HORIZONS

Issue 02

Summer 2024

Enter

Welcome to HORIZONS

Our summer edition coincides perfectly with *London Climate Action Week*, which seeks to mobilise whole-of-society climate action in the capital.

M**obilising liquidity** for climate action is a core focus for the LMA and I am therefore delighted to announce the launch of our transition taskforce, which has the key goal of facilitating the flow of capital to those sectors that most need to decarbonise. The rise of exclusionary policies, a widening geographical divide over what transition captures, and a hesitancy to undertake transactions that might attract greenwashing attention, have made sustainability-related liquidity dry up for these sectors. And this is just climate transition; we have yet to weigh in on the vital just transition debate – a debate discussed by those more expert than I as part of our inaugural Sustainability Seminar in Nigeria earlier this quarter.

Enhancing efficiency is another core focus of the LMA and this quarter we advanced our goal of making transactions more efficient with the publication of our template Sustainability Coordinator Letter; a seemingly simple project underscored by significant complexities. Read our summary report for more information.

Finally, **transparency**, a tenet we at the LMA strive to adhere to. We have a created a Governance tab for our Sustainable Lending microsite, which sets out the composition of our Sustainability Committee and Sustainability Regulatory Committee, as well as each of our active Task Forces. This ensures members have clear visibility around the institutions helping drive and shape our sustainability agenda. All of our work in progress, as well as recent publications and regulatory submissions, can also be found here.

Looking now to this summer edition of Horizons. Here we showcase the latest sustainability data alongside insights spanning sleeping SLLs, to sustainability in the supply chain and decarbonising the built environment. I would also highlight Sustainability Assembled, the only sustainability regulatory tracker to focus exclusively on the loan market.

I would love to have your feedback on this publication. Please contact me with any ideas, thoughts or suggestions.

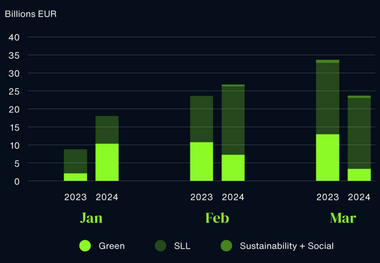
Gemma Lawrence-Pardew
Head of Sustainability

Q1 in Charts

Alexander Dakin, Data Analyst, Bloomberg

The global ESG loans market experienced strong momentum at the beginning of the year, but this dipped slightly towards the end of March, particularly in new green loan volumes.

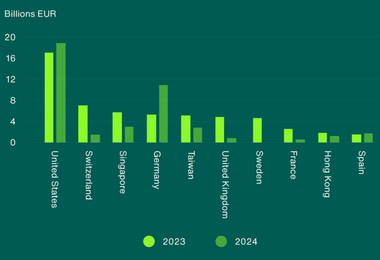
Global Sustainable Loan Volumes



Source: Bloomberg

A country-level breakdown reveals that the US leads with 26% of global ESG issuance. However, this is a decline compared to the same time last year. Notable countries gaining momentum include Switzerland, the UK, Sweden, and France in EMEA, as well as Singapore, Taiwan, and Hong Kong in APAC.

US leading global ESG issuance in Q1 2024



Source: Bloomberg

On a regional level, the Americas and EMEA are performing better than they were at this time last year, with EMEA showing the highest volume of issued loans.

EMEA leading regional ESG issuance in Q1 2024

Source: Bloomberg

Compared to this time last year, global issuance trends have shifted significantly from Q1 2023 to Q1 2024, with a notable decrease in financials from 12.5 to 9 billion Euros and a large increase in utilities from 8.3 billion EUR to 13.8 billion Euros

