HORIZONS

Issue 03

Autumn 2024

Enter

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Welcome to HORIZONS

From London Climate Action Week in the Summer, to New York Climate Action Week in the Autumn – the seasons are changing as rapidly as the *sustainability agenda* progresses.

While the summer hopefully afforded everyone an opportunity to enjoy some downtime, have a bbq and tune into the amazing sporting spectacles on show, the run-up to the end of the year holds many things to look forward to.

The first being our Sustainable Finance Conference, which is now officially open for registration. This year's conference theme is inspired by Homer's Odyssey, as we believe achieving sustainability is a unique journey. Just like Odysseus navigating perilous challenges to reach the calm shore, the path to sustainability has not been straightforward—and likely never will be. It requires us to collaborate, sail through challenges, and build an ecosystem that works for all of us. So be sure to join us on 7 November in whatever capacity you can.

We are also delighted to be sponsoring the upcoming City and Financial Global event "Making the UK a Global Hub for Transition Finance". Taking place on 10 October 2024, the agenda looks at advancing transition finance through key policy frameworks, market innovations, and comparative analysis of financing options. The agenda includes insights into successful case studies, best practices, and perspectives from various stakeholders, aiming to highlight the UK's role in scaling up transition finance solutions and addressing current challenges and opportunities. We would be delighted to see as many of you there as possible. Be sure to register using the unique link to access a 30% discount.

As the turbulent weather of the past few weeks reminds us, climate change waits for no-one. It is therefore no surprise that transition remains high on our agenda and our dedicated Task Force has been deliberating away over the summer to formulate a proposal to scale up transition finance in the loan market. Your responses to our market survey, generating 100+ pages of comments from over 90 global institutions, have been enormously helpful in advancing this work. A huge thank you to everyone who took part – your input is essential to ensure any project we implement is meaningful, impactful and - most importantly – reflects what the market needs.

Shades of green is an ever-expansive theme, and in July we were delighted to host a roundtable of industry experts discussing the importance of the blue economy. The amount of work already undertaken in this area is extraordinary – see my article on Financing the Blue Economy for more information.

Finally, I'd love to hear your feedback. Horizons has had a fantastic first year, but as we look to 2025, I want to make it even better. Please let me know what you'd like us to start, stop, or continue. This publication is for you, and can only be improved with your input. All feedback is welcome, so please be sure to contact me at gemma.lawrence-pardew@lma.eu.com. Let your voice make the change.

Gemma Lawrence-Pardew
Head of Sustainability

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ESG Syndicated Loans: Trends and Growth Drivers

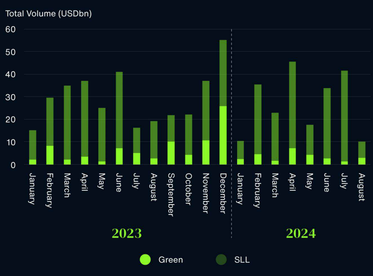
Anna Baraulina, Syndicated Loan Reporter, Loan Radar

Inma Rabasco, Data Analytics Manager, Loan Radar

Activity is picking up!

While in H1 2024 sustainability-linked and green loans volumes slightly decreased year-on-year, the beginning of Q3 2024 was quite active, which led to change of trend – as of end of August ESG loans (SLL+Green) are not only consistent with the same period of 2023 but even higher, thanks to increased volumes of SLL.

Sustainability – Linked Loans Picked Up in Q3 2024 Shifting the Market to Growth



Source: Loan Radar

ESG loan volumes have fluctuated between 19% and 27% of the total syndicated loan volumes quarterly since the start of 2023, with the July-August 2024 seeing a lower share of around 21%.

*Q3 2024 includes July and August only

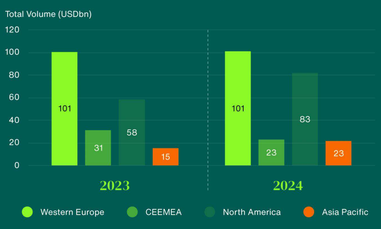
ESG Loans May Exceed One – Quarter of the Market in Q3 2024

Source: Loan Radar

The 2024 ESG lending growth has been driven by North America and Asia Pacific*

*Based on the information about deals signed in January-August 2023 & January-August 2024

North America and Asia Pacific Have Been Driving Growth in ESG Syndicated Lending



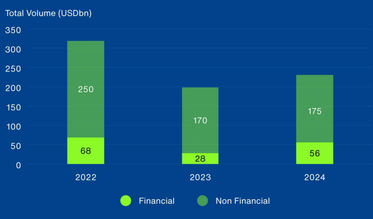
Source: Loan Radar

Financial/Non -Financial

The dynamics have been different for Financial companies whose ESG borrowings nearly doubled, compared to Non-Financial companies, whose ESG loans saw only a slight increase. This situation has changed since 2023, when both segments decreased notably in January-August vs the same months months of 2022.

*January-August for every year

Financial Institutions Have Demonstrated A Higher Appetite for ESG Borrowings



Source: Loan Radar

Currencies breakdown*

USD-denominated loans are leading the market followed by EUR-denominated loans, while the share of borrowings in other currencies in the total loan volumes has slightly declined.

*Based on the information about the deals signed in January-August 2023 & January-August 2024

Currencies breakdown

Source: Loan Radar

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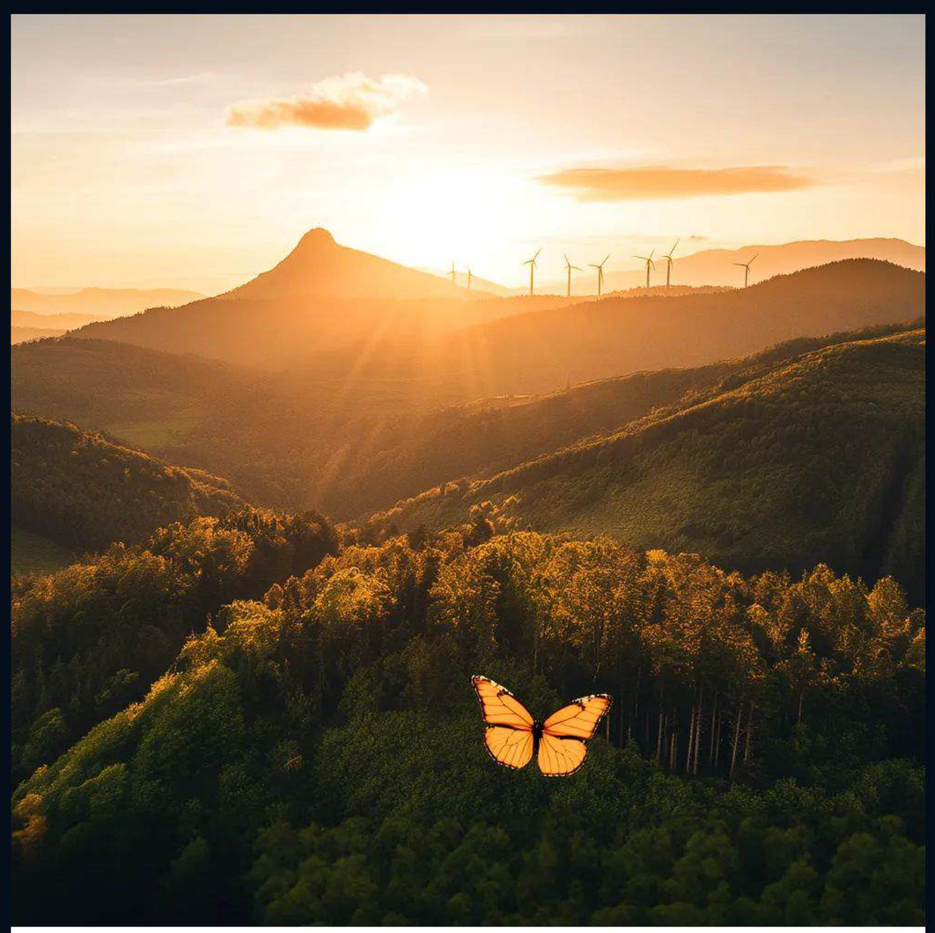
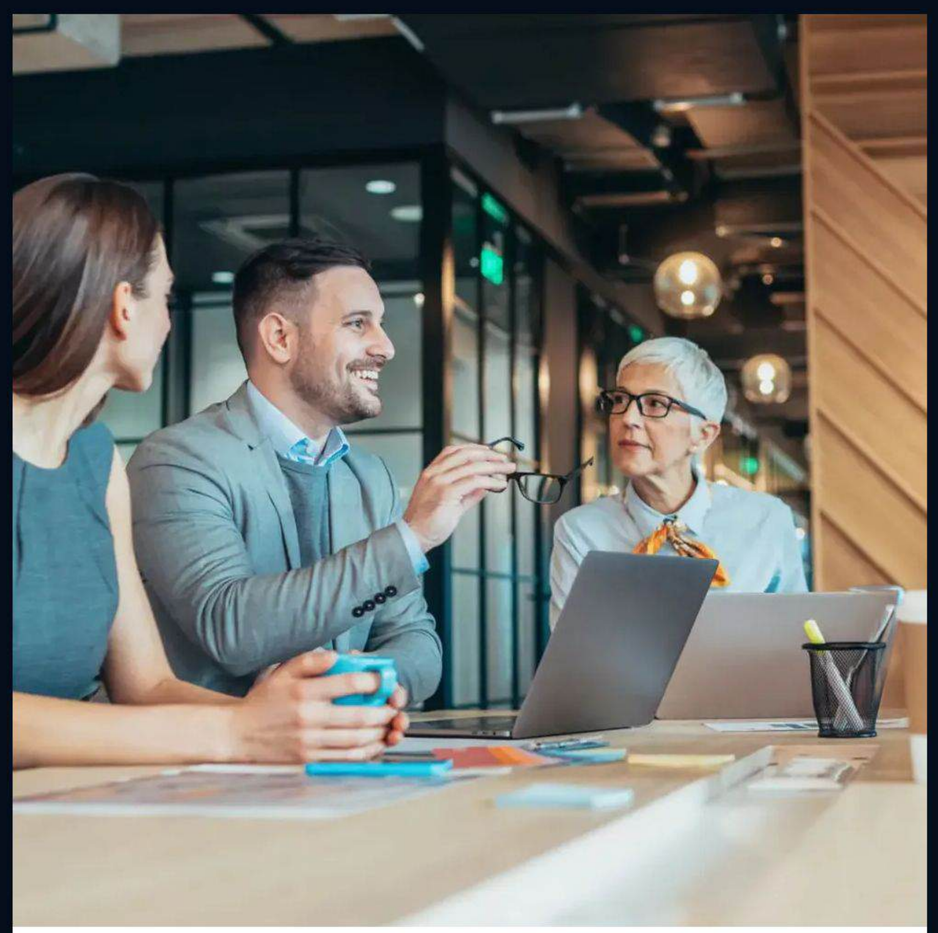
Thought Leadership



Scaling Transition Finance with Lessons from Environmental Markets

Multiple challenges have already been addressed in environmental markets. This article explores the valuable lessons learnt and how, together with technology, these can advance the transition of the real economy.

