HORIZONS

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Welcome to HORIZONS

As we reach the end of an extraordinary year, it feels only right that this final edition of Horizons is a bumper one. There has been so much happening across our community, and *we're delighted to bring it all together for you here.*

The highlight of the quarter has undoubtedly been the publication of our Guide to Transition Loans, a landmark piece of work that has been months in the making. Its reception across the market has been hugely encouraging, and it has been a privilege to speak to its themes and purpose across a range of platforms since launch, including, most recently, at COP30. Seeing this project take flight has been a proud moment for all involved, and we are incredibly grateful to all individuals, members and non-members alike, whose insight, time and expertise were invaluable in bringing it to fruition.

Also taking flight, quite literally, the Phoenix has flown. Our Sustainable Finance Conference drew record attendance and delivered a truly remarkable day of discussion, debate and connection, both on and off stage. The energy and engagement from the community were palpable, and we are thrilled to include a full write-up of the conference in this edition.

This quarter also marked an exciting moment for the LMA family. We were delighted to welcome Natalie Sinha, our new Vice President of Sustainability, who joined us in November. Natalie brings deep expertise, fresh insight and an infectious enthusiasm, qualities you will undoubtedly see on full display as we head into 2026. You can already hear Natalie's voice in her first LMA blog, which looks at the outcomes of COP30 and is available here. At the same time, we are wishing Hannah Vanstone a wonderful maternity leave as she prepares for her new arrival in the New Year. We couldn't be happier for her, and we look forward to welcoming her back when the time comes.

And while elves aren't the only ones busy this season, with strategic planning for 2026 well underway, we hope you all find time to enjoy a restorative festive break. After a year of intense activity, progress, and collaboration, we look forward to seeing you refreshed and ready for the new year.

As always, the LMA is here for you, our members and stakeholders. We would therefore love to hear what's on your wish list for 2026. Share your ideas with us, and we'll do our best to make them happen!!

Gemma Lawrence-Pardew
Head of Sustainability

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Market Overview: Measured Recovery Amid Shifting Conditions

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The sustainable debt market entered Q3 2025 with cautious resilience, posting a modest 4% quarter-on-quarter decline in issuance.

While activity remains below the peaks recorded in 2023, sentiment continues to strengthen as borrowers navigate a more stable rate environment and adjust to evolving disclosure and regulatory expectations.

Green Loans retained their position as the dominant instrument, underscoring sustained demand for structures with transparent, project-linked use-of-proceeds frameworks. Sustainability-Linked Loans (SLLs) followed, though issuance was driven primarily by seasoned borrowers recalibrating KPIs and verification standards. The shift reflects a broader market preference for credibility, measurability, and improved alignment between financing terms and sustainability performance.

Source: Bloomberg

EUR issuance retained its dominance in Q3, reflecting the resilience of the European market and ongoing alignment with CSRD and ESRS disclosure frameworks. The relative strength of EMEA's regulatory momentum continues to attract borrowers and investors seeking clarity in ESG reporting standards.

EUR vs. USD

Source: Bloomberg

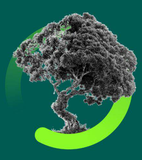
Sector Trends: Strong Divergence as Energy Leads Q3 Momentum

Sector activity in Q3 2025 highlighted sharp divergences across sustainable lending. Energy led, with volumes more than doubling year-on-year as transition and infrastructure financing accelerated, while Utilities saw a moderate decline but remained a core contributor. Industrials recorded solid growth, supported by efficiency and transition-focused borrowing, whereas Financials contracted significantly amid softer refinancing appetite. The steepest declines came from Communications and Technology, both normalising after outsized 2024 deals and facing longer regulatory timelines.

Global sector volumes

Source: Bloomberg

Regional Dynamics



EMEA maintained its position as the global anchor for ESG lending, accounting for the majority of new issuances, with notable strength in sustainability-linked refinancings.

North America displayed a cautious uptick, led primarily by Green Loans, while issuance in SLLs remained constrained by regulatory and political uncertainty.

APAC continued to expand steadily, supported by regional policy incentives in Japan and Australia that encouraged corporates to adopt sustainable lending structures.

Source: Bloomberg

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Redrawing Lines in the Sustainability Debate

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The end of the year is in sight, and the political winds blowing across Brussels are not just shifting – they are reshaping the foundations of majority-building in the European Parliament.

What began in November as a controversial vote on the Omnibus package has now culminated, in early December, in an interinstitutional (trilogue) agreement that both reflects and tests these new political dynamics. When the European Parliament adopted its position on the Omnibus reforms to the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD), **the way the vote was won became the story: for the first time this term, the Parliament's largest group, the centre-right European People's Party (EPP), secured a majority not through the centrist coalition that underpins the von der Leyen Commission, but through a partnership with the European Conservatives and Reformists (ECR) and the far-right Patriots for Europe (PfE).** That majority delivered a clear outcome in Plenary and signalled that the EPP now has an alternative route to parliamentary victories – one that moves right rather than towards its traditional allies in S&D and the liberal Renew Europe.