Global sector volumes

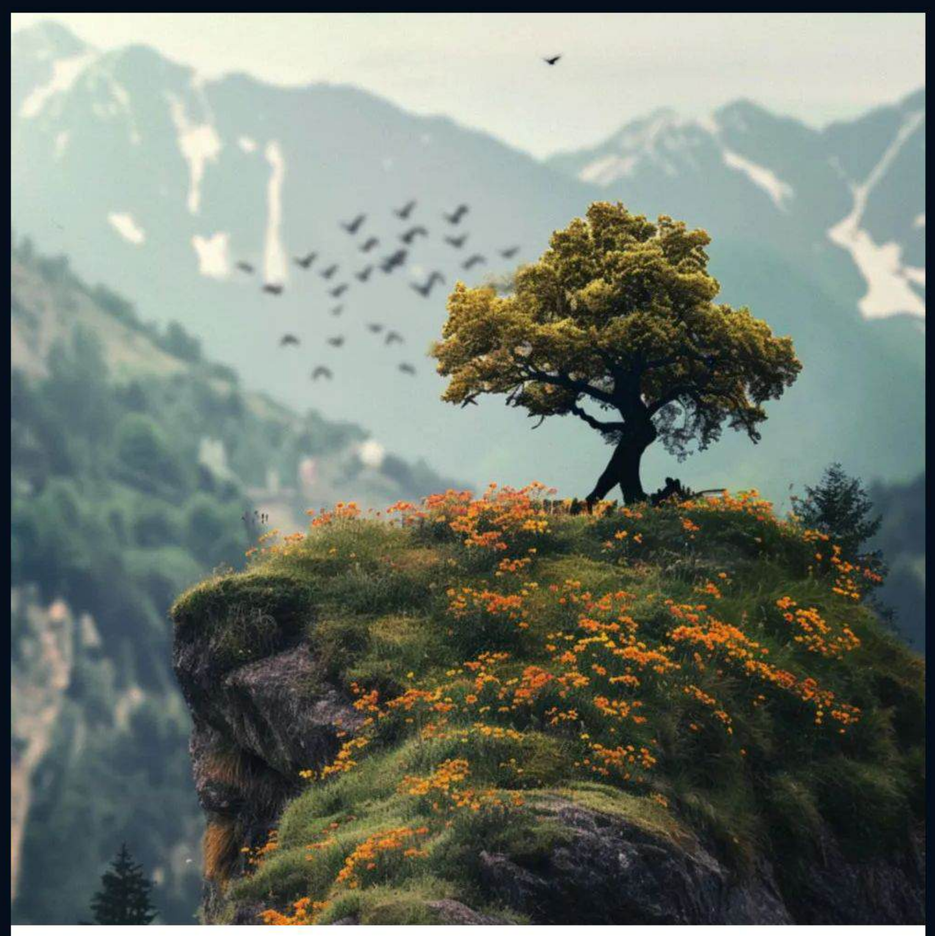
Source: Bloomberg

Compared to this time last year, EMEA has seen a significant spike in utility issuances along with increasing volumes in the financial sector.

