LMA Loan Market Association

10 Upper Bank Street London

E145JJ

t: +44 (0)20 4583 0576

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By email (tfmr@cityoflondon.gov.uk) and by online submission

Dear Sir/Madam

The Transition Finance Market Review ("TFMR") – Call for evidence (the "Call for Evidence")

We welcome the UK Government's efforts to increase the flow of capital to support the transition to a net zero future.

We are grateful for this opportunity to engage with the TFMR and to respond to this Call for Evidence. We would like to highlight, in particular, some of the current obstacles to transition finance in the loan markets and how the UK Government may be able to help boost financing for transition activities.

Q1 – Do you consider there to be a lack of clarity around the scope of transition finance? Why/Why not?

There is no single, accepted standard with regards to what constitutes transition finance. As highlighted by the International Capital Market Association in their recent paper, '*Transition Finance in the Debt Capital Market*',[1] there appear to be at least three different overlapping definitions in the market (economy-wide, climate transition and hard-to-abate transition). This can make it difficult for market participants to understand exactly where to draw the boundaries around transition finance and can lead to uncertainty for lenders looking to support transition through their financing activities.

Whilst existing industry-developed voluntary frameworks, such as the Green Loan Principles ("**GLP**", which seek to support borrowers in financing environmentally sound and sustainable projects that foster a net-zero emissions economy, protect and restore the environment, facilitate adaptation to climate change, and/or provide other environmental benefit) and the Sustainability-Linked Loan Principles ("**SLLP**", which look to support a borrower in improving its sustainability performance), do already exist to support transition to net zero, there is currently no dedicated framework of standards for labelled transition finance instruments in the loan markets in the UK[2].

While establishing regulatory 'guardrails' for transition financing would be useful, we do not think the TFMR should propose a fixed definition of transition finance at this stage. A rigid approach to defining

[1] Transition-Finance-in-the-Debt-Capital-Market-paper-ICMA-14022024.pdf (icmagroup.org)

[2] The APLMA and LMA are currently working with the market to see if an industry-developed framework for a 'transition' use of proceeds loan label in needed to sit alongside existing instruments. See Q29 below for more detail.

transition finance at a time of evolving contexts, scientific and technological developments could be counterproductive and restrict the market.

A better approach would be for the TMFR to suggest high-level and principles-based guidance on what is included in the scope of transition finance with an overall aim of enhancing transparency and consistency. This would also have the benefit of making the TFMR's work more applicable internationally, enabling financial services firms to provide tailored products to support the transition globally. We would particularly welcome guidance which acknowledges the fact that individual jurisdictions, as well as industries, have significantly different starting points for their transition, and capital needs to be capable of being deployed to help those with the furthest to go. A focus on defined/agree concepts around quantification of improvement achieved through transition activities, rather than absolute metrics, would substantially aid the delivery of capital for countries/industries starting further down the curve.

Q3 – Do you agree with the approach that transition finance includes all sectors of the economy to the extent that it is part of a credible net zero transition? Why/Why not? If not, please specify what should be excluded and why?

All sectors of the UK and global economy will need to transition for climate goals to be achieved in an orderly manner. Whilst certain activities may already be aligned with net zero goals, entire industries will need to re-orient their business activities for decarbonisation of the global economy to be achieved. In order to achieve this realignment of business activities, we believe it is essential that finance is available across all sectors (including hard-to-abate sectors) in order to support the significant investments needed to facilitate transition.

The sustainability-linked loan ("**SLL**") provides one example of a sector-agnostic financing instrument which has been successfully used to support transition, even in hard-to-abate sectors. Our accompanying guidance does however recognise that additional transparency may be required where SLL structures are utilised in sectors exposed to controversial issues given the need to ensure the credibility of the product as a transition tool.[3]

Q12 – Which standards, frameworks, guidance or tools are you using to guide your approach to transition finance and why? If your approach varies between jurisdictions, please explain why.

Alongside the APLMA and LSTA, we have helped to develop a number of global high-level frameworks for application across loan markets, including the GLP and the SLLP. Both green loans and SLLs can help to support transition by channelling finance to help deliver sustainable outcomes. We understand that there has however been an increasing reluctance in recent years to use these sustainable finance labels in the market, particularly in hard-to-abate sectors, as a result of concerns around, amongst other things, accusations of greenwashing. In addition, criticism by media outlets in the use of sustainability labels by hard-to-abate sectors, even where GLP and SLLP requirements are met, is further increasing company reticence to utilise the sustainable finance labels on offer.

To address this increasing reluctance, we updated the GLP and SLLP in February 2023 to ensure credibility and robustness of financing structures. However, in the absence of government/regulatory driven guidance and/or taxonomies around what activities fall within "transition" on a region-by-region or national basis, it is likely that limited appetite to apply sustainable finance labels to hard-to-abate sectors will remain.