This precedent carried directly into the atmosphere surrounding trilogues. Civil society organisations, trade unions, and several MEPs from S&D, Renew, and the Greens warned that the Parliament's right-leaning majority had set the tone for the negotiations, especially on climate transition planning and the extent of due diligence obligations. At the same time, Member States, led by The Danish Council Presidency, entered the process with their own priorities rooted in burden reduction and competitiveness. Although Council and Parliament positions were already relatively aligned on areas such as CSDDD scope thresholds and the removal of harmonised civil liability, **the political context made compromise more sensitive**, with climate obligations, impact identification, and the scale of reporting requirements emerging as the most contentious issues.

The trilogue outcome now confirms how these dynamics ultimately settled. **Politically, the deal broadly mirrors the direction set by the Parliament's right-leaning majority:** reporting requirements are cut back, climate transition planning obligations under CSDDD are removed entirely, and the due diligence regime is reframed around a targeted scoping exercise rather than full value-chain mapping. **At the same time, the final agreement does not land fully on Parliament's terms.** The CSRD scope threshold – set at 1,000 employees and €450 million turnover – aligns instead with the Commission and the Council, not with the Parliament's proposed 1,750 employees. The exemption for financial holding companies and transition relief for "wave one" reporters falling out of scope reflect institutional balancing rather than ideological victory. Similarly, the CSDDD's final scope of 5,000 employees and €1.5 billion turnover, its penalty cap of 3% of global turnover, and the postponement of application to 2029 all reflect a negotiated centre of gravity shaped jointly by Council caution and Parliament's simplification ambitions.

The result is a package that carries the imprint of the new majority dynamics. It is a settlement shaped partly by the Parliament's right flank, partly by the Council's long-standing focus on burden relief, and partly by Commission insistence on preserving the core structure of both directives. As Omnibus now reaches its conclusion, the political question that lingers is not just how the sustainability framework has changed, but how the EPP's experiment with alternative majority-building will reverberate across the next wave of files. With negotiations on major reform proposals still ahead – including the SFDR review and further adjustments to the Taxonomy – **the centre is no longer the Parliament's default landing ground.** Whether this becomes a one-off deviation or the beginning of a more structural realignment will shape the political dynamics of EU sustainable finance policy throughout 2026.

The SFDR review proposal: resetting the architecture

The European Commission has now released its proposal for the review of the Sustainable Finance Disclosure Regulation (SFDR), marking the beginning of a new negotiation cycle on one of the EU's most consequential sustainable finance files.

The proposal introduces a fundamental redesign of the framework, replacing the Article 8/9 system with three product categories: **Transition, ESG Basics, and Sustainable**. These categories encompass any financial product making sustainability-related claims, while products outside the system would be subject to strict naming and marketing prohibitions. This shift reflects the **Commission's ambition to deliver a more intelligible, more enforceable, and more coherent transparency regime** – one designed both to curb ESG overstatement and to support comparability for investors across jurisdictions.

This redesigned architecture also aims to connect more logically with the wider EU sustainable finance framework, with new provisions establishing a clearer link with the Taxonomy Regulation, the EU Climate Law, and the existing architecture of the CSRD. They also attempt to respond to years of market feedback on ambiguity, disproportionate disclosure burdens, and conceptual confusion around notions such as "sustainable investments" and the "Do No Significant Harm (DNSH)" criteria. The Commission's approach is to **reduce conceptual noise and ground the system in proportionate, objective criteria tied to category-specific objectives**.

What changes — and why they matter

At the heart of the Commission's proposal is a clearer articulation of what the three categories are intended to achieve. Sustainable products are designed to channel capital into activities that make a measurable contribution to environmental or social objectives. Transition products are aimed at financing the shift of high-emitting or hard-to-abate sectors toward credible decarbonisation pathways. ESG Basics products, meanwhile, are intended to capture strategies with a sustainability component but without the ambition or investment profile required for the other two categories.

Against this backdrop, the proposal introduces several substantive changes that reshape how the categories operate, who qualifies, and what must be disclosed. One of the most important is the narrowing of the new "environmental objective" definition to the six existing Taxonomy environmental objectives. The eligibility criteria for Transition products require alignment with the EU Climate Law objective of climate neutrality by 2050 and excluding companies deriving revenue from coal or engaged in fossil-fuel expansion. These refinements help distinguish Transition products from Sustainable products while setting a clear credibility threshold for both.