EMEA sector volumes

Source: Bloomberg

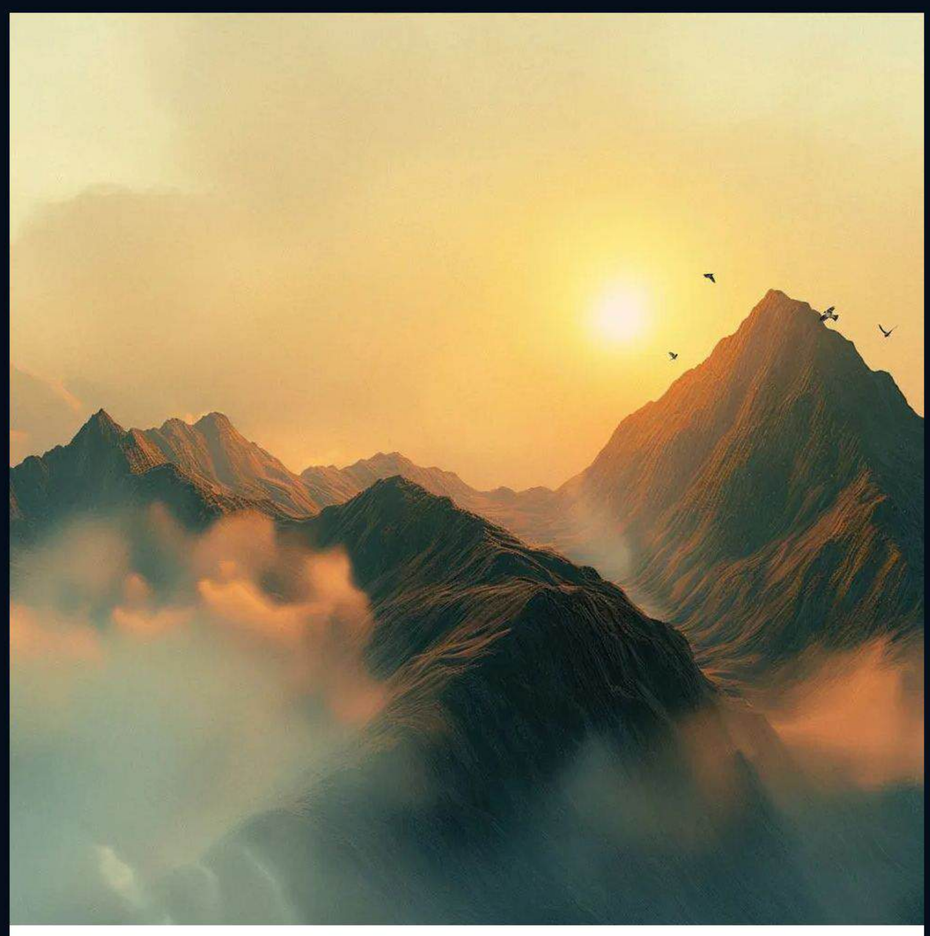
Thought Leadership



Sustainable Supply Chain Finance: A Path to Sustainable Growth

In this article, we explore the importance of sustainable supply chain management, propose establishing a market benchmark for sustainable supply chain finance, and discuss the associated challenges and opportunities.

Read more



Sleeping Beauty or Sleeping With The Enemy? A Closer Look At Sleeping SLLs

In this article, we explore the concept of sleeping SLLs and whether the construct should raises eyebrows or whether it is simply misunderstood.

Read more

Sustainable Supply Chain Finance: A Path To Sustainable Growth

Andrea Lamadrid Iannaco, Responsible of ESG Advisory, CaixaBank CIB

Laura Prats Bru, Responsible of Institutional & Transactional Sustainable Finance, CaixaBank CIB

Pablo Pérez-Montero, Global Head of Sustainable Finance & ESG Advisory, CaixaBank CIB

At a time when sustainability has become a cornerstone of corporate strategy, the focus on sustainability[1] principles within supply chain management is more critical than ever.

The global push for greener practices is not only a response to rising regulatory demands but also reflects increasing corporate awareness about the broader benefits of a sustainable approach.

In this article, we explore the importance of sustainable supply chain management, put forward our proposal for establishing a market benchmark for sustainable supply chain finance (**SSCF**), and discuss the challenges and opportunities associated with this.

The International Context: A New Era of Accountability

As organisations worldwide acknowledge their responsibility beyond their own operations, the supply chain's role in sustainability has gained unprecedented attention. This holistic view recognises that sustainability extends across the entire length of the value chain, including small and medium-sized enterprises (SMEs), prompting companies to adopt sustainability-centric selection criteria for suppliers and develop purchasing policies that align with these values. The emergence of international regulatory frameworks such as the Corporate Sustainability Due Diligence Directive (CSDDD), Corporate Sustainability Reporting Directive (CSRD), and the U.S. Securities and Exchange Commission's Climate Disclosure Rule, is a further reason for organisations to prioritise sustainability considerations. Compliance with these regulations nudge businesses towards more sustainable practices, fostering a global standard beyond borders and industries.

1. Incorporating environmental, social and governance (ESG).

Benefits of Embedding Sustainable Finance Solutions in Supply Chain Management

Integrating sustainable finance solutions into supply chain management offers several compelling benefits:

Better access to capital investment and capital allocation

Investors increasingly prioritise sustainability criteria when providing liquidity to the market, and are therefore drawn to organisations and projects able to demonstrate strong sustainability performance in their supply chains. This can result in more favourable financing terms and improved capital allocation towards sustainable projects.

Enhanced risk management

Incorporating sustainability factors into financial analysis enhances risk management. By identifying potential sustainability-related risks, companies can proactively pre-empt issues that could disrupt operations and harm their reputations.

Innovation

Sustainable finance drives investment in innovative technologies and solutions that enhance supply chain performance, including advancements in renewable energy, circular economy initiatives, waste reduction, and ethical sourcing. These innovations contribute to sustainability goals and position companies as industry leaders, sharpening their competitive edge.

Stakeholder engagement

Financing initiatives focused on sustainable supply chain management foster collaboration and engagement among all stakeholders, including suppliers, customers, investors, and regulators. This multi-stakeholder approach fosters a more comprehensive and effective dialogue and knowledge sharing, resulting in meaningful and collective action to address sustainability challenges.