Read more



Focusing on the E in Export Finance

This article looks at how ECAs are integrating sustainability into their operations, the challenges to be navigated and the market movements required to maximise impact going forward.

Read more

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Scaling Transition Finance with Lessons from Environmental Markets

Corinne Neale, Member of the Executive Team, Fiùtur

Andy Bose, SVP, Market Development and Policy, Fiùtur

Channelling trillions of dollars of "transition finance" towards cleaner energy, circular supply chains and more efficient infrastructure requires a rewiring of loan and risk management markets.

Many similar challenges have already been addressed in environmental markets, offering valuable lessons and advanced technology for the transition economy.

Transition Finance

Consensus is emerging on Transition Finance being defined as financing hard to abate sectors to meet the Paris Agreement temperature goal. The Glasgow Financial Alliance for Net Zero (GFANZ) characterises transition finance as enabling "an orderly reduction in emissions for carbon-intensive activities".[1]

Many businesses in hard to abate sectors see benefits in preparing for a decarbonised economy due to stricter regulations, investor demands for greenhouse gas (GHG) disclosures and changing consumer preferences. Trade flows are being affected too; for example, manufacturers of carbon intensive goods entering the EU face new emission thresholds and direct tax via the Carbon Border Adjustment Mechanism (CBAM).

Missing these signals results in transition risks, and as recently highlighted by the European Central Bank, transition risks result in elevated credit and litigation risks for financial institutions. So transition finance can be seen as a way for all parties to mitigate risk. Reducing the cost of capital for a borrower when GHG emissions are reduced can improve the underlying performance by reducing exposure to transition risk (Tandon, 2021[2]).

Although Transition Finance benefits are clear, its structure is still debated due to its complexity. Transitioning, by definition, implies supply chain asset-level changes, more amenable to lifecycle analysis than to the point in time proceeds or corporate level metrics used in sustainable finance. However, solutions are in sight, precipitated by the imminence of CBAM-style regulations affecting trade flows for specific commodities, and by environmental market experiences offering guidance.

"While there is no single definition of transition finance across the market, Standard Chartered has defined transition finance as any financial service provided to clients to support them in aligning their business or operations towards the 1.5 degree trajectory. Historically, one of the main challenges in this area has been that new-low carbon technologies are not sufficiently established in the market. But we're starting to see the innovation needed across technology and digital to encourage the transition, and the development of the supporting transition finance structures required behind this."

Nicolas Decaillet, Managing Director, Energy and Infrastructure at Standard Chartered Bank

1. https://www.gfanzero.com/publications
2. Tandon, A. (2021) Transition Finance: Investigating the State of Play: A Stocktake of Emerging Approaches and Financial Instruments, OECD Working Papers 179.

Insights from Environmental Markets

Environmental markets refer to both government-administered cap-and-trade "compliance" markets and voluntary markets. Initially focusing on SO2 and NOx emissions, these markets have evolved to address various challenges including land conservation, water quality, control of chlorofluorocarbon (CFC), and reducing GHG emissions.

- Like Environmental Markets, Transition Finance aims at aligning emissions to environmental targets;
- Both aim at the creation of premium products for the new economy;
- Both leverage a system of financial incentives and penalties;
- Both are subject to greenwashing scrutiny and encourage continuous digital innovations.

Most importantly the results are compelling. Environmental markets have reduced GHG emissions by c. 2 to 3% per year (Boning et al., 2023[3]). This experience provides a template for the infrastructure, incentives and rigour required for financing the transition economy.

3. Boning, J., Di Nino, V. and T. Folger, (2023) Benefits and Costs of the ETS in the EU, a Lesson Learned for the CBAM Design, ECB Working Paper No. 2023/2764.

FinTech fit for Purpose

With increasing scrutiny on the integrity of environmental markets outcomes, several technical tools and advances in market governance have been introduced that can be applied in transition financing. Here are foundational Fintech building blocks:

- More precise and complete environmental and ecosystem monitoring via satellite imagery, drones, and other remote sensing technologies providing real-time, asset-level information;
- Vertically integrated systems to digitise the complete lifecycle of physical commodities with auditable information on origin, processing/refining, transmission, and relevant environmental attributes;
- Interoperable Digital Ledger Technology (DLT)-based infrastructure automated with "smart contracts" to connect multiple parties via secure platforms, and register environmental claims that eliminate risks of double-counting;
- New digital governance frameworks[4] for delivery of high quality data and registering, transacting, reporting and retiring via standardised protocols.

See Fiùtur's "Trust Infrastructure for the Transition Economy[5] for more information on these areas.

4. https://www.fiuturx.com/intelligence/introductory-governance-framework-for-smart
5. https://www.fiuturx.com/intelligence/trust-infrastructure-for-the-transition-economy

Scaling Transition Finance

These advances enable lenders to reference verified outcomes for hard to abate products at asset level in supply chains. This is the domain of Trade Finance, Transaction Finance, Commodity Finance, Real Assets Finance and Exports and Import credits for transitioning assets. These advances extend asset lenders' capabilities in three immediate ways in hard to abate sectors:

1. Tracking emissions against targets for the specific asset to be financed with current data for valuation at the point of financing.
2. Leveraging the higher market price paid for premium products with verified lower emission products.
3. Leveraging market demand for Environmental Attribute Certificates (EACs) verifying emissions reductions. EACs create new revenue streams, e.g. the EU's Upstream Emission Reduction (UER) scheme, California's credits for low-carbon fuel, and Canada's credits for low-emission gas are regulated ways to monetize emissions reduction certificates. This enables environmental outcomes to be authenticated and valued, harnessing market forces to fund the transition This practice has been acknowledged as essential for transition finance by industry groups[6].

Transition Finance enhances traditional financing by referencing verified asset-level emission data to meet emission targets, measure transition risk and value transitioning assets. Better and higher frequency emission data at asset level will also enable lenders and their clients to build transition risk models. These models will foster innovation by isolating risks, analysing trends and pricing tailored transition risk mitigants. This virtuous loop will enable risk-sharing guarantees, and risk-sensitive collateral pools, covenants[7] and insurance[8]. Asset-level risk mitigants will reduce the need for risk capital, freeing funding to further scale the energy transition.

The finance industry is actively engaging with economic stakeholders, and it is becoming increasingly obvious that no-one can transition alone. New business models call for mechanisms such as digital registries and environmental outcomes' chains of custody for granular, verified, referenceable environmental information shared across parties. An illustration is provided in the graph below where producing assets' environmental outcomes are:

- Captured alongside physical production,
- Verified according to accepted standards,
- Referenced in data registries,
- Passed down the supply chain,
- Shared with interested parties to support capital deployment, until retirement of environmental claims certificates.

As pressure builds up to deploy funding towards the new economy and to mitigate environmental and social impact, environmental markets bring much-needed experience and tangible technology solutions. We should focus on rewiring the loan and risk management markets with 21st century digital tools. This is "just finance" with the level of insights necessary to take action.

With our appreciation to Ken Abbott, ex IHC CRO at Barclays for his review.

6. See for example https://www.sustainable-markets.org/taskforces/agribusiness-task-force/
7. https://www.moccae.gov.ae/en/media-center/news/4/12/2023/moccae-and-world-bank-treasury-partner-on-financing-the-future-of-food-f3-initiative-to-explore-innovative-bond-structures-for-projects-in-developing-countries.aspx#page=1
8. https://www.lloyds.com/news-and-insights/futureset/futureset-insights/risk-revealed-clean-technologies-and-hard-to-abate-sectors

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Focusing on the E in Export Finance

Nick Tostivin, Head of Finance and Global Head of Trade & Export Finance, Pinsent Masons

Camilla Ash, Associate, Pinsent Masons

Madiha Aslam, Director, Structured Finance, Innovo Group

Export Credit Agencies (ECAs) play a crucial role in facilitating international trade by providing financial support and insurance to domestic companies exporting goods and services.

Their broad function is to (a) mitigate the risks associated with exporting to foreign markets by providing loans, loan guarantees and insurance to support domestic companies, (b) provide financial support to exporters, ensuring they have the necessary funds to complete international transactions and (c) facilitate market expansion by enabling companies to explore and enter new markets, thus supporting national economic growth and international trade.

ECAs are increasingly integrating sustainability into their operations in a number of ways. The proliferation of sustainability standards and guidelines have crept into export credit transactions (partly due to fact that, under the UNFCC Paris Agreement, national governments now have a legal requirement to align with net zero goals and are mandating ECAs to align with their own commitments under UNFCC required Nationally Determined Contributions) just as ECAs are increasing their efforts and focus on projects that promote sustainable outcomes such as renewable energy and sustainable infrastructure, and are aligning their strategies with global net-zero targets, helping businesses transition to low-carbon operations. One example is UK Export Finance which has introduced a sustainability strategy (2024-2029) with an explicit £10bn target of providing “clean growth” for supporting sustainable projects in developing countries. Many ECAs are also part of international alliances aimed at promoting sustainable trade and investment. For example, The Berne Union is an international association of ECAs that promotes best practices in sustainable finance and trade, and the OECD Guidelines often form the backbone of the ECAs’ sustainable lending deals, ensuring that their financial support aligns with international sustainability standards.

In export finance, parties have a wide range of environmental guidance materials and practices to consider. How are these (successfully) navigated on transactions?

Navigating the wide range of environmental guidance materials and practices in export finance can be complex, but there are established frameworks and best practices that help ensure successful transactions.

Environmental due diligence is a key area on which ECAs, engineering, procurement, and construction (EPC) contractors, lenders and borrowers alike spend a lot of time on in the beginning phases of a transaction. Whilst an essential element of any sustainable finance deal, this takes time and costs money, which for some market participants can act as a deterrent.

Adherence to recognised international standards such as the IFC Standards, Equator Principles and the OECD Guidelines also help the underlying project to align with ECAs’ and lenders’ sustainability standards, demonstrating sustainability credentials, and support the associated “bankability” of a project.

Typically, the first assessment of the E&S requirements on a project is guided by an initial high-level review of the location and scope of the proposed project by the ECA and bank at the point that the transaction is initially brought to the financiers. At this stage a few items are key:

- To have a client and / or EPC with an E&S team who have experience of managing internationally financed projects and have knowledge of compliance requirements pertaining to IFC standards and Equator Principles. This enables all parties to have an initial realistic discussion on potential risk implications and categorization of the project.
- It is helpful if initial E&S studies up to national regulatory E&S standards are in place at this point, to help financiers make a more informed decision on the key risks to be mitigated. Typically, these may be included as part of the initial feasibility review the client might have conducted on the project.
- It is important that an initial scoping review of the project is then completed through a consultative process between the Client, EPC, ECA and lead Bank to ensure that all parties focus and agree on the core risks around the project under consideration and identify risks that can be considered secondary in nature (unless otherwise flagged in a subsequent report). This allows the identification of a “fit-for-purpose” scope of work for engagement of E&S consultants to conduct an impact assessment, leading to more efficient use of time and resources.

