LMA Loan Market Association

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By email only (taxonomyconsultation@hmtreasury.gov.uk)

To Whom It May Concern,

HMT: UK Green Taxonomy Consultation

The Loan Market Association (**LMA**).[1] is supportive the UK Government's dual objectives of (i) fostering market integrity and tackling greenwashing, and (ii) driving capital into sectors that are crucial for the transition (the **Objectives**). We therefore welcome the UK Government's efforts to engage with industry as part of this consultation on the value case for a UK Green Taxonomy (**UK Taxonomy**).

The successful mobilisation of private capital will be essential to delivering an orderly transition, and accelerating capital flows for transition should be a key priority for the UK Government in its bid to drive growth and the competitiveness of the UK on the global stage.

Loan markets have a pivotal role to play as a major source of liquidity in the UK. As the leading voice of the loan markets across EMEA, the LMA is committed to ensuring that the right tools and frameworks are in place to ensure liquidity to finance the transition.

Questions 1-3 – Transition Finance

Summary

Based on available evidence and the lack of a clear policy anchor, whilst we believe there are some potential use cases for a UK Taxonomy, **we do not believe there is currently a robust value case for the UK Government prioritising the development of a UK Taxonomy over other policies which may better support the Objectives**.

Potential use cases for UK Taxonomy

Whilst we are not clear there is, at this time, a strong value case for prioritising the development of a UK Taxonomy, we do believe that, where designed correctly and accompanied by complementary policy incentives, sustainable taxonomies may provide useful tools to the market.

Potential use cases may include:

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[1] See Annex 1 for more information.

- acting as a robust, science-based transparency tool to help build companies' and investors' confidence in sustainable investment decisions[2];
- supporting market participants to mitigate the risk of greenwashing by providing a voluntary classification system; and
- mitigating against market fragmentation by providing common categorisation and understanding of projects and opportunities.

Implementation challenges

The development and implementation of sustainable taxonomies globally has shown that, in practice, taxonomies often become complex, resource intensive, and have posed usability and interoperability challenges which have limited their real-world impact. In addition, taxonomies are not typically designed around economic growth and so may not be the best tool for accelerating growth of the new and innovative technologies required for transition.

Other challenges observed in relation to global taxonomies include:

- increased reporting burdens for corporates and financial institutions;
- binary classification systems which do not adequately accommodate transition activities;
- time and resource intensive to develop, even with second-mover advantage;
- failure to capture all sectors and activities; and
- key performance indicators (**KPIs**) reported under such taxonomies may not, in practice, provide decision-useful information to companies or investors.

A UK Taxonomy, if developed, would therefore need to overcome these challenges in order to provide a useful tool for achieving the Objectives set out above.

Contribution to Objectives

Taking each of the Objectives in turn, we have set out in more detail the reasons why we do not believe that the development of a UK Taxonomy (whilst potentially serving some use cases) should be prioritised over other government policies which may better support the Objectives:

I. Promoting market integrity and preventing greenwashing

- **Firstly**, there is already a sophisticated ecosystem of market-led initiatives, supported by regulatory frameworks, which market participants can, and already do, align with to help mitigate greenwashing risk. These include but are not limited to sustainability reporting in line with global standards, the setting of science-based targets and use of industry-led product-level best-practice frameworks such as the Green Loan Principles and Sustainability-Linked Loan Principles. ***The LMA is currently working with our members on market-led Guidance for Transition Loans with the aim of helping unlock some of the potential opportunities around transition finance. We would be very happy to discuss this work further with you and how it can help to unlock capital to support decarbonisation of the UK economy, and drive the UK's competitiveness on the global stage.***

- **Secondly,** as highlighted in the consultation paper, there are a range of taxonomies that have already been developed globally. Market participants can, and do, draw upon these when

[2] https://joint-research-centre.ec.europa.eu/scientific-activities-z/sustainable-finance/eu-taxonomy_en

looking to ensure that investments are "green". The bigger challenge arguably is how to distinguish those companies with a credible transition strategy from those without, and how to ensure that certain sectors and certain parts of the value chain are not left behind in the transition to net zero – see below for further explanation and our recommendations in relation to transition plans and transition finance.

- **Thirdly,** there are already multiple existing rules and expectations in place in the UK which aim to protect against greenwashing. These rules have been supplemented recently by the introduction of the FCA's Anti-Greenwashing Rule (**AGR**) and Guidance which aims to complement these existing rules. The AGR forms part of the UK's package of measures finalised through the FCA's Policy Statement on Sustainability Disclosure Requirements and investment labels. In addition, greenwashing guidance from the Advertising Standards Authority and the Competition and Markets Authority provide additional layers of protection for consumers against greenwashing risk.