Long-Term Value Creation

By integrating sustainability considerations into investment decisions, sustainable finance promotes long-term value creation for companies and investors. Adopting sustainable practices in the supply chain enhances resilience, competitiveness, and brand reputation. This contributes to better financial performance while laying a sustainable foundation for future growth.

Sustainable Supply Chain Finance

Despite its benefits, SSCF remains an emerging field.

Currently, the sustainable finance products on offer primarily fall into two categories: "Use of Proceeds" and "Sustainability-Linked" financing[2]. The former focuses on specific investments with positive environmental or social impacts, while the latter ties general financing to sustainability performance targets based on key performance indicators[3]. However, when we seek to adapt these structures for suppliers, we find different interpretations of application with no homogeneity in terms of structure, geography, and sector. This lack of universality of product offering has resulted in few companies implementing SSCF despite high levels of interest in the product.

It is therefore apparent that a standardised approach to SSCF is required. Such an approach should seek to:

(1) create clear criteria for evaluating sustainability performance of the suppliers;

(2) produce financing conditions for the most sustainable suppliers; and

(3) encourage sustainable development of the global supply chain, including amongst SMEs.

We have therefore created the following proposal to act as a market benchmark.

2. See green, social and sustainability-linked loan principles at www.lma.eu.com/sustainable-lending/resources.

3. In SSCF transactions, the KPIs tend to be bespoke to the transaction at hand (rare due to market difficulties in obtaining homogenised data) or based on ESG ratings/scoring from external vendors (at high cost to both the client and suppliers). In rare instances, they may align to a client's internal methodology and internal scoring system, but these are often not verified and lack external validation.

CaixaBank's Proposal

CaixaBank

The below figure demonstrates the double focus on the client and suppliers, where the sustainability performance of each supplier involved is measured, providing a comprehensive view of the entire supply chain.

The incentive structure of traditional sustainability-linked loans is maintained, with the sustainability performance of the suppliers triggering a price adjustment (or other economic incentive). This approach would incentivise excellent performance (Group 1), while offering pathways for improvement to those falling behind (Groups 2 and 3).

It also enables the corporate and institutional clients to understand the global performance of their supply chain, detect areas for development and achieve a progressive improvement in the global sustainability performance of suppliers.

We therefore believe this model could significantly improve supply chain sustainability.

Organizations

Lenders → **Client** → **Suppliers**

Agent Bank

Participant 1
Participant 2

Participant n

Double Approach

Additional added value:

- Companies will measure the overall ESG performance of their supply chain.
- Promoting positive management by:
  - Identifying areas of improvement.
  - Involving specific solutions.

Sustainable Supply Chain Finance Proposal

- Suppliers are the ones subject to be measured by ESG criteria.
- Their ESG Performance triggers the Price Adjustment with mirror structures.

ESG Performance		Price Adjustment	
Group 1	→	Price 1	→ (- X Bp) Best ESG Performance
Group 2	→	Price 2	→ (= Price) Neutral ESG Performance
Group 3	→	Price 3	→ (+ X Bp) Worse ESG Performance

Challenges and Opportunities

Implementing SSCF presents several challenges. Accurate, traceable data is essential to design scalable solutions that do not place SMEs at a disadvantage. It is therefore vital to raise awareness among all supply chain participants, particularly SMEs.

Financial institutions must also develop comprehensive solutions that allow the implementation of sustainability in practice, promote sustainability incentives and improve the management of the entire value chain.

"It's right to emphasise the value of high quality and verifiable data when looking at supply chains. That data will inform decisions not just on pricing, allocation and availability but on how accurately a lender can report its position to a regulator, a pressing need given the plethora of existing and new legislation. In ITFA, we have established what we are calling an Audit Council to look specifically at issues of data and common reporting standards matching the needs of banks and regulators but also setting a baseline for the type of data we need."

Sean Edwards – Chairman of ITFA and Head of Legal at SMBC Bank International plc

"The need for a clear framework for financial products classified under Sustainable Supply Chain Finance is of critical importance. We need to ensure these financial products gain as much as they can from the uniformization of standards that new regulatory frameworks, such as CSRD and CSDDD, will allow.