More broadly, Inter-agency collaboration also helps to further the objective of aligning sustainable finance practices. ECAs will often collaborate with other financial institutions and international bodies to share best practices and ensure consistent application of sustainability standards. For example, SACE (the Italian export agency) revealed its ESG Strategy at COP28. The primary goal of their strategy is to contribute to the community well-being and overall prosperity. After unveiling its strategy, SACE hosted a round table involving companies, financial institutions, and other stakeholders to explore solutions supporting the “ESG revolution”[1]. This example shows the increasingly collaborative approach ECAs are taking in market engagement, to develop good practice.

Finally, ongoing monitoring and reporting is an essential part of demonstrating the impact and outcomes of export finance (more on this below). This is something which is increasingly factored into the early stages of a transaction and then during the life of the project to measure positive sustainability impacts and ensure robust control measures are in place to mitigate any adverse sustainability impacts.

Increasingly, in practice, these impacts are considered during due diligence, and then legal mechanisms are integrated into the project financing documentation. This supports ongoing project monitoring, oftentimes using a formal Environmental and Social Action Plan, and includes the use of legal conditions (i.e. conditions precedent and/or subsequent), which need to be met by project contractors and/or operators often to the satisfaction of an independent sustainability expert.

1. SACE - Press Releases Detail ESG RE-EVOLUTION IN SACE

Do these measures help move the milestones or distract parties from achieving real impact?

There are challenges in integrating these measures, however it is crucial that all project finance parties are aligned in terms of understanding both the sustainability risks, and positive outcomes on any specific financing opportunity.

Whilst the benefits of incorporating sustainability practices into export finance transactions may be clear, there can be difficulties in achieving real world impact. To focus on the positives, stakeholders should seek to understand:

1. alignment of interest in sustainable practices amongst borrowers, export credit agencies and lenders, which can lead to long-term environmental and social benefits;
2. sustainable finance frameworks used by transaction parties, including ECAs, to help mobilise “sustainable finance” and “sustainability-labelled” capital, define use of proceeds for sustainable outcomes, measure and disclosure impact; and
3. identification and mitigation of environmental and social risks to protect investment value and enhance project outcomes.

However, there are some drawbacks of sustainability in export finance, such as:

1. Complexity, costs and lack of consensus – The volume of inconsistent market standards and guidelines gives rise, on occasion, to a lack of understanding or consensus amongst stakeholders. This can result in poorly defined due diligence and a creep in technical advisors adding complexity, delay and ultimately cost to due diligence exercise. The lack of consensus is illustrated when lenders other than just the leading bank in a syndicated loan arrangement have different due diligence requirements or standards for credit decisions.
2. Potential for greenwashing – Some market participants are reluctant to be trailblazers in their sustainability agenda due to the increasing regulatory security in ‘greenwashing’. In the context of the introduction of more stringent regulation – such as the new anti-greenwashing rule that took effect in UK financial services on 31 May this year – and enforcement, institutions are naturally tending to take a cautious approach to the way they manage sustainability risks and the associated claims about the sustainability credentials of the projects they finance. Institutions are also at increased risk of litigation and/or potentially damaging public relations campaigning from shareholders and activists. It is in this context that some institutions have been electing not to overtly publicise their support for, or make claims about, ‘green’ projects they invest in – a trend that has been colloquially referred to as ‘greenhushing’.
3. Inconsistencies – The lack of universal standards for sustainability compliance can lead to inconsistencies as to how these goals are applied and measured.

These drawbacks at times result in inefficient execution of transactions, wherein agencies and financiers struggle to appropriately assess the project specific risks associated with each project in the context of covering gaps as a result of inconsistent views. Oftentimes it leads to agencies and financiers requesting for additional reports and confirmations from external due diligence agencies in order to substantiate their decisions, leading to scope creep, additional costs and project delays. The prevalence of these delays in recent times across the ECA industry has also resulted in borrowers and buyers becoming wary of tapping ECA financing as a liquidity source for high-priority time-sensitive projects.

For efficient navigation across all these aspects, it is key for agencies and financiers to have fully functional collaborative ESG teams with the ability to assess risks based on the specifics of each project being considered, knowledge of flexibility required in implementing solutions across developing and emerging markets, and commercial acumen to understand the realities on ground to allow equitable implementation of standards.

What measures are being seen in the wider industry to enable equitable transition to a green economy?

The OECD has long been involved in setting standards relating to export credit and last year agreed to adapt terms and conditions that many export credit agencies apply globally, to better support the transition to a green economy.

The Equator Principles – a voluntary set of standards for determining, assessing, and managing social and environmental risk in project finance – were first launched in 2003. Development of the principles, which have subsequently been revised, reflected the desire of many institutions to meet external calls to place ethical considerations towards the forefront of financing decisions – by channelling loans and other forms of finance to projects that could demonstrate their compliance to minimum social or environmental standards. However, the anti-trust movement in the USA has seen firms de-listing from the Equator Principles in recent months and this sustainability backlash adds yet more doubt and uncertainty to the strength of these global standards.

This agenda has evolved in the years since, with new frameworks emerging to seek to encourage sustainable finance in response to today’s climate emergency and broader concerns about the impact of business operations and financing arrangements on people and the environment.

One of the frameworks now commonly used is the LMA’s ‘green loan’ principles and supplementary standards, designed to reflect the wider policy and regulatory agenda on sustainability that continues to evolve internationally – as well as the increasing demand on the finance industry in respect of sustainability from shareholders, customers, and activists.

At the moment, sustainability standards are often lifted and dropped from model provisions like the LMA principles into export finance contracts for projects. The thinking behind this is that it provides institutions with comfort that they are behaving according to industry standards on sustainability. However, this is a rigid approach that can effectively ‘gold-plate’ sustainability risk management requirements and may go beyond what is expected for individual projects.

A rigid application of the LMA principles and standards is not envisaged by the LMA itself. They are designed to be applied flexibly, giving financiers scope to apply some pragmatism and commercial sense when subjecting EPC contractors and borrowers to sustainability requirements. To do so will require upskilling and a more holistic and collaborative approach to sustainability risk management. The LMA is also working on a “Transition Finance” framework which will be a welcome addition to the sustainable market especially in hard to abate sectors in which there is potential for large emission reductions.

The International Chamber of Commerce has tried to address the lack of uniform standards and consensus on what constitutes sustainable trade or sustainable trade finance by publishing “Wave 2” of its Principles for Sustainable Trade. The ICC Secretary-General has recognised the growing interest in sustainability, which brings hope for change, but also a greater demand for precision and clarity. Their “Wave 1” framework sets the standards for sustainable trade mainly in the textiles industry and enables banks, businesses, governments, NGOs and regulators to assess transactions in a standardised way and to determine how transactions meet those standards. “Wave 2” is an enhanced set of principles, expanding to other industries like the agriculture, energy and automotive sectors, bringing together learnings from the pilot to increase its breadth and depth, as well as ensuring it is scalable to be applied to global trade transactions.

It will: (i) refocus the core assessment towards “Use of Proceeds” to increase alignment with existing sustainable finance frameworks, (ii) add a standardised means to assess the sustainability of how goods are transported; (iii) implement a “graded score” so that one can articulate and compare the extent to which a trade transaction is sustainable; (iv) enable the use of approved taxonomies and third party sustainability scores to assess transactions; and (v) remove the need for any subjective judgement to increase the robustness of the framework and enable its automation going forward.

The reporting of environmental data is an increasingly strenuous task. In export finance, where the borrower and buyer can be different entities, how is the reporting requirement dealt with?

Typically the reporting requirements on each transaction are agreed with the buyer, borrower and EPC during the finalisation of loan documentation and post review of the environmental and social due diligence conducted on the project by export credit agencies and the financiers.

Each export finance transaction is bespoke and reporting requirements are not standardised. To increase efficiency and bring down cost, there needs to be consistency in the market on reporting, so that financial institutions, ECAs, EPC contractors, borrowers and professional advisors can enter into sustainable transactions knowing what will be required in terms of environmental due diligence and reporting from the outset.

At times borrowers also question the rationale of default-related provisions in the loan documentation as a result of non-compliance with environmental reporting deliverables, where the latter in reality sit under the purview of the buyer. A more standardised methodology (with some scope of making it project-specific) would help borrowers understand basic requirements around monitoring.

As a standard, for sovereign financings, the borrower should ensure reporting requirements are met by the buyer as part of the covenants agreed in the loan documentation. In practice, the reporting deliverables and prepared and submitted to the buyer by the underlying EPC contracted on each project, who has direct visibility of ESG deliverables on ground. In this case therefore it is important to engage EPCs who employ teams with knowledge of international ESG standards, and have the ability to monitor and report on these requirements on a timely basis. In parallel, it is equally important to have buyers with systems that ensure efficient delivery of information to the EPCs for completion of monitoring reports where necessary.

A useful option is to have project implementation units (PIUs) in place at the buyer / regulatory authority level for development projects, with clear roles and responsibilities identified. In order to have efficient implementation of these PIUs, it is necessary that agencies and financiers invest time and resources towards conducting workshops at buyer-level (vs. only interacting with the borrowers) and engage in capacity building exercises for the sustainable upskilling of human capital and project implementation.

Further, there is a need for export credit agencies and financiers to develop an understanding of availability of local information on various ESG deliverables in order to determine and implement monitoring requirements that are achievable in the context of local data (as opposed to using boilerplate requirements from developed markets and trying to implement those in developing and emerging markets in the name of improving ESG standards).

Conclusion – To cover what actions you would like to see the market take moving forward to maximise sustainability impact

There is merit in developing a robust, certified new sustainability labelling system, such as FAST Infra Label, as it could offer institutions a simpler way of satisfying themselves as to the sustainability risks in a project while being cross-cutting of the different standards in operation. Labelling could especially help unlock capital in the context of transition finance, where there is an urgent need to accelerate investment in clean energy and other carbon-reduction projects to meet international climate targets.

More broadly, however, export financiers need to be willing to work in partnership with EPCs to recognise the fact that projects are run differently in developing or emerging markets relative to the developed world. The differences between a sustainability-linked transaction in the developed world compared to in the developing world or hard-to-abate sectors means that the application of standards cannot be uniform. In the developing world especially, there is a pressing need for new transport, health and sanitation projects – potentially life-changing infrastructure. There is a balance to be struck between meeting sustainability standards from a climate protection perspective, whilst at the same time not adding delay to, and pushing up the cost of, delivering such projects by imposing overly burdensome sustainability requirements, particularly in countries where the swift development and conclusion of these projects is needed the most.

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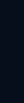
Influencing the ecosystem: In conversation with Igneo Infrastructure Partners

Niall Mills, Managing Partner and Global Head of Igneo Infrastructure Partners

Sophie Durham, Managing Director, Head of Responsible Investment, Igneo Infrastructure Partners



In this Q&A interview, Niall Mills and Sophie Durham, of the leading infrastructure investor Igneo Infrastructure Partners, discuss the firm's approach to sustainability, its "improve not exclude" approach to funding and how combining decarbonisation with circular economy initiatives generates value.

1. Igneo has repeatedly shown that sustainability is investible, leading the field in impactful infrastructure investment for nearly 30 years. Why have you adopted this approach as a business model?

Igneo's strategy is to generate stable, long-term returns for our investors through building a diversified portfolio of mature, mid-market, unlisted, income-generating infrastructure companies.