The ESG Basics category, although designed to be broad, is subject to its own exclusions, including a limit on coal-related revenues, reflecting the Commission's intention that even the least stringent category maintain baseline integrity. Despite initial expectations, the proposal keeps the Principal Adverse Impacts (PAI) framework at product level – now with voluntary indicators and without the prescriptive obligations of SFDR 1 – and retains certain taxonomy-linked disclosures for products pursuing climate mitigation objectives, requiring an explanation of how taxonomy-aligned investments contribute to the 70% portfolio threshold.

Additional adjustments further streamline the regime. The proposal now eliminates several entity-level disclosure requirements and expands grandfathering for closed-ended funds created before the new rules apply. Taken together, these changes point toward a system that is more targeted, more grounded in product-level outcomes, and less dependent on broad conceptual definitions.

How the proposal aligns with the broader simplification agenda

The Commission's SFDR review is designed not in isolation, but as an integral part of the EU's wider simplification agenda. The ban on national gold-plating directly supports the Commission's broader effort to limit fragmentation across Member States, an issue that has been repeatedly raised by industry and regulators alike. The narrowing of scope – in particular, the removal of financial advisers and insurance intermediaries – also mirrors the targeted reduction in complexity observed in other sustainability files.

Equally important is the Commission's effort to restore trust. SFDR has suffered reputational damage in recent years, with concerns about inconsistent implementation, over-claiming, and a lack of alignment with other EU legislation. By embedding objective criteria, setting portfolio thresholds and tightening exclusions, the proposal seeks to deliver a clearer and more credible system without replicating the compliance burdens of SFDR 1.

Where the politics leaves policy next quarter

Heading into Q1 2026, Omnibus is set to be published into law. The SFDR review proposal, meanwhile, enters its early negotiation phase. While more targeted and less ideologically charged than Omnibus I, its trajectory will still be shaped by the Parliament's new political arithmetic. How the EPP chooses to assemble majorities – and whether the centre-right continues to look rightward or returns to its centrist partners – will influence the pace, ambition, and clarity of the negotiations in the months ahead.

Tracking the reshape: where do we stand?

Policy Intervention	Description	State of Play	RAG (Progress)
Omnibus: Stop-the-Clock Directive (Level 1 legislation)	The directive postpones by two years the CSRD requirements for large companies yet to report and listed SMEs, and by one year the transposition and application of the CSDDD.	Approved by both the European Parliament and the Council, national transposition is required by 31 December 2025.	
Omnibus: Substantive amendments (Level 1 legislation)	This proposal encompasses changes to the CSRD, CSDDD, and EU Taxonomy in relation to scope, due diligence obligations, and precise reporting requirements.	Trilogue negotiations concluded in December, with the revised texts now set to be published into law.	
ESRS amendments (Level 2 legislation)	Amendments to the ESRS are linked to reporting requirements under the CSRD. The Commission has tasked EFRAG with streamlining the number of datapoints and aligning the ESRS framework with international standards.	EFRAG recently submitted its revised standards and to the Commission, which will serve as basis for a delegated act to amend the ESRS. This adoption would have to be followed by co-legislator scrutiny.	
Taxonomy (Level 2 legislation)	This legislative file proposes amendments to the EU Taxonomy delegated act focusing on simplifying reporting templates, DNSH simplification, and a de minimis financial threshold of 10%.	The Commission adopted its revised delegated act in July. Currently in the final stages of co-legislator scrutiny, the new revised rules are expected to soon enter into force, to apply from 1 January 2026.	
Review of the Sustainable Finance Disclosure Regulation (SFDR)	The review aims to simplify the existing framework, reducing legal ambiguities and compliance costs and improving clarity. This includes the introduction of a new category system, the removal of legacy concepts, and a ban on gold-plating.	The Commission put forward its review proposal on 20 November 2025 and negotiations in Parliament and Council are expected to start relatively soon.	

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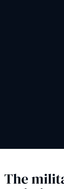
Should sustainable investors bite the bullet and accept the environmental cost of defence spending?



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Recent geopolitical shifts have sparked debate around the inclusion of the defence sector in sustainable investor portfolios, prompting a fresh evaluation of exclusion policies and investment mandates.

Rightly, social considerations have been the primary focus when discussing defence investments, due to the significant potential social harms and benefits. A common argument in favour of sustainable investment into defence activities is the potential for the sector to contribute to UN SDG 16, peace, justice and strong institutions.

Exclusion policies outline investor boundaries on this topic, distinguishing defensive and peace-keeping investments from harmful weaponry. Many investors have strict exclusions for conventional or controversial weapons however, with dual-use technologies and more complex supply chains, a wider universe of defence activities requires accurate assessments of social and environmental impacts to redefine boundaries. The environmental impact of defence spending is less explored, and hence will be the focus on this article.