Sustainable finance can help facilitate improvements to sustainable performance throughout the value chain. Either through project-based financing such as green or social bonds, aligned with the green taxonomy and the soon-to-be social taxonomy, or through target-based projects such as sustainability-linked financing. As with all sustainability reporting, voluntary or not, greenwashing needs to be proactively considered. If companies and financial institutions want to trigger real change across the value chain, sustainable supply chain finance instruments must be clear, trustful, reasonable and, simultaneously demanding as well as financially enticing."

Joana Capote Soares – EMEA Transactions & Sustainable Finance Service Line Lead at Anthesis Group

Despite these challenges, the opportunities are significant. Establishing universal benchmarks for SSCF can provide transparency and demonstrate alignment with international standards. This would enable clients to gain a holistic view of their supply chain, identify areas for improvement and drive collective progress towards sustainability goals. SSCF can enhance sustainability across the entire value chain, ultimately benefiting both businesses and the environment.

Conclusion

Integrating ESG principles into supply chain management through sustainable finance can transform corporate sustainability. By addressing both challenges and opportunities, businesses can harness the power of SSCF to foster a more sustainable, resilient, and competitive global economy.

Sleeping Beauty or Sleeping with the Enemy? A Closer Look at Sleeping SLLs

Andrew Prasad, Director and Senior Legal Counsel, SMBC Bank International

Natalya Tueva, Executive Director, Head of Sustainable Finance, Loan Capital Markets EMEA, SMBC Bank International

Tim Rennie, Partner, Ashurst LLP

"Sleeping"[1] is a term often seen put before "sustainability-linked loan" (SLL) and can be used to express an intention for a brief nap, a prolonged hibernation, or an eternal slumber.

But what does it actually mean? Should the construct be regarded with mistrust or is it simply misunderstood?

With 35% of 2023 European sustainability-linked leveraged loan transactions incorporating sleeping SLL terms, we seek to explore whether the exceptional has become somewhat normalised.

1. Also known as "agree to amend", "shell SLLs" and "inactive SLLs" amongst other things.

1. What is a sleeping SLL?

A sleeping SLL is essentially a conventional loan agreement that contains provisions to convert the facility to a SLL[2] after the closing date, i.e. the mechanics of a SLL are baked into the documentation, with these mechanics to be activated when the SLL components are agreed post-origination.

The sustainability aspects of the loan – the key performance indicators (KPIs) and/or sustainability performance targets (SPTs) – are therefore delayed.

2. As discussed in the Best Practice Guide to Sustainability-Linked Leveraged Loans published jointly by the LMA and The European Leveraged Finance Association

2. An exception to the rule

The Guidance to the Sustainability-Linked Loan Principles (SLLP) states that in "exceptional instances" a sleeping SLL may be used[3]. Examples of exceptional instances include:

Merger & Acquisition (M&A). For a company that is undergoing an M&A activity, it may be challenging to scope the KPI(s) and/or calibrate the SPTs at the time of the loan origination due to time constraints. Additionally, the effect of the transaction would need to be clearly understood on the group's overall ESG strategy.

Company's governance, such as a delay by the company in obtaining its internal governance sign off, for example by the executive committee on the proposed KPI(s) and/or SPTs.

Concurrent SLLs where the SLL components of a company's core facility dictate the SLL construct of its other global facilities.

Fund Finance. Practical challenges have been observed[4] in applying the SLLP in the context of fund finance transactions for various reasons, including difficulty of setting KPIs due to a fund's limited physical operations, uncertainty of investment pipeline or a lack of consistent metrics across a fund's underlying investments; limited historical ESG data on borrowers, the fund or sponsor, and the underlying investments.

But should these exceptions remain exceptional or be developed to enhance the toolkit offered to borrowers to aid them on their sustainability journey?

3. Para 3.B.II.e) in the Guidance on Sustainability-Linked Loan Principles produced jointly by the APLMA, LMA and LSTA.
4. See A Guide to the Application of the SLLP in Fund Finance.pdf (lma.eu.com) for more detail.

3. Guidelines and guardrails

Sleeping SLLs have been adopted as the parties anticipate the terms incorporated pre-signing will have a positive impact on keeping costs down and the speed of adoption for the parties once the outstanding SLL terms are commercially agreed.