Our portfolio companies typically operate large, physical assets, which can often have a significant impact on the environments and communities in which they operate. These companies provide essential services to the economy and to communities, so it is vital that they offer security of supply and have a strong social license to operate. Health and safety risks can be high due to the nature of the assets and the work involved. Several of our portfolio companies must also navigate energy transition risks and opportunities, as the world shifts from fossil fuels to renewable energy.

Although none of our current range of funds has an explicit sustainable investment objective or "impact" strategy, the infrastructure investments we make can only be managed successfully, maximising long-term value for our clients, if we identify and manage the material environmental, social and governance risks and opportunities. We treat these issues with equal weight as commercial, financial, legal, technical and other matters. As well as mitigating risk, improving performance can result in positive environmental and social impacts while fostering long-term value creation.

2. Responsible Investment is a cornerstone of your philosophy and you specifically call out the importance of "improvements not exclusions". Why take this approach when other financial institutions are increasingly issuing exclusionary funding statements?

Our approach is firmly grounded in a philosophy of improving performance on environmental, social and governance issues to reduce risks and help generate long-term value, rather than excluding certain companies or industries altogether.

We will only pursue investment opportunities if we believe the business can be sustainable in the long term, and that we can make any necessary improvements during our ownership to make this happen. However, where possible, we believe that we can significantly increase long-term value and have positive environmental and social impacts.

Our investment in MVV Energie is a great example of this. MVV is a German utility that operates along the full energy supply chain. Like many of its peers, MVV has a history of over 150 years and has traditionally relied on fossil fuels to generate power and heat for its customers. This was a key area for due diligence pre-acquisition. At the time, MVV was already one of the first among its peers to recognise the importance of transitioning to net zero, with targets to phase out coal in the mid/late 2030s and reach net zero by 2050.

Working with our co-shareholder, the City of Mannheim, we have significantly accelerated progress towards these targets since investing in MVV. Our new business plan will see MVV invest €7 billion in the next decade, to phase out coal up to 10 years earlier than originally planned and achieve net zero 15 years earlier, by 2035. In fact, MVV expects to be "climate positive" at this point, capturing and permanently storing more carbon than the company emits (and generating new revenue streams in the process).

Of course, it's about real action, not just targets, and MVV has made significant progress towards its goals. In 2024, MVV launched its innovative river heat pump on the Rhine, one of the largest of its kind in Europe. This will displace coal use at the GKM power plant and supply climate-friendly heat to around 3,500 households. MVV has also implemented its first carbon removal project: c.1,000 tonnes of CO2 per year is captured at the company's bio-waste anaerobic digestion plant in Dresden and either used in the production process or liquified and permanently stored in demolition concrete. MVV has installed a carbon capture pilot plant at its Mannheim energy-from-waste facility, which is currently testing the capture, liquefaction and loading of CO2, for scaling up in the future. The company has also increased its proprietary electricity generation from renewable energies to 633 MW, representing 41% of all generation.

These initiatives helped to deliver a more than 25% decrease in MVV's scope 1 and 2 emissions from 2023-24, amounting to a reduction of almost 1 million tonnes of CO2 in a single year.

An exclusionary approach might have prevented us from making the investment in MVV Energie. By going ahead, making long-term investments and focusing on improvements, we are avoiding millions of tonnes of GHG emissions. MVV has also been an extremely successful financial investment for our investors.

There are many similar examples in our portfolio – whether it's building the world's largest electric ferry at Scandlines, meeting almost 10% of Portugal's total electricity production with renewable energy at Finerge, or working with our customers to prepare for more sustainable marine fuels at Evos. Every company has initiatives in place not only to manage risks but also to capitalise on the huge opportunities presented by the energy transition and other environmental and social challenges.

3. You naturally partner with the loan market to acquire liquidity for your investments. How do you communicate your sustainability commitments to the loan market?

Our commitment to sustainability is a key driver of our success, even without explicit sustainable investment or transition labelling.

Our financing approach aligns with our goal to support the transition and sustainability strategies of our investee companies by using debt products that provide additional incentives to improve their sustainability KPIs. We have set ourselves an ambitious target to incorporate green financing frameworks, green loans, or sustainability-linked loans into the capital structure of our investee companies, to the extent feasible and accepted by the lending market within their respective sectors.

In response to evolving expectations from the lending community, infrastructure issuers who adopt these products are now expected to adhere to more stringent criteria and ensure that any targets outlined in the lending documentation are sufficiently ambitious to demonstrate a serious commitment to reducing environmental impact, enhancing sustainability and improving conditions for the communities in which they operate.

These targets and their measurements, once deal-specific and self-assessed, are becoming more standardised and require external definition and verification. We welcome this trend and we are committed to support it as it enables more certain comparisons across asset classes and sets clear and ambitious thresholds for the entire industry.

Currently, four of our European assets have implemented a combination of these financing products, and we are dedicated to applying this approach to virtually all of our assets as they come up for refinancing.

4. Looking specifically at some of your projects. Not only are you bringing about accelerated decarbonisation pathways, but also implementing circular lifecycles of assets. Can you share examples and explain how this is intrinsically linked to value creation?

Our UK energy-from-waste business is a fantastic example of combining decarbonisation with circular economy initiatives and generating real, sustainable value in the process.

enfinium is a leading British energy from waste operator. The company converts residual, non-recyclable household and industrial waste into heat and reliable baseload power for the electricity grid. It processes around 2.3 million tonnes of waste per year, equivalent to the "black bin" bags produced by more than two million UK households annually. The only other options for dealing with this waste are to export it (making it someone else's problem) or send it to climate-damaging landfill. By using it to generate electricity, we are reducing GHG emissions and extracting the maximum value and energy potential of the waste. Generating value from key by-products of the combustion process also contribute to the circular economy: enfinium recycles all of its incinerator bottom ash (IBA), for example, to recover ferrous metal scrap, which is recycled into new steel and aggregates for use in construction.

In 2024, enfinium took a major additional step, releasing a Net Zero Transition Plan that will see the company invest c.£1.7 billion achieve net zero in its operations by 2033 and deliver the net removal of up to 1.2 million tonnes of carbon from the atmosphere per year by 2039. The plan shows how, by installing carbon capture technology at all enfinium sites, the company can capture and remove carbon from both the fossil and the biogenic content of the waste it processes – neutralising enfinium's Scope 1 emissions and also generating high-quality carbon removals, which could be traded and generate a new revenue stream for the business. The vision is to transform enfinium from a waste management company into a carbon removals business powered by unrecyclable waste.

enfinium is already making progress to implement its net zero plan, including a £200m investment commitment to install CCS at its Parc Adfer site in North Wales. enfinium has also launched the UK's first energy from waste carbon capture pilot at its Ferrybridge 1&2 facilities, which will commence operations this summer (similar to MVV's pilot project). Other ongoing investments to decarbonise enfinium's operations include the installation of gale breakers at the Ferrybridge 1 site to significantly enhance the energy efficiency of operations. In February, enfinium's carbon capture project for Ferrybridge 1 and 2 was designated a "Project of National Significance" by the Secretary of State for Energy Security and Net Zero.

5. Finally, sustainability is more than a focus on the environment, it is also a focus on people. How have you integrated the social factor into your decision-making processes?

While the environmental element of ESG gets a lot of attention, social factors are critical.

As part of Igneo's Five Minimum Standards, we prioritise key practices around health and safety, diversity, good governance and employee engagement (with climate change forming the fifth minimum standard).

Health and safety is our immediate priority following new investments.

Our portfolio companies employ over 20,000 people globally and around 11,000 more as contractors. We have a responsibility to foster a culture where risks to their health and well-being are actively managed and mitigated. We are proud that when you look across our global portfolio, the average portfolio company Accident Frequency Rate has decreased by 60% within three years of Igneo ownership.

When it comes to diversity, our aim is to see at least 30% female representation across the board in our portfolio companies, and we are now very close to this among our companies' board representatives and senior management teams in particular (as well as now reaching 45% female representation in Igneo's own team).

Finally, labour rights and modern slavery have been a key area of focus, particularly in the supply chains of our portfolio companies. Forced labour risks in solar panel supply chains are a priority. We first issued guidance on this topic for our portfolio companies in 2022, including suppliers that should be avoided due to a heightened level of risk and additional due diligence and mitigation measures we expect our companies to take when procuring panels. We will be updating our guidance in 2024 to reflect new research, our collaboration with a leading international NGO working on this topic, and best practice from our portfolio.

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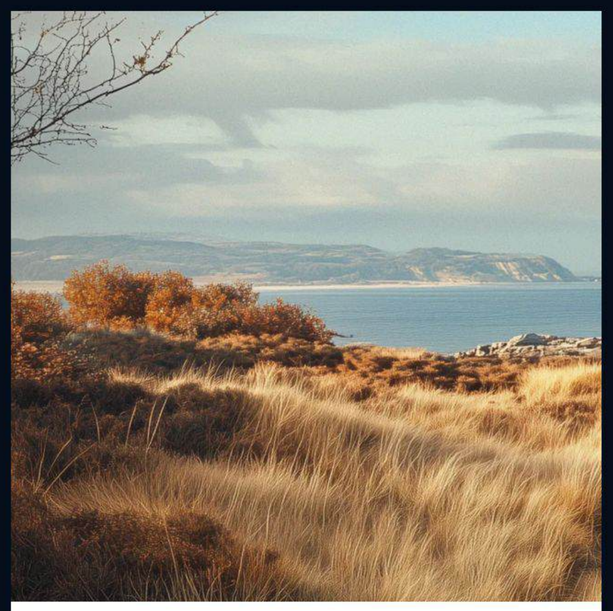
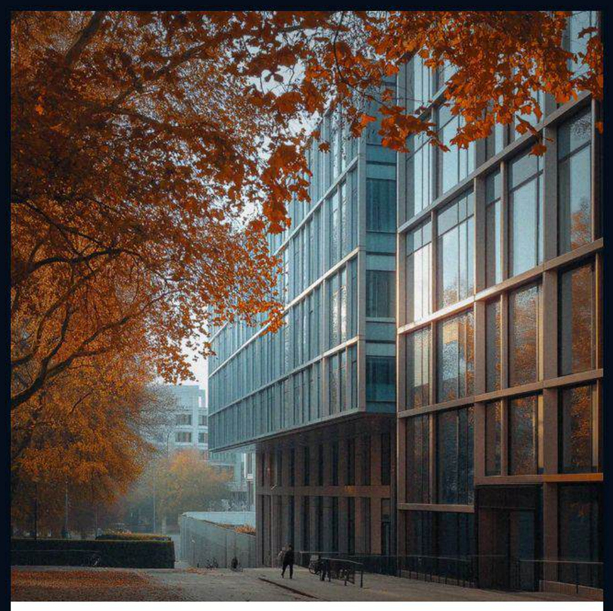
LMA Articles



Financing the Sustainable Blue Economy

Blue ecosystems are vital for human prosperity. In this article we dive into some of the specifics and what resources are available for market participants.