II. <u>Mobilising capital into sectors critical for the transition</u>

Based on available evidence, we have not seen any robust evidence that a UK Taxonomy (without further policy interventions) would lead to a significant mobilisation of capital for transition. The reasons for this include:

- **Firstly,** where used as a classification tool, taxonomies which are subject to regular review may not provide the requisite level of policy certainty for medium to long-term investment decisions into green sectors given that what is classified as 'green' today may be subject to change over investment horizons.

- **Secondly**, whilst there have been some recent examples (e.g. Singapore)[3] of transition activities being incorporated into taxonomies, this alone does not address one of the key reasons for the transition finance gap, namely the lack of bankable opportunities.[4]

- **Thirdly** - and perhaps most importantly - there have been well-documented usability challenges around existing taxonomies. As above, there is a risk that, if not designed correctly, a UK Taxonomy could become another disclosure tool which may add to the existing compliance burden (including administrative, assurance and regulatory compliance burden and associated costs) on companies and financial institutions without leading to any significant real economy impact.

<u>Our recommendations:</u>

Whilst we do believe there are some potential use cases for a UK Taxonomy, we remain concerned that a poorly designed, frequently updated and difficult to use taxonomy could lead to uncertainty, limited use and may even deter capital from being invested in a manner that is taxonomy aligned.

Instead, we believe the UK Government should prioritise its efforts on driving growth of the transition finance market and unlocking the opportunities of transition. As per the Transition Finance Market

[3] https://www.mas.gov.sg/-/media/mas-media-library/development/sustainable-finance/singaporeasia-taxonomy-updated.pdf
[4] https://rmi.org/five-barriers-transition-finance/

Review final report, the *"success of a UK based transition finance market… hinges on clear, supportive signals from Ministers and a cohesive push across Government."*[5]

We believe there are three clear ways in which the UK Government can do this:

1. **Support for new transition finance products, such as transition loans, the development of a national transition plan and sectoral decarbonisation pathways will be critical**. We would therefore recommend that UK Government focusses on efforts in this area over the development of a UK Taxonomy which may, if not correctly designed, fail to drive additional investment into transition. We have already seen examples of this type of government action (for example, in Japan) driving use of labelled transition finance instruments. As mentioned above, we would also be happy to discuss our work around Guidance for Transition Loans and how this industry-led initiative can help to support the UK Government's aim of mobilising increased capital for transition.
2. **Companies, in particular SMEs, need on the ground support with their sustainability reporting and transition planning efforts**. The UK Government should therefore prioritise the consultation around the implementation of UK Sustainability Reporting Standards, including transition plan reporting, aligned to those developed by the International Sustainability Standards Board and providing companies with the guidance and support required to be able to implement this. By helping to reduce the compliance burden on companies in this way, the UK Government will also be helping to increase productivity and boost the UK's competitiveness on the global stage.
3. **Work with industry to unlock the opportunities of public-private investments to support the transition of critical sectors**. UK Government has a key role in de-risking investments in sectors critical to the transition and supporting the flow of additional liquidity to finance the transition.

Finally, should the UK Government decide against the development of a UK Taxonomy itself, it may wish to explore as an alternative whether there is any appetite to develop a market-led UK-specific taxonomy, perhaps initially focussed on priority sectors for the UK economy.

<u>Q. 5-7 – Key Design Questions</u>

<u>Use of different taxonomies in the loan markets</u>

<u>Classification</u>

As mentioned above, market participants can and do already use sustainable taxonomies as a voluntary classification tool to guide investment decisions. Green loans, like green bonds, are use of proceeds instruments used to finance green projects. As referenced in the Green Loan Principles, taxonomies can provide a tool for identifying green projects to be financed by green loans. In this regard, sustainable taxonomies can, by providing a voluntary point of reference, help with identifying and communicating sustainable investment opportunities.

However, the real-world impact of sustainable taxonomies here has been limited by, amongst other things, a scarcity of investible opportunities aligned with technical screening criteria under taxonomies, such as the EU Taxonomy, which set a high bar for alignment. Usability and interoperability challenges (see further below) with sustainable taxonomies, including the EU

[5] https://www.theglobalcity.uk/PositiveWebsite/media/Research-reports/Scaling-Transition-Finance-Report.pdf

Taxonomy, have further limited the ability of market participants to use taxonomies to guide investment decisions.