However, parties should be mindful of previous criticisms for the sleeping SLL construct, which resulted in adverse headlines and acted as a contributing factor to the 2023 FCA review of the SLL market[5]. It is therefore imperative that when adopting a sleeping SLL construct, the following guidelines be strictly adhered to:

No publicity

Until the KPI(s) and/or SPTs are agreed and set, and all other core components of the SLLP are met, the loan is not a SLL and no party should communicate, or refer to it, as such.

Ratification timeline

Implementation and ratification of all required SLL components by the lenders should take place no later than twelve months post origination.

Consent

Parties must ensure that the KPI(s) and SPTs undergo the same scrutiny and attention as they would have had they been proposed at the outset of the transaction and the Guidance on SLLP recommends that all lender affirmative consent be required to the setting of any KPI(s) and/or SPTs, to maintain the integrity of the product. Where this is not practical due to the size of the syndicate, parties may agree to a lower threshold for consent, e.g., Majority Lender consent.

Furthermore, consideration should be given to:

Pricing

Any sustainability-linked margin adjustment should be agreed by the borrower at the outset.

Supplementary ESG material and transparency.

The SLL ratification process should be accompanied by detailed ESG lenders presentation sufficient to allow lenders to satisfy themselves as to the borrower's proposed KPI(s), SPTs and other credentials to confirm that the documentation meets the SLLP.

Internal reporting.

Lenders are not expected to include a facility in their internal reporting of SLL transactions until the sleeping SLL terms are switched on, and those terms meet that lender's internal SLL requirements.

"Incorporating a streamlined ability to include a sustainability linked feature in a loan at a later date is one that must be carefully considered, but may be a helpful tool for borrowers. Ultimately, it is essential that the rigor of constructing the sustainability linked feature when it comes mirrors that of a Day 1 SLL."

Tess Virmani – Deputy General Counsel and Head of Policy at the LSTA

5. Review of the Sustainability-Linked Loans (SLL) Market letter (fca.org.uk).

4. Into the detail

The extent to which SLL provisions can be agreed pre-signing will depend upon the specifics of each transaction and should in any event reflect the SLLP. Before putting pen to paper – or having your legal adviser do the same – specific consideration should be given to:

- Whether only the KPI(s) and/or SPTs need to be agreed post-signing or whether other SLL provisions also need agreeing;
- How the SLL amendments will be incorporated into the facility agreement (e.g. by way of a certificate, amendment letter or amendment and restatement agreement requiring conditions precedent such as legal opinions);
- What level of consent is required to approve any SLL amendments, i.e. can a lender be dragged into a SLL financing which has SLL terms that do not satisfy its internal criteria; and
- Any additional requirements sustainability coordinator(s) and lenders may need to satisfy regarding sleeping SLLs.

The answer to these questions will have implications regarding the customer relationship, the economics under the financing and consequences regarding other internal and external items.

In consideration of the above, sleeping SLL terms should use the LMA's Draft Provisions for SLLs[6] as far as possible to ensure alignment with the SLLP, noting that the sleeping construct itself is not catered for. As the KPI(s) and/or SPTs are often not agreed on sleeping SLL transactions at signing, additional terms will be necessary to incorporate the parties' agreement of these components and, only then, for the parties to label the facility as a SLL. The LMA recommends that the sustainability co-ordinator assists with the agreement of the KPI(s), SPTs and any other amendments required to "switch on" the SLL terms. However, some banks may be apprehensive regarding agreeing to terms or a transaction process where no detailed settled market practice exists for fear they and their financing are viewed as "leading the market".

"The sleeping construct is something we are deliberating from a drafting perspective as we approach the first anniversary of the Draft Provisions. The LSTA have successfully incorporated guardrails for sleeping SLLs into their own Drafting Guidance for SLLs, and this is something we will consider adding to our own Draft Provisions later this year."

Gemma Lawrence-Pardew – Head of Sustainability at the LMA

6. www.lma.eu.com/sustainable-lending/documents#draft-provisions-for-sustainabilitylinked-loans222.

5. Looking ahead

If not applied correctly, use of a sleeping SLL construct could raise SLL integrity-related concerns, increasing greenwashing risk and reputational harm for those parties involved. However, whilst it pays to be mindful of the potential risks and criticisms occurring from a sleeping SLL construct in each individual instance, the potential positives should not be underplayed.

