the related SPTs, in relation to these finance products to be aligned to the EU Taxonomy. Sustainability linked finance products can enable borrowers and issuers to set interim SPTs which may form part of a wider, long-term sustainability strategy. As such, these SPTs may not meet the level of ambition set out in the EU Taxonomy but may nonetheless represent important milestones in a company's sustainability journey. A requirement to tie KPIs to those set out under the EU Taxonomy would significantly limit the flexibility of these products, as there is no one-size-fits-all approach to selecting KPIs and the most material and relevant KPIs for each borrower/issuer will need to be selected on a case-by-case basis. Given that the EU Taxonomy is limited in scope to environmental issues, setting KPIs or SPTs using the EU Taxonomy only would also prevent the use of these financial products to address social or governance issues.

Question 32: Several initiatives are currently ongoing in relation to energy-efficient mortgages and green loans more broadly. Should the EU develop standards or labels for these types of products?

Yes

If yes, please select all that apply in the following list:

- a broad standard or label for sustainable mortgages and loans (including social and environmental considerations);
- a standard or label for green (environmental and climate) mortgages and loans.

Question 51: Should the EU support the development of more structured actions in the area of financial literacy and sustainability, in order to raise awareness and knowledge of sustainable finance among citizens and finance professionals?

4 – Agree

If you agree, please choose what particular action should be prioritised.

- Integrate sustainable finance literacy in the training requirements of finance professionals. 4 – Agree.
- Stimulate cooperation between Member States to integrate sustainable finance as part of existing subjects in citizens' education at school, possibly in the context of a wider effort to raise awareness about climate action and sustainability. 4 – Agree.
- Beyond school education, stimulate cooperation between Member States to ensure that there are sufficient initiatives to educate citizens to reduce their environmental footprint also through their investment decisions. 4 – Agree.
- Directly, through targeted campaigns. 3 – Neutral.
- As part of a wider effort to raise the financial literacy of EU citizens. 3 – Neutral.
- As part of a wider effort to raise the knowledge citizens have of their rights as consumers, investors, and active members of their communities. 4 – Agree.
- Promote the inclusion of sustainability and sustainable finance in the curricula of students, in particular future finance professionals. 4 – Agree.
- Other. 3 – Neutral.

Question 54: Do you think that green securitisation has a role to play to increase the capital allocated to sustainable projects and activities?

4 – Rather important

If necessary, please explain your answer to question 54.

Securitisation can increase the availability of bank credit, reduce the cost of funding, contribute to a well-diversified funding base and act as an important risk-transfer tool to improve capital efficiency and allocate risk to match demand.

As you set out, reaching the current 2030 climate and energy targets alone would require additional investments of approximately €260 billion a year by 2030. Securitisation is therefore a vital tool, which allows banks to raise fresh money, as well as to free up capital for new lending.

The requirement to free up new capital for lending is even more pressing given the ongoing COVID-19 outbreak, where financial institutions are being called upon to support struggling businesses across the board as we wait for markets to return to a new norm. The role of green securitisation will therefore be even more prevalent that previously envisaged.

Question 55: Do the existing EU securitisation market and regulatory frameworks, including prudential treatment, create any barriers for securitising 'green assets' and increasing growth in their secondary market?

No

Question 56: Do you see the need for a dedicated regulatory and prudential framework for 'green securitisation'?

No

Question 62: In your view, how can the EU facilitate the uptake of sustainable finance tools and frameworks by SMEs and smaller professional investors? Please list a maximum of three actions you would like to see at EU-level.

First, provide an accessible framework which is easy to use. There is a still a lot of education to be done in the SME and smaller investor space. Having a clear, defined and accessible framework would greatly assist the education piece and provide SMEs and smaller investors with clear parameters in which sustainable finance tools can be beneficially used.

Second, provide robust ESG frameworks for SMEs. These frameworks will not only inform SMEs as to where they currently sit on the path to sustainability, but also inform lenders/investors when they are making credit checks, as to the validity of any proposed sustainable financing offer. ESG service providers will be able to advise SMEs as to their options for improvements (where relevant) going forward, further aiding the education piece needs in this section of the market.