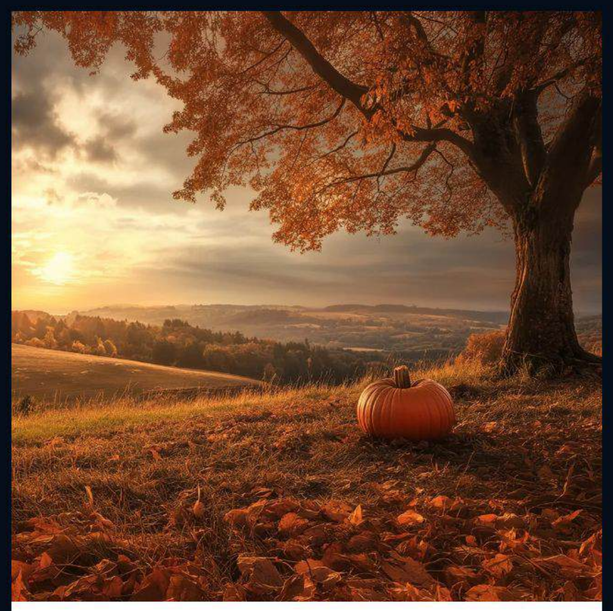
Read more



Call to Action — Sustainability Due Diligence for Commercial Real Estate Lenders

This article explores the use of the BBP's Acquisitions Sustainability Toolkit by lenders.

Read more



The End of ESG?

ESG is dead – or at least you'd be forgiven for thinking that based on recent headlines.

But we disagree – read this article to find out why.

Read more

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Financing the Sustainable Blue Economy

Gemma Lawrence-Pardew, Head of Sustainability, Loan Market Association

Blue ecosystems – coastal and marine ecosystems that are the habitat for many millions of species and provide services and benefits such as food security, livelihoods in the form of fishing or tourism, coastal protection and carbon sequestration – are vital for human prosperity.

They provide the foundation to feed over three billion people, provide direct and indirect employment for around 350 million people[1] and add around $1.5 trillion annually to the global economy.[2]

Human activities, such as overfishing, pollution and unchecked coastal development, endanger the health of these ecosystems putting the vast value they provide at risk. With around half the world's population living close to ocean and coastal ecosystems[3], investment in the sustainable blue economy is needed now, but it must be done in a way that is compatible with a healthy ocean and stable climate.

"The blue finance space is gaining traction and vital to help protect our ocean from dangers such as overfishing. Science-backed approaches, such as credible and robust certification schemes, play a key role when designing products that can contribute positively to a sustainable blue economy."

Ray Dhirani, Head of Capital Markets Outreach at the Marine Stewardship Council & Aquaculture Stewardship Council

At last year's LMA Sustainable Finance Conference, we asked delegates to identify the most pressing issues in the sector, and blue finance was high on the agenda. To proactively address this, we convened experts to establish what the loan market could do to promote investment in blue projects. The answer centred on education. Blue investors (both actual and wannabe) can already access a wealth of information (see below) – our role at the LMA is to make it known to enable progress to be made on this critical agenda!!

1. https://blogs.worldbank.org/en/jobs/how-can-blue-economy-drive-development-and-jobs-youth
2. Ibid
3. A. Nobel (2024), 'Blue Finance: Closing the water financing gap.' , <Blue finance: Closing the water financing gap – Rabobank>

Financing Blue Opportunities

As is so often the case in sustainability, definitions are crucial when discussing the blue economy. Its scope is often uncertain – questions arise as to whether it captures oceanic and freshwater projects, or one or the other. Furthermore, is "blue" a colour in its own right or merely a theme falling under the "green" label?

We take the view that the term 'blue finance' is a theme under the 'green' label, which captures both oceanic and freshwater projects. There is already a plethora of information available in the market to aid with the financing of both, a non-exhaustive list of which can be found at the end of this article.

In addition, there are success stories to learn from. These include the Rockefeller Asset Management/UBS Ocean Engagement fund[4], which identified investable opportunities worth more than $1.1 trillion in areas such as wastewater treatments or sustainable aquaculture, as well as the DWS Concept ESG Blue Economy Fund[5].

4. https://www.rockco.com/media/ubs-launches-ocean-engagement-fund-in-collaboration-with-rockefeller-asset-management/
5. https://funds.dws.com/en-ch/equity-funds/lu2306921490-dws-concept-esg-blue-economy-lc/

Applying Sustainability-Linked Loans (SLLs) to blue finance?

Entities in the blue sector can access sustainability-linked and use of proceeds structures. With respect to the application of SLLs, discussion will inevitably center on the materiality of key performance indicators and ambitiousness of sustainability performance targets. In selecting appropriate targets, help is at hand in the form of the UNEP FI's 2024 Setting Sail: Target setting in the Sustainable Blue Economy[6], which provides robust guidance for setting blue KPIs and ICMA's Illustrative KPI-registry[7], which includes a range of sustainability KPIs to measure performance and impact across both ocean and freshwater ecosystems.

What is clear is that a sustainable blue future is on our horizon and we will be keeping our members updated on developments in this rapidly growing area.

Publications

- UNEP FI's 2018 Sustainable Blue Economy Finance Principle[8] and supporting sector specific guidance (Turning the Tide and Diving Deep)[9]
- APLMA, LMA and LSTA's 2018 Green Loan Principles[10]
- ADB 2021 Sovereign Blue Bond Quick Start Guide[11]
- IFC's 2022 Guidance for Blue Finance[12]
- ADB's 2022 Ocean Finance Framework[13] and Green and Blue Bond Framework[14]
- ADB, ICMA, IFC, UNEP FI and UN Global Compact's 2023 Bonds to Finance the Sustainable Blue Economy, A Practitioner's Guide[15]
- Rabobank's 2024 Blue Finance: Closing the water financing gap[16]
- TNFD's 2024 Additional Sector Guidance - Aquaculture[17] (and forthcoming fisheries guidance)
- The World Bank Group's 2024 Global Aquabusiness Investment Guide : A Living Framework to Guide Sustainable Development in the World's Fastest Growing Food Sector[18]
- UNEP FI's 2024 Setting Sail: Target Setting in the Sustainable Blue Economy[19]
- EIB, Finance Earth's 2024 Identifying investment opportunities for EIB to support improvements in fishery sustainability[20]

6. https://www.unepfi.org/publications/setting-sail-target-setting-in-the-sustainable-blue-economy/
7. https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/
8. https://www.unepfi.org/blue-finance/the-principles/
9. https://www.unepfi.org/blue-finance/resources/
10. https://www.lma.eu.com/application/files/8916/9755/2443/Green_Loan_Principles_23_February_2023.pdf
11. https://www.adb.org/sites/default/files/publication/731026/adb-sovereign-blue-bonds-start-guide.pdf
12. https://www.ifc.org/content/dam/ifc/doc/mgrt/ifc-guidelines-for-blue-finance.pdf
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14. https://www.adb.org/sites/default/files/publication/731026/adb-green-blue-bond-framework.pdf
15. https://www.icmagroup.org/assets/documents/Sustainable-finance/Bonds-to-Finance-the-Sustainable-Blue-Economy-a-Practitioners-Guide-September-2023.pdf
16. https://www.rabobank.com/knowledge/d011423183-blue-finance-closing-the-water-financing-gap
17. https://tnfd.global/publication/additional-sector-guidance-aquaculture/
18. https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099051424100040397/p5031171986f9e0bc1ba561d4aebd9fcca9
19. https://www.unepfi.org/publications/setting-sail-target-setting-in-the-sustainable-blue-economy/
20. https://finance.earth/wp-content/uploads/2024/01/EIB-Report-Investment-Opportunities-in-Fishery-Sustainability-vFinal.pdf

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Call to Action — Sustainability Due Diligence for Commercial Real Estate Lenders

Hannah Vanstone, Lead Sustainable Finance Regulatory Affairs Officer, LMA

On Monday 16th September, the Loan Market Association (LMA), together with the Better Buildings Partnership (BBP) and CREFC Europe (CREFCE), hosted a roundtable meeting attended by various lenders active in the commercial real estate lending market, which explored the use of the BBP's Acquisitions Sustainability Toolkit (the Toolkit) by lenders.

The Toolkit was relaunched by BBP in February 2024 and gives commercial property owners practical guidance on how to ensure sustainability risks and opportunities are reviewed during the acquisition process. The Toolkit is divided into 3 parts namely: (i) the Sustainability Investment Checklist, which sets out information required during the due diligence process; (ii) the Investment Critical Decision Trees, which have been developed to help property owners identify risks and determine any mitigation measures; and (iii) Asset Onboarding, which provides important questions that should be considered post-acquisition. Importantly, to help guide lenders, the Sustainability Investment Checklist highlights specific checks deemed high priority for lenders, based on feedback from members of CREFCE and LMA.

We believe it is important for lenders, buyers, vendors and agents to be aligned on the sustainability due diligence as far as possible in order to reduce friction in the market, improve efficiency and to ensure that sustainability considerations can be properly taken into account. This is an area where industry collaboration is therefore key to ensure that the right tools are available to promote constancy and efficiency in the market.

Feedback from participants indicates that the list of high priority questions for lenders in the Sustainability Investment Checklist are useful but may still be too detailed as a starting point. We are calling for on you, our members, to provide feedback on your experiences of using the Toolkit, particularly the list of priority questions for lenders included in the Toolkit.

We intend to host a follow up meeting in January 2025 with market participants to identify whether any follow up work is needed to evolve the guidance in the Toolkit to reflect what lenders need. If you would like to provide feedback, be involved in this work or find out more, please reach out to me (hannah.vanstone@lma.eu.com).

"The BBP's Acquisitions Sustainability Toolkit, refreshed in 2024, seeks to create more consistency in how commercial real estate buyers, vendor and agents address sustainability during due diligence. It is crucial that lenders are on board with this too, and we are delighted to be working with members of LMA and CREFCE to explore how this alignment can be extended to the lending community".

Adam Baranowski, Head of Climate Action & Investment, Better Buildings Partnership

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The end of ESG?

Hannah Vanstone, Lead Sustainable Finance Regulatory Affairs Officer, LMA

ESG is dead – or at least you'd be forgiven for thinking that based on recent headlines.

But we disagree. Indeed, ESG is still very much alive and kicking. However, it is our view that, just as summer recently transitioned into autumn in the UK, ESG is entering a new season – a complex and critical one that will determine its long-term legacy.

Has ESG had its day in the sun?

Recent data from the labelled loan market does point to a dampening of spirits. SLL volumes have fallen 19% from their peak in 20221 and green loans remain a relatively small part of the market at 4.52% (Bloomberg, 02/09/24). Similarly, net monthly outflows from ESG equity funds stood at a record level of $14bn in April 2024.2 There is already evidence that factors including the anti-ESG backlash, increasing scrutiny around ESG claims and increased regulation have led some to pull back from making claims about their ESG credentials (so-called "greenhushing").[3]

Beyond these headline figures, there are deeper trends which may be driving a structural shift of the market away from ESG:

1. Politics

2024 is a record year for elections, and in the US and elsewhere, ESG has become a political issue – even being branded as an example of "woke capitalism".[4] The outcome of elections will undoubtedly shape the future impact of ESG.