Beyond the well-debated social costs and benefits, can defence investment be consistent with UN SDG 13, climate action? Should the drive for more investment in defence come from sustainable investors? Can an investment in defence ever be considered environmentally sustainable?

Side note: The author takes seriously the grave social costs of war and concurrent social value of functioning defence systems. For this article, the focus will be exclusively on the environmental impacts and the responsibilities of sustainable investors in this context.

The military emissions gap

Global military operations are estimated to account for 5.5% of global emissions,[1] not counting those associated with combat. This stems from the vast operations of militaries, including fuel for aviation and fleets; the manufacturing and use of weaponry and munitions; and the operation of bases.

To invest responsibly, sustainable investors need to have visibility on downstream environmental defence impacts for impact monitoring. However, national military emissions reporting is not a mandatory part of the UN FCC's requirements. For Nationally Determined Contributions, leaving investors with a 'military emissions gap' and dependent on estimates for carbon calculations.

As NATO national military budgets are pledged to rise to 5% of GDP by 2035 (in 2025 alone European NATO defence spending is expected to increase by 5.9%), accurate recording of military emissions will become integral to impact monitoring. Without international incentives to encourage emissions reductions, the rapid upscaling of military operations could carry a heavy environmental price tag.[2]

1. Parkinson, S. & Cottrell, L., 2022. Estimating Global Military Greenhouse Gas Emissions, Scientists for Global Responsibility, United Kingdom.
2. UK Government, 2024. Climate Change and Defence: A Dstl Biscuit Book, Defence Science and Technology Laboratory. www.gov.uk.

A world at war

In the context of live global conflicts, military greening initiatives only scratch the surface of defence emissions, which fly incognito in global emission reporting.

Cottrell (2022) provides a framework for a more holistic military carbon accounting for the impact of warfare, including Scope 3+ categories, such as bunker fuels, reconstruction, aid delivery, debris, soil degradation, land use changes, medical care and the displacement of people.[3]

Using Cottrell's framework, the Initiative on Greenhouse Gas Accounting of War estimate the emissions cost of Russia's invasion of Ukraine at 175 million tCO2e between 2022-2024[4]. That's the equivalent of running 23 coal-fired power plants, over the same time period.

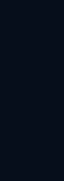
Similarly, the first 120 days of the Israel-Gaza conflict were estimated to have surmounted the annual emissions of 26 individual countries; rebuilding could emit higher than the average emissions of 135 countries.[5] This study underscores coupled emissions impacts of destructive acts of war, parallel to the grave scale of loss of lives, homes and liveability of the area.

Non-destructive inventory can also have an outsized emissions footprint. One study uncovered the "hidden" carbon costs of concrete blast walls used by the US in Iraq for enforcing civilian checkpoints and shielding from IED explosions. It estimated that 412km of concrete walls erected in Baghdad emitted 200,000tCO2e (equivalent to 43,000 ICE vehicles).[6]

For sustainable investors, evaluating adverse impacts is a familiar concept. Defence investments must also be consistent with "*Do No Significant Harm*" approaches applied in other sectors; environmental and social impacts must be considered for each investment.

3. Cottrell (2022).
4. IGAW, L et al. (2024). Climate Damage Caused By Russia's War In Ukraine by Initiative on GHG accounting of war.
5. Cottrell, L et al. (2024). A Multitemporal Snapshot of Greenhouse Gas Emissions from the Israel-Gaza Conflict.
6. Nemark, B., Belcher, O., Ashworth, K. and Lehn, R. (2024). Concrete Impacts: Blast Walls, Wartime Emissions, and the US Occupation of Iraq. Antipode, 56, 983-1005.

Do no significant harm to people and planet



The use of explosive and chemical-based weaponry can have pollutive impacts on local ecosystems and waterways, alter land-use, degrade goodiversity,[7] and lead to habitat destruction.

Taking an extreme example, during the Vietnam war the US dropped 20 million gallons of the so-named herbicide 'Agent Orange', which affected 20% of Southern Vietnamese forests. This saw the destruction of 5 million acres of forests and 500,000 acres of crops, with long-lasting consequences for local species and biodiversity (as well as catastrophic impacts on human lives).

Clearly, these chemicals would not belong to a sustainable portfolio. Large chemical companies saw reputational repercussions for their role in the ecological and social devastation, and subsequently many chemical weapons have fallen on the restriction policies of many sustainable investors.

Less commonly discussed is the contribution of conventional military weapons to ecological pollution, namely from metal in gun residues, bullet decay, and detonation. Lead, zinc and nickel have been found in soil and ecosystems in battlefields, firing ranges and training grounds.