Third, provide clear industry sector goals. Certainty as to direction will greatly aid SMEs and smaller investors in setting their sustainability strategies, which will be capable of review against the industry sector goals. In turn, lenders/investors will be able to provide the financial toolkit to support the achievement of a sustainability strategy, knowing that the direction of the company can be verified against the industry sector goals set.

Question 66: In your view, does the EU financial system face market barriers and inefficiencies that prevent the uptake of sustainable investments?

3 - Neutral

If necessary, please explain your answers to question 66.

The primary inefficiency in this area is a lack of harmonisation of policies and practices towards, and understanding of, sustainable investments.

Many jurisdictions have started developing environmentally sustainable finance tools to mobilise their financial sectors, and these tools are being supported through the creation of private initiatives at a national and international level. However, such actions are not necessarily enough and efforts in this area need to be integrated and coherent. We would therefore very much welcome, and support, the Commission taking a leading role in ensuring harmonisation and coherence across the initiatives underway in the sustainable finance space, with a view to enhancing transparency and clarity for all participants in this space. This would likely drive greater uptake of sustainable investments, with financial institutions already showing a great willingness to support and make available the additional investment required to finance the EU's aim of climate-neutrality by 2050.

Question 77: What can the Commission do to facilitate global coordination of the private sector (financial and non-financial) in order to deliver on the goals of the Paris Agreement and/or SDGs? Please list a maximum of three proposals.

First, the Commission could look to promote context-specific technology, to accelerate the implementation of smarter solutions in sustainable investment. These solutions should seek to increase transparency and access to information relating to sustainable investments, thereby addressing the information asymmetries surrounding sustainable investments, and assisting investors in identifying and assessing potential sustainable investments.

Second, the Commission should support a stronger policy for basic education in sustainability across sectors and asset classes. As noted at Q6, **a lack of clarity around what can be categorised as 'sustainable'** is a key challenge to mainstreaming sustainability and this is something that we, at the Loan Market Association, are looking to solve. Education as to sustainability, climate change and ESG factors varies considerably across financial markets, and a basic education, aimed at creating a knowledge benchmark for practitioners, would greatly aid the delivery of a climate-neutral EU by 2050.

Third, the Commission should seek to incentivise the deployment of green capital. This can be led in part via the setting of clear sustainability frameworks, seeking to harmonise the initiatives already live in this space across various jurisdictions, and in part via the provision of a roadmap of milestones on the way to a climate-neutral EU by 2050.

Question 78: In your view, what are the main barriers private investors face when financing sustainable projects and activities in emerging markets and/or developing economies? Please select all that apply.

- Lack of internationally comparable sustainable finance frameworks (standards, taxonomies, disclosure, etc.)
- Lack of clearly identifiable sustainable projects on the ground
- Excessive (perceived or real) investment risk
- Difficulties to measure sustainable project achievements over time
- Other

Please specify what other main barrier(s) private investors face when financing sustainable projects and activities in emerging markets and developing economies.

- Lack of underlying assets/sustainable projects
- Lack of differentiation in capital treatment for sustainable vs. non-sustainable projects

Question 82: In particular, do you think that existing actions need to be complemented by the development of a taxonomy for economic activities that are most exposed to the transition due to their current negative environmental impacts (the so-called “brown taxonomy”) at EU level, in line with the review clause of the political agreement on the Taxonomy Regulation?

Yes

If yes, what would be the purpose of such a brown taxonomy?

- Help supervisors to identify and manage climate and environmental risks.
- Create new prudential tools, such as for exposures to carbon-intensive industries.
- Make it easier for investors and financial institutions to voluntarily lower their exposure to these activities.
- Identify and stop environmentally harmful subsidies.

Question 83: Beyond a sustainable and a brown taxonomy, do you see the need for a taxonomy which would cover all other economic activities that lie in between the two ends of the spectrum, and which may have a more limited negative or positive impact, in line with the review clause of the political agreement on the Taxonomy Regulation?