As companies continue to navigate the regulatory landscape, which has become a critical consideration when implementing their sustainability strategies, a sleeping SLL could be a helpful bridge available to a borrower in order to find the right balance between a commitment to further its sustainable finance strategy and its evolving sustainability reporting obligations.

In Conversation with TFT: Decarbonising the Built Environment

Mat Lown, Chief ESG & Knowledge Officer, TFT

Decarbonising the built environment will require collaboration between built environment professionals and the finance industry.

The LMA's Hannah Vanstone met with Mat Lown, Chief ESG & Knowledge Officer at TFT, to discuss his views on the latest developments helping to deliver a more sustainable built environment, and how lenders and investors can help to support the drive towards sustainable real estate.

How are sustainability considerations impacting on developers' decision-making?

"Sustainability considerations are driving more developers and investors to engage sustainability specialists earlier, to understand their carbon position from the outset.

As a result, developers are able to work more closely with engineers and surveyors to appraise existing buildings against their goals, or the goals of an owner or a tenant, and pinpoint the most practical interventions. Existing buildings may carry many unknowns which could have a bearing on their sustainability potential. For example, there may be opportunities to significantly reduce embodied carbon by re-using the existing structure and facade."

What are the latest developments around circular construction that market participants should be aware of?

"High carbon materials such as steel and concrete are under increasing scrutiny, with alternatives emerging - such as the cement-recycling process recently announced by Cambridge University researchers. In tandem with these advances, developers can now do more to understand the value of materials on site, or near site, and how each can be adapted or re-used.

There is a growing market for second-hand materials, particularly for structural steel, which developers should engage with. Supporting the growth of that market into the future means thinking further ahead too, asking: how are building elements designed to support disassembly, reconfiguration and repair (rather than wholesale replacement)? For example, using more mechanical fixings and less adhesive or welded joints will help to prolong the life of each piece of material within a building, and enable dismantling for future reuse.

Two rules of thumb are now relevant to every project:

1. Consider the hierarchy of reduce > reuse > recycle, to always look for the lowest embodied carbon solution to begin with.
2. Engage with technical skillsets – e.g. architects, engineers, surveyors and sustainability specialists - to make sure that ambitious or novel approaches are incorporated into project design at the earliest possible stages. The sooner this is done, the greater the scope for improvement at the lowest cost."

What are some of the main challenges and opportunities for those looking to retrofit an existing building?

"The first challenge is understanding what already exists and what is feasible for re-use. At a high level: how suitable is a given building for an alternative use and how much of the existing structure, fabric and services can be retained? Often, institutional-grade assets already have reports which account for future expansion or adaptation. But for smaller, older buildings, navigating these unknowns means investigating their potential at an early stage. We must look at the whole building, which includes consideration of both its operational and embodied carbon. This work is significant, and it will shape the strategy and the success of the retrofit or refurbishment project.

Looking further upstream to acquisition, investors or owners must now seek the best available data on a building's potential for adaptation and decarbonisation as part of their due diligence."

What role do lenders and investors have to play in decarbonising the built environment?

"I think lenders and investors can influence and even drive decarbonisation by challenging developers to reduce embodied carbon arising from new developments and designing in greater scope for future disassembly and material re-use.

We are currently working with a lender for whom we're undertaking embodied carbon assessments that include opportunities to reduce carbon emissions."

Case study

Photo: Philip Vile

"Holbein Gardens, round the corner from London's Sloane Square, was transformed from being a tired 1980s office building into a sustainable asset and a pioneering example of a low embodied carbon development. It even exceeds LETI's pioneer standards for embodied carbon.

Our work on the project began long before the building itself was discussed, because TFT co-created a sustainable development brief with Grosvenor which encompasses themes such as climate resilience, social benefit, connectivity, green spaces, resource use and more. Holbein Gardens became an early test case for that.

This brief was taken forward into the design with a holistic approach, from the building's blue roof, through its openable windows connected to air quality sensors, the use of lime plaster with low VOCs, and down to the reuse of raised access floors and other materials with high recycled content.

In terms of circularity, there was a focus on retaining existing materials, reusing them either onsite or offsite, and finally recycling the remaining materials. Another Grosvenor site in Bermondsey was identified as a potential location to extract steel from, which was incorporated within the structure of Holbein Gardens.