[3] SLLP_Guidance_23_February_2023_v.2.pdf (lma.eu.com)

Q14) Do you consider there to be a role for regional or national pathways to be incorporated in transition finance standards, frameworks or guidance? Why or why not? Please describe any international examples.

We agree with the TFMR view that linking transition frameworks to national and regional contexts needs to be done in a way that ensures interoperability between different jurisdictional frameworks and approaches to transition finance.

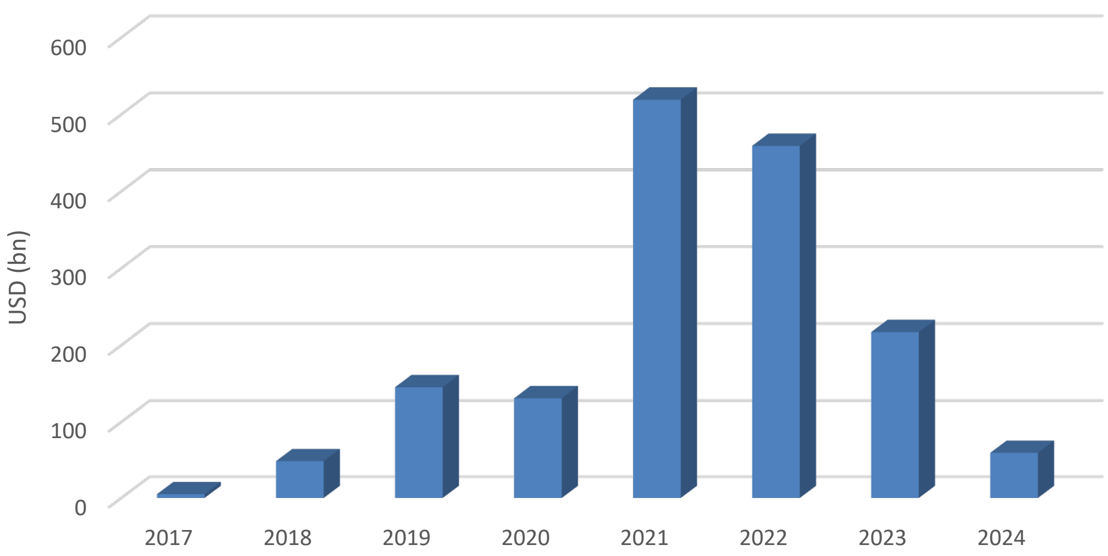
We would encourage the UK Government to take action in this area to develop its own sector specific roadmap/pathways (such as those produced by the Government of Japan) and/or to endorse existing roadmaps/pathways to the extent applicable. This could help to provide market participants with greater certainty that they are financing companies and activities that are aligned with the UK Government's own decarbonisation strategy and could, in turn, help to increase liquidity for transition finance. In doing so, the UK could help to develop a model for transition finance which could be rolled out to other jurisdictions, subject to relevant adaptations for the applicable jurisdiction.

As noted above, it is essential that due recognition is given to individual national and regional contexts/starting points and any transition finance standards, frameworks and/or guidance developed ensure that capital can be deployed to all genuine transition activity, irrespective of placement on the transition curve.

Q29 – Are there any needs or use cases that are not being met by the current instruments? Are new or additional financing strategies, market tools, practices or products needed?

We are currently investigating whether there is a need for an additional 'transition' use of proceeds loan label in the market to sit alongside the existing green, social and SLL instruments, believing that industry-developed voluntary labels are the best way to drive behaviour. As mentioned, one of the key drivers for these discussions has been the recent drop-off in SLL volumes (see Figure 1) which we understand has been driven, at least in part, by concerns around greenwashing accusations in the market.

Figure 1: Global SLL Volumes



Source: Bloomberg
As of 2 May 2024

We are still at the initial stages of our investigations, and we would therefore appreciate the opportunity to be involved in continuing discussions as part of the TFMR in order to ensure that the outcomes of our work around transition finance can be shared.

Q36 – Do you think there is a role for the UK to facilitate the development of global thought leadership on transition finance, and if so, what strategies could it employ to influence and facilitate this development?

We support efforts from the UK Government to drive international efforts to deploy capital towards transition finance. Whilst thought leadership in this area may be helpful to some degree, we believe that what the market really needs in order for transition finance to become truly scalable is clear and credible transition pathways that they can rely on.

Whilst the UK Government's 2023 publication on Mobilising Green Investment was well received, it will be the UK's proposed Green Taxonomy that will most likely help drive transition financing once available, together with any future sector specific decarbonisation pathways.

As above, we would urge the UK Government to work with other legislators, to ensure that there is interoperability and harmonisation, where possible, between different jurisdictions with regards to transition finance.

If we can be of any further assistance, please do not hesitate to contact me by email at Hannah.Vanstone@lma.eu.com.

Yours faithfully,

Hannah Vanstone
Senior Associate Director, Head of Sustainable Finance Regulation
Loan Market Association