With growing complexity of technological equipment, e.g. armed drones, the range of metals has expanded, as well as the potency and incidence of explosives. Armed drone munitions, such as Hellfire missiles and GBU-38 and GBU-39 bombs, contain TNT and RDX which persist in the environment.[8] Pollutive impacts are compounded when drone strikes hit water, sanitation, power and fuel sites.

One study explored plastic pollution from fibre optic cables powering drones, which takes over 600 years to degrade, harming local wildlife from cable entanglement and generating pollution when caught in blasts. As defence technologies and materials become more complex, so do their environmental challenges.

8. Zhu, Y., Che, R., Tu, B., Miao, J., Lv, X., Li, J., Zhu, Y., and Wang, F. (2024). Contamination and Remediation of Contaminated Firing Ranges: An Overview. Frontiers in Environmental Science, 12. Article 1352603. doi: 10.3389/fenvs.2024.1352603.

Critical raw materials & complex supply chains

Critical raw materials (CRMs) see competing demands from the defence and energy transition markets, compounded by concentrated supply chains; this exacerbates price pressure and ecological impacts.

Demand

Military supply chains rely on CRMs such as aluminium, graphite, cobalt, and copper; used for aircrafts, tanks, missiles and submarines. These CRMs are familiar to investors in the energy transition; in 2022, the most used materials for renewables included copper, silicon, graphite, nickel, manganese, lithium, and cobalt.[9]

Copper in particular is in high demand. According to the EDA, NATO 155mm artillery shells contain 9.5kg of copper. Ukraine fires at least 3,000 shells a day, amounting to 2500kg of copper daily. In 2024, the IEA estimates the defence sector's share of copper consumption to be around 2% of total consumption in Europe, and around 5-7% in the US. This does not account for copper-intensive dual-use technologies, such as digital infrastructure, robotics and power supply infrastructure.

The overlap in use of CRMs across defence, transition technologies (electric vehicles, solar PVs) and digitalisation (wiring, batteries, microchips) has a compounding demand impact. The EU Critical Raw Materials Act (CRMA) identifies core CRMs and 16 Strategic Raw Materials (SRMs) as vital to these 'strategic' sectors (see Table 1).

Table 1: Critical Raw Materials by Classification

Critical Raw Material	EU CRMs*	EU Strategic Materials*	NATO Defence CRMSs**	UTC Energy Transition CRMs***
Aluminium	■	■	■	■
Cobalt	■	■	■	■
Graphite	■	■	■	■
Lithium	■	■	■	■
Manganese	■	■	■	■
Platinum group metals	■	■	■	■
Copper	■	■		
Nickel	■	■		
Silicon metal	■	■		
Gallium	■		■	
Germanium	■		■	
Rare earth elements	■	■	■	
Titanium metal	■	■	■	
Tungsten	■	■	■	
Bismuth	■			
Boron	■	■		
Magnesium	■			
Fluorspar	■			■
Phosphorus	■			■

Source: *European Commission Critical Raw Materials Act (March, 2023); **NATO List of 12 Defence-Critical Raw Materials (15 December 2024) ***Energy Transitions Commission, A Critical Raw Material Supply-Side Innovation Roadmap for the EU Energy Transition (December 2024).

The allocation of capital to defence investments evokes indirect market impacts for energy and transition sectors via higher demand for raw materials, which may translate into higher prices or limited availability in the event of supply shocks.

Supply

Recent supply increases in core CRMs from China have seen downward pressure on prices, but this is not a guaranteed long-run trend with exploration activities plateauing in 2024 and a persistent risk of geopolitical supply shocks remaining.[10] Moreover, climate risks are affecting CRM supply: in 2025, 7% of global copper supply was at risk of disruption due to floods and drought.[11]

The high geographical market concentration of CRM supply carries environmental and social risks. China supplies 95% of the world's graphite and owns 46% of aluminium supply. It also is a monopoly supplier for CRMs such as yttrium, neodymium, samarium, germanium and tungsten, used in military equipment. For cobalt, 53% of global supply is mined in the DRC and of the 19 DRC mines, Chinese companies have ownership of 15 (as of 2020).[12] By 2030 the EU CRMA aims that a single country should not provide over 65% of any strategic CRM.

In addition to security and human rights risks, intensive mining and processing of CRMs carries a high environmental cost, requiring energy-intensive and pollutive equipment and exposing around 23 million people to toxic waste along riverbanks.[13] To reduce reliance on new CRMs, the EU CRMA targets that 15% of annual CRM usage should come from recycled sources by 2030.

What can sustainable investors do? Emerging CRM technologies could present opportunities to improve the sustainability of CRM supply chains, whilst contributing to national defence and security efforts by augmenting supply. The IEA identifies the following opportunities:

- AI exploration could improve success rates by fourfold.
- Ionic adsorption clay deposit processing technologies, which could significantly reduce capital intensity and waste generation, and facilitate production in new countries.
- Recycling could reduce the growth in new mining by up to 40%.