Don’t know / no opinion / not relevant

Whilst the creation of a "catch all" taxonomy would provide for a complete classification of investment types, allowing the market to confidently map sustainable and unsustainable activities, it is questionable whether the creation of such a taxonomy is feasible or whether it would create confusion in the market. In addition, it would need to be seriously considered as to whether such a taxonomy could be viably maintained in the face of constantly advancing science in the area of climate change.

There is growing expertise in the marketplace, within the investors and companies themselves, as well as dedicated third parties, to support the making of informed decisions that lead to a more sustainable global economy. We would therefore suggest that the Commission has greater priorities to focus on than the creation of such a taxonomy, that will better assist the vital flow of funds into sustainable investments.

Question 86: Following the financial crisis, the EU has developed several macroprudential instruments, in particular for the banking sector (CRR/CRDIV), which aim to address systemic risk in the financial system. Do you consider the current macroprudential policy toolbox for the EU financial sector sufficient to identify and address potential systemic financial stability risks related to climate change?

4 – Rather sufficient

Whilst the current macroprudential policy toolbox does not specifically identify and address the long-term risks associated with climate change, we do not believe further action is required.

Lenders and investors already assess the long-term impact of climate change when making investment decisions, for example when undertaking credit appraisals, and ensure these risks are priced accordingly. Their due diligence processes allow lenders/investors to take a long-term view on how potential borrowers are responding to climate change and the strategic measures they are putting in place. Lenders/investors will also take into account other impacts, such as consumer views on climate change and how this may impact appetite going forward.

Even if action were required, given the ongoing COVID-19 crisis, we do not believe now is the time to introduce any changes that might restrict a bank's ability to lend and support companies through the crisis, particularly SMEs. The global environment is one where banks need to be equipped to support corporates, from investment grade to SMEs, through the crisis, as well as being able to support sustainable investments so that we can achieve our 2030 and 2050 targets.

Question 99: In your opinion, should the European Commission take action to enhance the availability, usability and comparability of climate-related loss and physical risk data across the EU?

Yes

If yes, for which of the following type of data should the European Commission take action to enhance its availability, usability and comparability across the EU?

- Loss data
- Physical risk data

Please specify why you think the European Commission should take action to enhance the availability, usability and comparability of climate-related loss data across the EU?

Greater transparency and availability of climate-related loss data is likely to result in financial institutions better assessing and pricing in the risks associated with unsustainable activities, as well as taking steps to avoid and mitigate against such losses. There is a clear demand for more reliable and comprehensive data to be made available in this area to assist credit teams within banks to better manage risk across portfolios, both at the point of origination and when monitoring such portfolios. The enhancement of data in this space would therefore be supported.

Please specify why you think the European Commission should take action to enhance the availability, usability and comparability of climate-related physical risk data across the EU?

General education around physical climate risks, how they are manifesting and the financial consequences would be very much welcomed as this would help to further raise awareness of such issues with asset owners and managers, together with investors.

We note that the Task Force on Climate-related Financial Disclosures (TCFD) has recommended that metrics on physical climate risks and opportunities should be included in financial disclosures. Building on this, and providing for enhanced availability, usability and comparability of physical risk data will allow market participants to better integrate climate change considerations into existing risk assessment and decision-making processes.

Data availability for value chains, tangible assets (including location data), intangible assets, countries of operation and financial data should therefore be reviewed and, where possible, built out and made more readily available to the market.

Question 102: In your view, should investors and / or credit institutions, when they provide financing, be required to carry out an assessment of the potential long-term environmental and climate risks on the project, economic activity, or other assets?

Yes

What action should the EU take? Please list a maximum of 3 actions.

In taking any action, the EU should look to apply de minimis provisions when requiring an assessment, so as not to undermine the economics of any transaction and make sustainable finance tools uncompetitive against other financing options in the market. In addition, it may be that different assessment requirements are required on a single vs portfolio financing arrangement.

Next Steps

We would be pleased to discuss any aspect of the above with you in more detail. If we can be of any further assistance, please do not hesitate to contact me by email at gemma.lawrencepardew@lma.eu.com or on +44 (0)20 7006 1372. We would also be pleased to meet to discuss the above at your convenience.

Yours faithfully,

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