Following the results of the European Parliament elections in June this year, some have already predicted that we could see a weakening of existing climate laws over the next five years.[5] A recent Economist article further suggested a win for Trump may lead to the EU Taxonomy being amended to permit more investments in defence.[6]

However, the picture is not universally clear. In the United Kingdom, for example, the newly elected Labour party has already announced a host of policies aimed at combating climate change, including a vow to lift the de facto ban on onshore wind farms.[7]

2. Macroeconomic factors

Macroeconomic conditions and geopolitical tensions have added to the headwinds for ESG. Higher interest rates have made financing more challenging, and against this backdrop ESG may have fallen down the priority list for treasury teams with limited time and resources.

The war in Ukraine has reminded many market participants of the importance of energy security and boosted demand for oil and gas companies. Meanwhile, the relative underperformance of ESG investments[8] (for example, from May 2023 to May 2024, global sustainable equity funds made an 11% return, compared with 21% for conventional stock funds)[9] has raised the question of whether pursuing ESG goals is at odds with investor returns and asset managers' fulfilment of their fiduciary duties.[10]

3. Greenwashing and ESG litigation risk

High profile greenwashing cases have hit the headlines over recent years, causing reputational and often financial damage to those involved. These cases have spurred the development of anti-greenwashing regimes worldwide, in which making excessive claims about ESG credentials risks incurring fines or other regulatory sanctions. Similarly ESG litigation - and climate litigation in particular - poses another risk, with over 2,700 cases currently captured in the Sabin Center for Climate Change Law's climate change litigation databases.[11] Many of these cases have centred on claims of climate neutrality or other environmental claims.[12]

1. M. Kuchtyak 'In 2023, global SLL volumes tumbled 19% to $548 billion from a record-high of $677 billion in 2022.' (2024): 'Quality is key to growth in sustainability-linked loans' <Quality is key to growth in sustainability-linked loans :: Environmental Finance (environmental-finance.com)
2. Investors pull cash from ESG funds as performance lags (ft.com)
3. What is 'greenhushing' and is it really a cause for concern? | World Economic Forum (weforum.org)
4. What are ESG and 'woke capitalism'? State treasurers weigh in on fight over where tax money goes - ABC News.
5. Explainer: From trade to climate, five takeaways from the EU election | Reuters
6. Investors exit clean energy funds as higher interest rates bite | Reuters.
7. Policy statement on onshore wind - GOV.UK (www.gov.uk).
8. This statistic is quoted in the FT, attributing it to a May report from J.P Morgan.
P. Temple-West and W. Schmitt (June 2024): 'Investors pull cash from ESG funds as performance lags'
9. Investors pull cash from ESG funds as performance lags (ft.com)
10. Environmental, Social, and Governance Factors v. Fiduciary Duty - JSTOR Daily
11. About - Climate Change Litigation (climatecasechart.com)
12. Majority of climate-washing litigation succeeds in producing positive outcomes but prompts companies to proceed cautiously - Thomson Reuters Institute

Are we at the start of the end of ESG already?

In a word: no. The reasons why are numerous and include the following:

1. Regulation

Corporates already operate within the context of a number of recent ESG regulatory regimes. In Europe, these include ESG reporting requirements arising from the Corporate Sustainability Reporting Directive and other reporting regimes. Banks and non-bank financial institutions are similarly caught by a range of ESG disclosure requirements under regulations in the UK and EU.

At an asset level, there is a risk that assets become 'stranded' – that is, that they lose significant value or become liabilities due to changes in the market or regulatory environment. This risk is already starting to materialise in certain sectors (e.g. price differentiation between top-rated and poorly performing real estate assets[13]).

2. Risk management

Neither ignoring ESG nor greenhushing are likely to be an effective long-term solution to managing the risks arising from environmental, social and governance factors. It will not, for example, protect against transition risk, where minimum regulatory standards are imposed by law. Nor will it protect against climate-litigation risk, where business activities can be linked to environmental or social harm. Companies that resist integrating ESG into their decision-making aren't merely missing out on opportunities, they risk being left behind.

3. The Value Proposition

Finally, it is impossible to ignore the focus of investors on ESG.

A recent survey from PwC reported that three quarters of investors agree that how a company manages sustainability-related risks and opportunities is an important factor in their investment decision-making.[15] ESG matters are already integrated into investment decision-making processes throughout the market. Companies therefore need to be prepared for detailed questioning about a range of ESG issues and how they will transition their existing business activities.

13. How the conversation around green real estate is changing | World Economic Forum (weforum.org)
14. Gao, Yumeng and Herbert, Benjamin and Melin, Lionel, The ESG Disclosure Premium (April 24, 2024). Available at SSRN: https://ssrn.com/abstract=
15. Global Investor Survey 2023 | PwC

ESG remains well and truly on the agenda.

So while some may not be shouting about ESG matters quite so loudly now, ESG remains well and truly on the agenda. Those who fail to take ESG seriously may find themselves stuck out in the rain without an umbrella for cover.

We will be discussing in more detail how politics is shaping the ESG agenda as well as the value proposition for sustainability at our upcoming Sustainable Finance Conference on 7 November.

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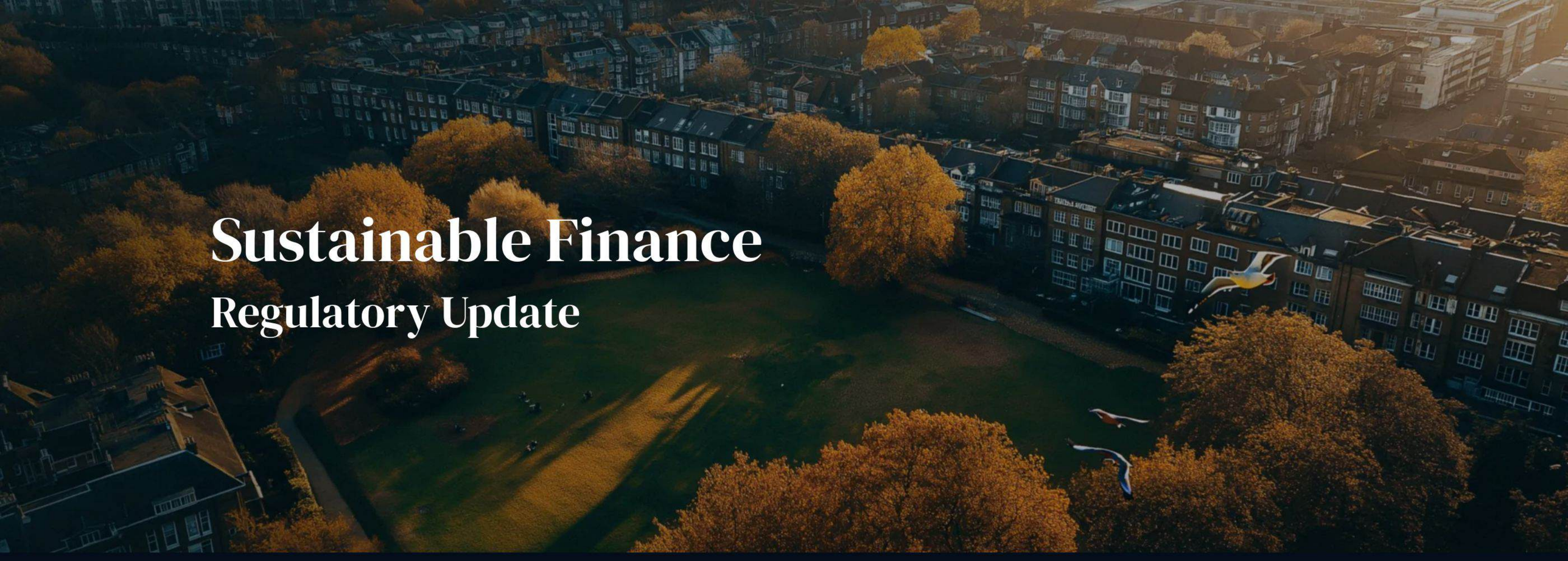

Sustainable Finance

Regulatory Update

Navigating the key sustainable finance regulations across EMEA

Sustainability Assembled

Regulatory and Standards Tracker

London is distinctly autumnal as we approach the end of September. With summer behind us, we expect a flurry of activity across EMEA in the sustainable finance regulatory landscape.

Earlier this month, the former European Central Bank President Mario Draghi released his report, *'The Future of European Competitiveness'*,[1] which highlights the importance of getting the regulatory framework right. His findings will contribute to the European Commission's work on a new plan for sustainable prosperity and competitiveness as well as the development of Europe's new Clean Industrial Deal. Draghi stresses the need for radical change to boost productivity and restore Europe's competitive edge against the US and China.

Global decarbonisation, as Draghi highlights, represents a key industrial growth opportunity for the EU – provided the right policies are in place. However, he points out that regulatory burdens have become a significant obstacle to Europe's competitiveness. Indeed, more than 60% of EU companies see regulation as a barrier to investment, with 55% of SMEs citing regulatory hurdles and the administrative burden as their greatest challenges.[2]

For sustainable finance across EMEA, getting the regulatory landscape right is also essential to enhancing liquidity sufficiently for transition and green innovation. Legislative change in this area has been rapid and a complex ecosystem of sustainable finance regulation has evolved across EMEA. Striking the right balance between maintaining the integrity of sustainable finance products and allowing the flexibility for continued innovation is crucial. ***The Loan Market Association will continue its active dialogue with regulators*** to address key opportunities and challenges in financing the global transition.

As mentioned in the last edition of Horizons, I am collaborating with King & Spalding on a Greenwashing Insights Report to highlight the impact of greenwashing risks on the loan market and will explore the tools available to help market participants. ***I would be delighted to hear your views – please feel free to reach out if you'd like to get involved.***

I am currently working on our Sustainable Finance Regulatory Committee project agenda for 2025. Please do complete this survey to let us know your views on where we can help.

You can also contact me direct at hannah.vanstone@lma.eu.com.

Hannah Vanstone
Lead Sustainable Finance Regulatory Affairs Officer, LMA

1. 'The future of European competitiveness – A competitiveness strategy for Europe', Mario Draghi (September 2024) EU competitiveness: Looking ahead - European Commission (europa.eu).
2. As above.

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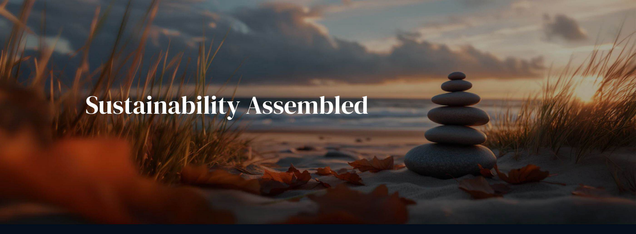

Sustainability Assembled

Sukhvir Basran, ESG Partner, King & Spalding

sbasran@kslaw.com

Regulatory and Standards Tracker

As we come to the end of the third quarter of 2024, in this issue of Sustainability Assembled we consider how policy makers and regulators are supporting market participants to ease the burden of regulatory compliance whilst also addressing greenwashing risk.