9. De Haes, A & Lucas, P. (2024). Environmental impacts of extraction and processing of raw materials for the energy transition.
10. IEA (2025). Global Critical Minerals Outlook 2025, IEA, Paris, Licence: CC BY 4.0
11. Ibid
12. Girardi, B. et al. (2023). Strategic Raw Materials for Defence. The Hague Centre for Strategic Studies.
13. De Haes, S. and Lucas, P.L. (2024), Environmental impacts of extraction and processing of raw materials for the energy transition, The Hague: PBL Netherlands Environmental Assessment Agency.

Opportunity cost

The opportunity cost of investment into defence, both from governments and investors, has distributional impacts on the availability of capital for transition investments. Investment into defence is happening, but the question is: should it come from sustainable investors?

The prioritisation of defence in government budgets requires redistribution of money towards this sector, which comes at a cost to others. We could see EU funds, which might otherwise be earmarked for climate transition finance, diverted towards security and defence projects which could have been financed through specific funding such as the NATO Innovation Fund or European Defence Fund.

Similarly, if investors divert capital towards defence funds, especially if they are labelled under Article 8&9, there is an indirect displacement effect on climate-focused funds seeking capital. Whether evidenced in higher costs of capital or in reduced flows, this triggers indirect market headwinds for crucial climate investments.

Some argue that GDP growth from defence investment and technology spillovers may be growth-generating and therefore help in the long-run to prop up climate financing. But climate investment is needed sooner rather than later, particularly for long-run supply-side projects; resulting in adverse consequences for long-run net zero targets.

Conclusion

Should sustainable investors accept the environmental cost of defence spending? Certainly, in an epoch of certain growth in militarisation, sustainable investors must have a strategy for navigating a sector with known high environmental and social risks.

With a varied range of defence activities, investors might consider which components of military activities/technologies they help to scale; avoiding the most emissions intensive or pollutive. In times of rapid upscaling, finding the 'Windows of Opportunity'[14] which advance military efforts in a more sustainable way is optimal, whilst avoid entrenching fossil-fuel reliance or ecological harm.

The prerequisite questions ought to be: Is there additionality from a sustainability perspective, whilst meeting DNSH minimum standards? If the answer is no, could this project be funded by other sources of capital, particularly funding pots designated to defence? Fundamentally, might this come from sustainable finance?

Companies and governments can support investors by providing transparent reporting on environmental impacts; so that they are able to accurately evaluate and adhere to DNSH criterion, consistent with their responsible investing frameworks. Investors can be asking the right questions as part of their due diligence, and applying pressure on defence companies to step up environmental protections.

14. B Johnstone, & J. Schot, (2023). Shocks, institutional change, and sustainability transitions, Proc. Natl. Acad. Sci. U.S.A. 120 (47) e2309234120 DI. https://doi.org/10.1073/pnas.2309234120

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The Missing Link in EMDE Transition Finance: Lessons from Peru's National Development Bank

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A legal reform that links funding and lending may be the missing ingredient for scalable small and medium sized enterprise (SME) transition finance in emerging markets and developing economies (EMDEs).

SMEs represent most firms in EMDEs, yet thematic capital rarely reaches them. Policy debates tend to focus on taxonomies, disclosure and corporate transition plans, while the institutional mechanics that move capital to smaller firms receive far less attention. Peru offers a practical case. A recent reform of its national development bank reshaped the chain from funding to final lending, strengthened governance and created space for transition-aligned products. This article examines the SME financing gap, the limits of private and commercial credit, the effects of a legal decree, the mechanics of thematic funding, the role of microfinance institutions and the evidence from past programmes. Together, they point to a coherent architecture for SME transition finance in EMDEs.

1. An overlooked gap in the transition finance debate

SMEs in EMDEs face a structural problem. They need long-term capital to modernise, yet most financial systems are not designed to lend to them at scale. Transition finance is gaining attention across global markets, yet the discussion still centres on large corporates with access to international capital markets. SMEs remain in the shadows despite being responsible for most employment and production in emerging economies. Many face higher energy costs, inefficient equipment and outdated processes. They cannot absorb sudden shocks or finance long-term upgrades. If the real economy is expected to decarbonise, SMEs are the essential that markets treat their scale and risk profile. In many EMDEs, the median SME loan has a tenor of less than two years, which makes any modernisation process nearly impossible.

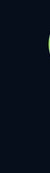
2. Why this matters for EMDEs

Emerging economies depend on SMEs for growth and social stability. Therefore, a transition pathway that excludes them will fall short of national climate targets and strain supply chains. Most SMEs rely on local lenders that face binding risk constraints. High interest rates, limited collateral and short loan tenors prevent firms from investing in cleaner technologies or efficiency improvements.