Reporting

We would recommend against the design of a UK Taxonomy primarily as a disclosure tool since there are other tools to better support the disclosure of decision-useful sustainability information, including corporate transition plans and corporate sustainability reporting standards, such as those developed by the International Sustainability Standards Board.

The majority of our members agree that any reporting under a UK Taxonomy should be on a *voluntary* basis – albeit that there may be some merit in mandatory reporting requirements for the UK Government and in the public sector to drive adoption and support market confidence.

Any KPIs related to a UK Taxonomy would require careful design alongside industry, including financial institutions and investors, to ensure that they result in the provision of decision-useful information. Challenges around reporting against the Green Asset Ratio, for example, in connection with the EU Taxonomy (which have resulted in low levels of reported alignment)[6] should be considered in the design of any reporting requirements linked to a future UK Taxonomy.

Interoperability and usability

We believe that interoperability is key to the success of any sustainable taxonomy. As noted in the Singapore-Asia Taxonomy, "capital is global"[7] and therefore interoperability between different global taxonomies is key to the flow of capital. We would therefore emphasise the importance of the interoperability of any sustainable taxonomy to its success and would encourage any UK Taxonomy, if developed, to use interoperability as a guiding principle in its design – both with regards to market-led and jurisdictional taxonomies.

We would also highlight the success criteria for future taxonomy developments developed by the International Capital Market Association which we believe provide useful guiding principles. These set out that taxonomies should be:

- Targeted;
- Additional;
- Usable;
- Open and compatible; and
- Transition enabled.[8]

The Singapore-Asia Taxonomy provides a good practice example of a sustainable taxonomy which has looked to embed transition finance through a traffic light system, and which also embeds the principle of interoperability at its core. We believe that failure to include transition activities will result in only a small portion of economic activities being taxonomy-aligned and therefore this would be unlikely to unlock any significant additional capital to meet transition demands. However, even if included, a focus on putting in place the ecosystem for the growth of transition finance, including sectoral

[6] https://www.risk.net/risk-quantum/7959249/first-green-asset-ratios-come-in-low-as-eu-banks-protest-methodology
[7] https://www.mas.gov.sg/-/media/mas-media-library/development/sustainable-finance/singaporeasia-taxonomy-updated.pdf
[8] https://www.icmagroup.org/assets/documents/Sustainable-finance/ICMA-Overview-and-Recommendations-for-Sustainable-Finance-Taxonomies-May-2021-180521.pdf

decarbonisation pathways and reporting requirements in relation to transition plans may better serve this objective overall.

Finally, we wish to emphasise the importance of learning lessons around usability challenges – including those outlined in the recent report on 'The EU Taxonomy Framework: Research on the Impact on Companies'.[9] – from other taxonomies should the UK Government decide to develop its own taxonomy. Lessons should be learned, in particular, from the challenges around the application of the Do-No-Significant-Harm and minimum standards criteria in the EU Taxonomy, and we believe that any UK Taxonomy must be based on simple, objective and easily applied standards to ensure that the UK Taxonomy is practicable and implementable for a wide range of UK businesses, including financial institutions, investors and corporates.

We would be happy to discuss any of the above recommendations or observations in relation to this consultation in more detail with you.

Please do not hesitate to contact hannah.vanstone@lma.eu.com and gemma.lawrence-pardew@lma.eu.com should you wish to discuss this response in more detail.

Yours faithfully,

H Vanstone

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[9] https://assets.publishing.service.gov.uk/media/673b32c6abe1d74ea7dade98/the-eu-taxonomy-framework-research-on-the-impact-on-companies.pdf

Annex 1
Loan Market Association

Since our foundation, the Loan Market Association has supported the loan markets, with a focus on enhancing liquidity, transparency, and sustainability. Today, with 850+ members in 69 jurisdictions, we represent an ever-growing diversity of participants in international capital markets, including institutional investors, private and public sector issuers, banks, non-banks, technology solution platforms and market infrastructure providers, spanning the UK, US, EMEA, and Africa.

Through member representation on the LMA's various institutional committees and working groups, we actively engage with our members to ensure their voices are heard. Their input and guidance help shape the future of the loan markets and these groups drive the delivery of positive outcomes.

Today, our activities are busier than ever, with a rapidly growing range of services offered to members. This includes an expanded library of documents, LMA Academy and training offerings, LMA Player and on-demand podcasts and webinars, increased focus on ESG and sustainability initiatives, and operational enhancements aimed at reducing settlement times.

Our goal remains to ensure the loan product retains its place as a critical financing tool in the market. For more information, please visit our website: www.lma.eu.com