With Climate Week in New York upon us, in this issue we remind ourselves of the key recommendations set out in the Report on the Future of European Competitiveness (the **Draghi Report**). The need for public and private collaboration in mobilising capital and ensuring social cohesion during the transition have been highlighted in the Draghi Report and will also no doubt feature high on the agenda across New York this week. As policy makers consider the impact of regulation on SMEs and mid-caps, it is worth reminding ourselves of the importance of the loan market in a just transition. The LMA has published the Sustainability-Linked Loan Principles, Green Loan Principles and Social Loan Principles, as well as additional supporting documents such as the sustainability-linked loan model provisions, the accompanying term sheet and the sustainability coordinator letter. The LMA has also recently started work on the development of a transition use of proceeds label. The suite of labelled loan products is versatile and intended to be used across the market and can therefore be used in conjunction with benchmarks and ESG standards to create innovative financing structures accessing greater liquidity whilst maximising impact and addressing risk. This can include for example, blended finance structures or green loans which are aligned to investor ESG demands, and which increase efficiencies for borrowers by utilising data and information gathered for regulatory compliance.

Although the Draghi Report refers to a lack of guidance as a barrier for regulatory compliance, this quarter has seen the publication of additional guidance and support in the form of Q&As, mapping and alignment tools and guidance in Europe. The UK Financial Conduct Authority (FCA) has also provided additional time and support to firms in order to meet the higher standards of disclosure under the UK's Sustainability Disclosure Requirements.

The Draghi Report

According to the Draghi Report, a minimum annual additional investment of EUR 750-800 billion is needed to achieve the objectives set out in the report. This needs to be a combination of both private and public capital and further changes to the financial sector are recommended in order to ensure that such finance is suitable for the levels of innovation required for a just transition.

One of the key recommendations of the Draghi Report is to reduce the regulatory burden on companies, particularly SMEs. The Drahi Report highlights the well-known challenges faced by companies and market participants as a result of the accumulation and frequent changes to regulation across the EU. It also points to the cost of compliance and the overlap and inconsistencies between sustainable regulation, made worse by the lack of available guidance to assist companies to navigate the interaction between various pieces of regulation.

The recommendations included in the Draghi Report include the appointment of a new commission Vice President for Simplification to streamline and quantify the flow of regulation and cutting regulation for SMEs by a further 50% upholding proportionality for SMEs and extending it to mid-caps.

There has been a mixed response from the market on the analysis and recommendations relating to regulation. The evolving and overlapping nature of key pieces of regulation is of course a challenge however some stakeholders consider that any attempted simplification of the regulation may cause additional issues – particularly for those organisations who have designed and implemented controls and processes based on the current and/or anticipated regulatory regime. In addition, this also poses the risk of increasing the misalignment between regulation and market expectations, leaving banks and funds struggling to obtain the information they are required to disclose to investors.

As highlighted by the Draghi Report, there are a number of challenges for SMEs operating across Europe. One of these is that SMEs will need access to capital in order to decarbonise and innovate. The LMA is looking closely at how it can support greater liquidity in relation to the flow of sustainable finance to SMEs. The LMA will be looking to start work on a dedicated project in this area in 2025. **Please contact Gemma Lawrence-Pardew if you are interested in finding out more about this project.**

FCA: Four month extension on "naming and marketing" sustainability rules

On 9 September 2024, the FCA offered firms limited temporary flexibility until 2 April 2025 to comply with the "naming and marketing" rules under the SDR regime. As is widely reported, firms have been busily preparing themselves for compliance with the "naming and marketing" and disclosure rules which will come into force from 2 December 2024.

In its statement, the FCA refers to the "good progress" made by firms and the "strong pipeline" of applications for labels, however acknowledges that firms are struggling to meet the required changes – particularly in meeting the disclosure standards relating to investment labels or when changing the name of products.

Recognising these challenges, the FCA is offering limited temporary flexibility until 2 April 2025 for firms to comply with the naming and marketing rules (ESG 4.3.2R to ESG 4.3.8R of the ESG sourcebook) in relation to a sustainability product which is an authorised investment fund. The extension only applies in "exceptional circumstances" i.e. where the firm (i) has submitted a completed application form for approval of amended disclosures in line with ESG 5.3.2R by 5pm on 1 October 2024; and (ii) is currently using one of the terms "sustainable", "sustainability" or "impact" (or a variation of those terms) as part of the name of the fund and is either intending to use a label, or change the name of the relevant fund.

Firms should note that:

- the temporary measures do not apply to funds which are using any other sustainability-related terms;
- notwithstanding the temporary flexibility, firms are expected to comply with the naming and marketing rule as soon as they can;
- firms should comply with all other relevant rules including the anti-greenwashing rule; and
- firms should already be complying with the FCA's pre-SDR guiding principles.

Further information and analysis in respect of these rules can be found in Horizons01 and Horizons02.

Background

ESMA: Guidelines on Funds' Names

On 21 August, the European Securities and Markets Authority (ESMA) published their translations in official languages of the "Guidelines on funds' names using ESG or sustainability-related terms" (the Guidelines). The aim is to protect investors against unsubstantiated or exaggerated sustainability claims in fund names whilst also clarifying the criteria that asset managers should consider when considering the use of specific terms in fund names.

Firms should note that the Guidelines apply from 21 November 2024 and national competent authorities have two months from this date to notify ESMA whether they (i) comply, (ii) do not comply but intend to comply, or (iii) do not comply and do not intend to comply. The transitional period for funds existing before the application date will be six months after that date (i.e. 21 May 2025) and any new funds created on or after 21 November 2024 will need to apply the Guidelines immediately.

For further information and analysis please see Horizons01 and Horizons02.

ESMA: Updated Consolidated Q&A on the Sustainable Finance Disclosure Regulation (SFDR)

In July, ESMA published an updated consolidated Q&A in relation to the SFDR and SFDR RTS which includes Q&A relating to Principal Adverse Impact, calculations relating to sustainable investments and scoping.

The SFDR has also featured in a number of regulatory updates and reports this quarter including (i) ESMA's opinion aimed at improving the usability and coherence of the EU Sustainable Finance regulatory framework – which included recommendations to phase out the concept of 'sustainable investments', (ii) the additional guidance published by the Taskforce for Nature-Related Financial Disclosures (TNFD) which maps the SFDR Principal Adverse Impact Metrics to TNFD core metrics, and (iii) the Commission's FAQ relating to the Corporate Sustainability Reporting Directive which clarifies certain provisions of SFDR (see below for additional details).

These developments, whilst welcome, also illustrate the challenge highlighted in the Draghi Report and emphasise the need to improve usability and understanding of the SFDR in an efficient and comprehensive way. With uncertainty remaining over the future of the SFDR (see Horizons01), market participants continue to grapple with challenge of scoping and implementing SFDR.

Further information and analysis in respect of SFDR can be found in Horizons01 and Horizons02.

Spotlight on the "S"

The "S" in ESG or social factors are often lower on the agenda for market participants and companies, with reasons cited including the lack of regulatory focus, lack of quality/disaggregated data and information and the absence of relevant benchmarks and standards. In the loan market, this perception has not prevented large number of sustainability-linked loans from including a social KPI (often a gender-related KPI) and for increasing social loan issuance with a gender lens. The LMA, together with 2X Global and Sukhvir Basran at King & Spalding are working on the "Gender Lens Guidelines" for the loan market. These guidelines aim to bring the breadth and experience of 2X Global (including their recently launched 2X Certification) to the private sector in order to support the integration of gender lens terms and KPIs in sustainable loan products. We would be delighted to hear your views. Please feel free to reach out if you would like to be part of the reviewing group.

In the wider market:

- The Draghi Report (see above) emphasises the need for a just transition recognising that policymakers must not repeat past mistakes in being insensitive to the social consequences of growth and innovation. The report highlights the crucial need for the transition to increase growth and innovation whilst also ensuring social inclusion. This includes the need for increased public services, housing, education and training as well as childcare during the transition and stakeholders must be aware of the unintended social consequences of innovation and automation. As programmes are developed there is also a need to be inclusive across regions and cities with a focus on cohesive policies.
- In July 2024, the World Benchmarking Alliance (WBA) launched the 2024 Social Benchmark Insights Report. The 2024 Social Benchmark assesses the SDG2000 – companies identified by the WBA as 2000 of the world's most influential companies. The 2024 Social Benchmark focuses on performance by these companies in respect of human rights, providing decent work and ethics. The WBA's report sets out 18 indicators which aim to assess the extent to which a company is effectively contributing to a just transition and overall highlights the gap between current corporate practices and expectations for the creation of a just and equitable transition to a sustainable future.
- The European Banking Authority has published a report on the application of gender-neutral remuneration policies by institutions and investment firms. The review looks at the gender pay-gap and the monitoring of indicators in the area of equal pay and opportunities.

Regulatory and Standards Tracker

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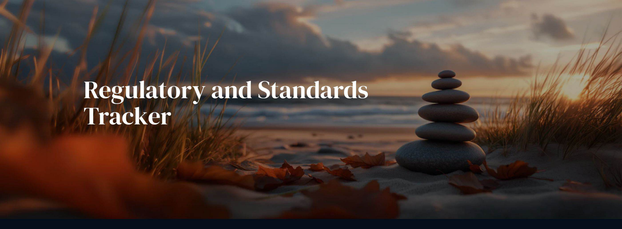

Regulatory and Standards Tracker

ESMA: measures to support corporate sustainability reporting

Link to the original document

The European Securities and Markets Authority (ESMA), published a Final Report on the Guidelines on Enforcement of Sustainability Information and a Public Statement on the first application of the ESRS.

CS3D published in the Official Journal/FAQ

The Corporate Sustainability Due Diligence Directive (CS3D) has been published in the Official Journal of the EU on 5 July 2024. The member states have two years to transpose the CS3D into national laws with CS3D applying the year after.

The Commission has also published related frequently asked questions to assist companies in the application and implementation of CS3D. As well as covering scope and application of CS3D, the FAQs also clarify issues relating to auditing and assurance requirements.

EFRAG releases study on early implementation of ESRS

Link to the original document

EFRAG has released a study into preliminary practices related to the implementation of European Sustainability Reporting Standards (**ESRS**). Recognising the nascent stage of implementation, the study aims to provide an overview of emerging practices analysed against four focus areas key to the implementation of ESRS (being materiality assessment, value chain, gap analysis on data and organisational approach). The study also highlights key challenges and is based on information relating to 28 large undertakings based in the EU and includes both financial and non-financial undertakings.

Further information and analysis in relation to the four focus areas and ESRS can be found in Horizons01 and Horizons02.

EFRAG: 23 new ESRS explanations

Link to the original document

EFRAG announced the release of 23 further Explanations for the purposes of providing practical and timely support to stakeholders in implementing ESRS. The explanations have been added to the Compilation of Technical Explanations and increases the number of explanations announced during 2024 to 93. Users will find the additional explanations grouped according to their nature and relevant disclosure requirements. In an effort to improve usability, hyperlinks and a log of questions received can now be found in the Compilation of Technical Explanations.

Further information and analysis in relation to guidance and resources provided by EFRAG can be found in Horizons01 and Horizons02.

EU Commission: FAQs relating to CSRD

Link to the original document

In a further aim to improve usability and increase efficiency, on 6 August 2024, the European Commission published a set of frequently asked questions aimed at supporting users to implement the EU corporate sustainability reporting rules. The FAQs (i) set out the interpretation of certain provisions of Corporate Sustainability Reporting Directive (CSRD), (ii) clarify certain provisions of SFDR and (ii) clarify certain aspects of the first set of ESRS.