3. Peru as an instructive example

Peru illustrates this challenge. It has a dynamic SME sector, significant energy transition needs and one of the most active microfinance systems in Latin America. It has also experienced unusually political volatility. Peru has gone through intense political turnover during the past decade, yet the institutional reforms at Corporación Financiera de Desarrollo S.A. (COFIDE) have remained in place across successive administrations. This offers valuable insight for other EMDEs that face similar instability.

4. Who is COFIDE and why its evolution matters



Peru's national development bank, COFIDE, was created to channel long-term financing into productive sectors and complement the work of commercial lenders. For many years, COFIDE operated mainly as a second-tier on-lending institution, channelling resources to intermediary financial institutions (IFIs). This helped expand credit but limited its ability to design new products or match funding sources with lending strategies. A recent institutional reform, enacted via legislative decree (DL 1692), broadened the bank's mandate and gave it greater operational flexibility. This shift is central to understanding how national development banks can support SME transition finance.

What DL 1692 Actually Does

DL 1692 is the 2023 reform that modernised the legal and operational framework of Peru's national development bank.

It introduced three essential changes that matter for transition finance:

1. It clarified COFIDE's mandate and strengthened governance, reducing the effect of political turnover on long-term lending strategies.
2. It allowed the bank to take institutional deposits and co-finance directly with other lenders, which expands its funding base and lets it structure programmes that reach SMEs more effectively.
3. It aligned the bank with international development finance practices, including clearer rules for thematic lending and risk management.

Together, these changes allow COFIDE to build a more coherent, end-to-end sustainability architecture, from how it raises capital to how it channels it to SMEs.

This type of reform is still uncommon in many EMDEs. Peru's experience shows that updating the legal mandate of a development bank can create the institutional stability that transition finance requires.

5. Why DL 1692 Matters for Institutional Investors and Development Finance Institutions

DL 1692 is not a minor governance update. It is the type of enabling reform that most emerging markets say they need but rarely deliver. For lenders, it changes the risk calculus in three practical ways. In practice, DL 1692 gives Peru a more complete architecture for sustainable lending, from the thematic bond investor at one end to the SME or rural household at the other. First, it gives COFIDE a cleaner and more flexible funding model. It can now raise capital from the bank to match the tenor and currency of its liabilities with the needs of SMEs. This alignment sounds technical, but it has direct consequences for pricing, liquidity, and portfolio stability. Second, the decree permits COFIDE to co-finance directly with private institutions rather than operating solely through IFIs. This creates a clearer legal route for blended transactions, co-lending structures, and future securitisations of SME portfolios. Third, it sets the foundations for a transition finance architecture that can carry both public and private objectives without adding unnecessary friction.

The result is clear. Investors seeking scalable exposure to SMEs in EMDEs often face legal uncertainty, weak intermediaries, and limited data. DL 1692 reduces those friction points. Together, changes to bring COFIDE closer to international development finance practices and offer a model other countries may adopt to unlock capital at scale.

6. A thematic funding architecture that provides clarity

Following the reform, COFIDE accelerated its use of thematic instruments. It entered international markets with a USD 300 million social bond in 2024 and a USD 400 million sustainable bond in 2025, followed by a PEN 120 million Blue Bond (about USD 36 million at current exchange rates) to finance water and sanitation upgrades through municipal microfinance institutions. The 4.5 percent pricing confirms strong investor confidence in COFIDE's framework and expands the pipeline of targeted programmes that can later incorporate transition tags. Thematic instruments often lower the cost of capital compared with conventional funding, which strengthens COFIDE's ability to design affordable SME programmes.

These operations show that COFIDE can now mobilise capital at scale under a credible sustainable framework. Each issuance follows recognised international principles. Eligible categories are defined. An exclusion list is applied. All thematic bonds are reviewed by independent Second Party Opinions (SPOs), which assess the credibility of the framework against international principles. Annual reports disclose allocations and impact. The framework covers SME finance, renewable energy, inclusion and essential infrastructure. For investors, this provides transparency and comparability. For domestic lenders, it creates a reliable source of funding for targeted programmes.

Evolution of COFIDE's Thematic Issuance and Institutional Milestones (2019–2025)

7. Channels that reach micro and small enterprises

Most SME lending flows through municipal microfinance institutions and rural banks. COFIDE provides funding to these institutions under simple eligibility rules. Borrowers must maintain a Normal or CPP (with potential problems) credit classification, which indicates that the loan shows no material repayment concerns, and avoid activities included in the exclusion list. The placement targets suggest meaningful reach. The bank expects to channel around PEN 3,000 million (about USD 900 million at current exchange rates) to roughly 200,000 micro and small enterprises during 2025 and 2026. This structure can be adapted to transition finance by adding basic sector screens or efficiency criteria without changing operational processes.