Further information and analysis in respect of CSRD, SFDR and ESRS can be found in Horizons01 and Horizons02.

"The EU has taken major steps in building a comprehensive sustainable finance framework over the past six years, encouraging companies to embark on their transition paths. Our focus now is to ensure that our tools are usable and effective, while continuing to reduce the administrative burden on companies."

Commissioner for Financial Services, Financial Stability and Capital Markets Union, Mairead McGuiness.

ESMA Opinion: Sustainable investments: Facilitating the investor journey

Link to the original document

ESMA has published an opinion aimed at improving the usability and coherence of the EU sustainable finance regulatory framework. The opinion takes into account the Joint ESAs Opinion on the SFDR (see Horizons02). The following key recommendations are included in the opinion: (i) the EU Taxonomy should be completed and extended to include a social taxonomy and become the sole, common reference point for assessment of sustainability; (ii) the concept of 'sustainable investments' in SFDR should be phased out; (iii) a number of recommendations have been made in support of the transition including providing a legal definition of transition investments and high-quality standards for transition bonds and sustainability-linked bonds; (iv) adapted transparency recommendations including minimum sustainability KPIs for all sustainability financial products; and (v) introduction of a product categorisation system for sustainable and transition investments

FRC: update to UK Stewardship Code

Link to the original document

The Financial Reporting Council (FRC) announced changes to the UK Stewardship Code application process in July 2024 committing to five key areas as part of the next stage of revisions to the Code. These five areas are: (i) purpose (considering all stakeholder views and clarifying what is meant by effective stewardship), (ii) principles (the reporting that is necessary), (iii) proxy advisors (how the Code can promote greater transparency), (iv) process (reducing the burden of reporting and improving the usability and accessibility of information) and (v) position (aligning and working with other regulators).

FRC assessment: Quality of reporting from private companies

Link to the original document

The FRC issued its second assessment of the quality of reporting from private companies choosing to follow the Wates Principles. The report shows that the Wates Principles are most frequently used amongst large private companies. The assessment highlights some areas of improvements since the last report however indicates that companies continue to find certain key disclosures challenging including outlining purpose, relating such purpose to wider strategy and values and explaining the impact of stakeholder engagement on board decision-making.

TNFD/GRI: alignment and interoperability

The TNFD and GRI have published a guidance document and the TNFD-GRI interoperability mapping aligning the TNFD's Recommendationswith relevant GRI standards.

Please see Horizons01 and Horizons02 for further analysis on TNFD Recommendations, GRI standards and alignment of ESG standards.

TNFD: Additional Guidance for Financial Institutions

Link to the original document

In July the Taskforce for Nature-Related Financial Disclosures published additional guidance for banks, re/insurance companies, asset managers, owners and DFIs. The document includes guidance final TNFD disclosure metrics, mapping SFDR Principal Adverse Impact metrics to TNFD core metrics as well as additional resources and references.

SBTi publishes technical outputs

Link to the original document

The Science Based Targets initiative has published four technical outputs as part of the revision of the SBTi Corporate Net-Zero Standard. The technical outputs include (i) a scope 3 discussion paper (ii) evidence received on the effectiveness of Environmental Attribute Certificates (iii) Synthesis report of evidence on the effectiveness of Environmental Attribute Certificates in corporate climate targets – Part 1: Carbon credits and (iv) Findings of independent systematic review on the effectiveness of carbon credits in corporate climate targets.

Updated Net Zero Investment Framework (NZIF 2.0)

Link to the original document

The updated NZIF revises terminology, criteria as well as the guidance on several asset classes. The updates include: (i) the new Portfolio Decarbonisation Reference Objective has been clarified to better support the goal of "financing reduced emissions" rather than "reducing financed emissions, (ii) new guidance has been included for Sovereign Bonds, Real Estate and Private Debt, Infrastructure and Private Equity, and (iii) new emissions performance criterion for listed equities and corporate fixed income. NZIF also includes examples of best practice.

ICGN: The assurance of sustainability reporting

Link to the original document

The International Corporate Governance Network has published a report which sets out a guide to understanding sustainability reporting, investor expectations regarding sustainability reporting, the quality of external assurance and key questions that investors can consider raising with boards.

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Background: Sustainability Disclosure Requirements (SDR) and investment labels (PS23/16)

The SDR and investment labels regime (PS23/16) were published by the FCA on 28 November 2023 and comprise of a package of measures to assist consumers to navigate the market for sustainable investment products. As part of these package of measures, the FCA introduced an anti-greenwashing rule, naming and marketing rules for investment, four labels to assist consumers in understanding differences between investment products and detailed information in the form of pre-contractual, on-going product level and entity-level disclosures.

The SDR applies on a staggered basis: the anti-greenwashing rule took effect from 31 May 2024 and managers of UK-based investment funds have been able to use the investment labels since 31 July 2024.

Projects

The Green, Social and Sustainability-Linked Loan Principles create the foundations upon which this market can thrive and we continue to work to produce greater clarity, transparency and granularity around these Principles to drive forward sustainable lending liquidity.

This quarter has seen the following activity:

Q2 Publications	WIP
Mandate Letter for SLL Sustainability Coordinator	Model Provisions for Use of Proceeds Transactions
Guidelines for Sustainability-Linked Loans Financing Bond	Transition Task Force
	Annual Review of the Green, Social and Sustainability-Linked Loan Principles

Regulatory Submissions

Q2 Publications	WIP
Transition Finance Market Review Call for Evidence, where we expressed the view that in order to meet climate goals, there is still a vital need to transition various hard-to-abate sectors and that transition finance will be essential to enable this transition to take place.	

Resources

Regulatory Submissions

Q4 2023

European Commission's Targeted Consultation on the Sustainable Finance Disclosures Regulation (SFDR), where we stressed, among other things, the need for further clarity around certain key concepts under the SFDR as well as a need for greater interoperability across global reporting regimes

Q1 2024

UK Financial Conduct Authority's consultation on its anti-greenwashing rule guidance, where we requested, among other things, clearer guidance on market best practice to ensure that market participants understand the correct processes to follow to avoid inadvertent greenwashing.

ESRS enter into force

In December 2023, a first set of sector agnostic ESRS was published in the Official Journal of the EU. The ESRS are intended to apply to all companies falling under the scope of Corporate Sustainability Reporting Directive (CSRD) regardless of the sector that they apply to.

An LMA summary regulatory alert relating to this can be accessed here.

European Financial Reporting Advisory Group (EFRAG) publishes ESRS Implementation Guidance (ESRS IG)

In December 2023, EFRAG released the first three draft ESRS Implementation Guidance (ESRS IG) documents to provide implementation support for organisations preparing their first statements according to ESRS. The following guidance has been made available:

- Draft EFRAG IG 1 - Materiality assessment implementation guidance: describes the reporting requirements on the materiality assessment and includes FAQs on the double materiality assessment and interoperability with other standards;
- Draft EFRAG IG 2 Value chain implementation guidance: describes the reporting requirements on the value chain within the materiality statement (setting out, relevant metrics and targets), considers the reporting boundary of the group for sustainability reporting and includes FAQs to provide further information and includes a 'value chain map' summarising certain value chain implications; and
- Draft EFRAG IG 3 Detailed ESRS datapoints implementation guidance: contains detailed ESRS data points as an excel spreadsheet along with an explanatory note. EFRAG indicates that IG 3 can be used to perform a data gap analysis.

The ESRS IG documents are non-authoritative and are intended to support ESRS. In the event of any inconsistency, the ESRS shall prevail.

ESRS: Two year delay to sector-specific and general standards for non-EU companies

Earlier this year, European Parliament and Council negotiators agreed to a two-year delay with respect to the adoption of sector-specific sustainability reporting standards and those for non-EU companies. The delay is aimed at reducing the administrative burden on companies whilst also allowing European Financial Reporting Advisory Group (EFRAG) additional time to develop the relevant European Sustainability Reporting Standards (ESRS).

The two-year delay for these specific standards affects the extent of reporting for relevant companies but does not affect the existing staggered reporting timelines under Corporate Sustainability Reporting Directive (CSRD). Companies are still required to report on time against the sector-agnostic ESRS (see above).

Sector-specific reporting by companies is considered an important source of information for investors, particularly in the context of "high-risk" sectors such as oil, gas, and mining. The EC will therefore publish sector-specific sustainability reporting standards in eight areas as soon as they are available and before the deadline of June 2026. It is unclear at present which eight sectors the EC will prioritise.

The agreement on the delay needs to be formally adopted by the Council and the European Parliament before it can enter into force (see EU press release).

CSRD and ESRS: Background

On 5 January 2023, the Corporate Sustainability Reporting Directive (**CSRD**) entered into force and from 1 January 2024, CSRD and the European Sustainability Reporting Standards (**ESRS**) will apply to the first group of companies (large EU listed companies, public interest entities and groups as well as large non-EU issuers and groups) for reports published in 2025.

The European Financial Reporting Advisory Group (**EFRAG**) is developing the ESRS, the reporting standards which set out the information that companies will need to disclose and report on in accordance with CSRD. Below, we summarise the most significant developments relating to CSRD and ESRS.

GRI publishes updated Biodiversity Standard

GRI 101 is intended to reflect internationally agreed best practice and also align with new developments to ESG standards and law and regulation including international goals such as the Kunming-Montreal Global Biodiversity Framework, the Taskforce on Nature-related Financial Disclosures disclosure and ESRS E4 Biodiversity and ecosystems.

Key updates include

IFRS Sustainability Disclosure Standards

- the Government is aiming to make ISSB-endorsed reporting standards (UK SRS) available in Q1 2025 following assessment of IFRS S1 and S2 by the UK Technical Advisory Committee
- following positive endorsement and a consultation process, the FCA can use the UK SRS to introduce sustainability-related reporting requirements for regulated UK-listed firms
- a decision regarding future requirements is expected in Q2 2025 at which point, the Government will also consider exemptions from pre-existing requirements under the Companies Act 2006. Any changes would be effective no earlier than accounting periods beginning or after 1 January 2026.

Transition Plan Disclosures

Given the overlap between IFRS 2 and the TPT Disclosure Framework, the FCA will consult in 2025 on enhancing its expectations on transition plan disclosures with reference to the TPT Disclosure Framework. The Government will also consult in Q2 2024 on how the UK's largest companies ought to disclose their transition plans.

SDR and investment labels

The Government has announced its intention to issue a consultation in Q3 2024 on whether to extend the scope of SDR to include funds under the Overseas Funds Regime (OFR). On 1 May 2024, HM Treasury and the FCA jointly published a roadmap for the implementation of OFR.

Green Taxonomy

The UK Government will continue to develop the proposed UK Green Taxonomy and will consult on its design in due course. The consultation will seek feedback on the overarching framework and once finalised, there will be a testing period for voluntary disclosures and use for at least two reporting years before exploring mandating disclosures. A decision as to whether to introduce mandatory disclosures against the Taxonomy has not yet been taken and is reserved until such a time that the consultation is complete.

Key Documents

Report

Key Takeaways

Synopsis and User-guide

Supplementary Materials

Supplementary Materials 1

Supplementary Materials 2

Dependencies Analysis