COFIDE's SME Finance Value Chain After DL 1692

8. A countercyclical role that commercial lenders and private credit cannot replicate

The country's experience during the pandemic showed the value of a strong development bank. Under the Reactiva Perú programme, COFIDE helped maintain credit flows to SMEs at a time when commercial lenders were retrenching. Government guarantees and central bank support allowed the bank to act as a stabilising anchor. Evaluations show that the programme preserved jobs and supported payment chains. Repayment performance remained manageable despite the scale.

Commercial lenders and private credit funds behave differently under stress. When volatility rises, both tend to widen pricing or slow disbursements, which creates a credit gap that national development banks must fill. This countercyclical capacity rests on a public mandate, a longer planning horizon and the operational ability to support smaller and riskier firms.

Private credit has expanded in EMDEs. yet most funds remain focused on mid-market corporates with predictable cash flows, strong collateral and stable legal environments. SMEs in emerging markets offer none of these features. This is why national development banks, rather than private credit funds or commercial lenders, remain central to any credible transition finance strategy.

9. Signals of energy transition readiness

COFIDE has not yet launched a dedicated SME transition loan, but many of the necessary components are already in place. Thematic frameworks and operational guidelines provide investors with confidence. Regulated microfinance institutions and rural banks can apply simple eligibility tags. Environmental and social criteria embedded in multilateral lines can be adapted to transition objectives. The bank already reports allocations and impacts through sustainability disclosures.

Earlier experience already exists. Peru's rural solar electrification programme illustrates COFIDE's ability to structure transition-aligned investments. Through a rural solar electrification concession, COFIDE helped finance around 170,000 solar home systems that now serve close to one million people in off-grid areas. Before the programme, many households relied on kerosene lamps, candles and biomass used for indoor cooking. These fuels are expensive and generate significant indoor air pollution. The project replaced those sources with solar power, reduced respiratory risks, and improved daily living conditions in remote communities. This track record shows that the institution has the operational base to support SME transition finance once eligibility and transition criteria are defined within the existing thematic framework.

10. What this means for loan markets

If SMEs are expected to adopt cleaner technologies, upgrade equipment and reduce emissions, they will need products that match their size and risk profile. Private credit alone cannot fill this gap. National development banks with thematic funding platforms, local distribution networks and stable mandates will play a central role. Peru's experience shows that transition finance for SMEs is not a mystery. It is an institutional design problem.

References available to the public

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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	Q1 2024
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	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.

What is the view of the Platform on Sustainable Finance?

Platform on Sustainable Finance: Simplification of the EU Taxonomy

On 5 February 2025 (prior to publication of the Omnibus Package), the Platform on Sustainable Finance (**Platform**) published a report - Simplifying the EU Taxonomy to Foster Sustainable Finance ((**Report**) - which builds on previous work by the Platform including the Compendium of Market Practices published in January 2024 (see previous Horizon publications).

The Report refers to the EU's plans for a package of measures aimed at refinement and simplification of the EU Taxonomy in order to increase its effectiveness. The Report sets out specific recommendations to reduce the reporting burden for non-financial companies and simplify reporting for financial institutions by using estimates, proxies, a streamlined DNSH assessment approach and the introduction of a materiality concept. The Report also emphasises the importance of improving interoperability between the EU Taxonomy and other Taxonomies internationally in order to enhance the flow of capital.

The following four core proposals are included for simplifying taxonomy reporting:

1. **Reduce corporate reporting burden** by one-third by: (i) making the OpEx KPI voluntary disclosure, other than for R&D, in line with the Accounting Directive; (ii) introduce a materiality threshold for reporting the Turnover, OpEx, CapEx KPIs and the combined KPIs of financial companies; (iii) improve alignment with financial reporting; and(iv) simplifying reporting templates and reducing data points;
2. **Simplify GAR to encourage green and transition lending** by (i) creating symmetry with similar numerator and denominator composition; (ii) simplifying retail exposure reporting and focusing on substantial contribution; (iii) allowing for the use of estimates and proxies for reporting along with safe harbours to protect against greenwashing; and (iv) applying the materiality principle to the combined KPI for financial undertakings, excluding immaterial business areas;
3. **Provide a practical approach to DNSH criteria** by (i) providing for a lighter compliance assessment process; (ii) reviewing the DNSH criteria as part of the Omnibus; and (iii) introducing a temporary "comply or explain" approach for DNSH assessment of the Turnover KPI; and
4. **Help SMEs access sustainable finance** by (i) adopting a streamlined and voluntary approach exposures to unlisted SMEs; and (ii) adopt a simplified approach to the Taxonomy for listed SMEs.

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.

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