In turn, there was also some steel in the former roof of Holbein Gardens which went through the same process, finding a new lease of life forming new risers in the building. The remaining Holbein Gardens steel ended up on yet another project, forming the new roof works at Grosvenor's Fivefields building.

One of the greatest challenges facing re-use is storage. For portfolio owners like Grosvenor, the ambition to reuse significant amounts of steel was made possible by having other sites to provide it. However, there are examples of steel reuse, including FORE Partnership's T.B.C. London, which incorporates salvaged steel from the former House of Fraser store at 318 Oxford Street. For those who don't have that availability, they might instead need to engage with providers like Cleveland Steel (part of the Holbein Gardens project team) to determine what is available or might soon become available.

More generally, Holbein Gardens has shown us what is possible when the right criteria are considered early on in a project. One benefit is increased awareness among the project team, and embracing the less polished aesthetics which are characteristic of re-used materials. It also demonstrates the ability to carry out due diligence on available materials, and the importance of establishing a supply chain which can carry out measurement, analysis and adaptation of materials in re-use."

Before **After**

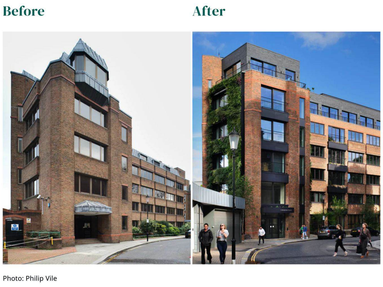
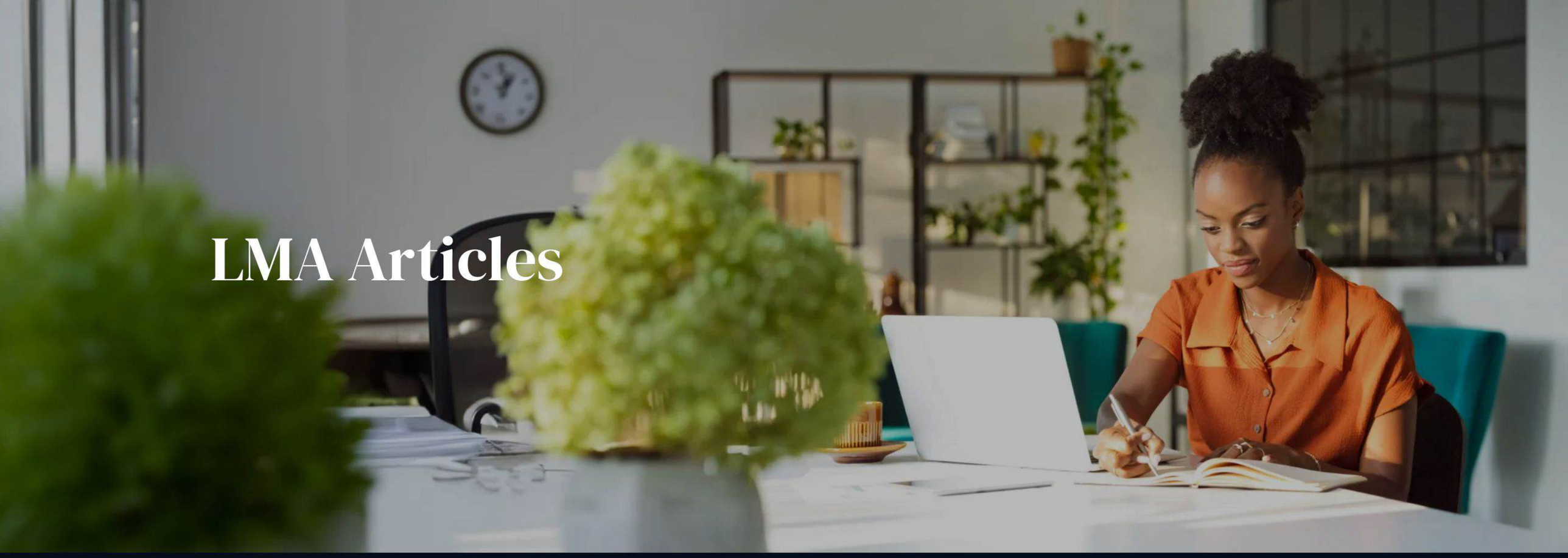
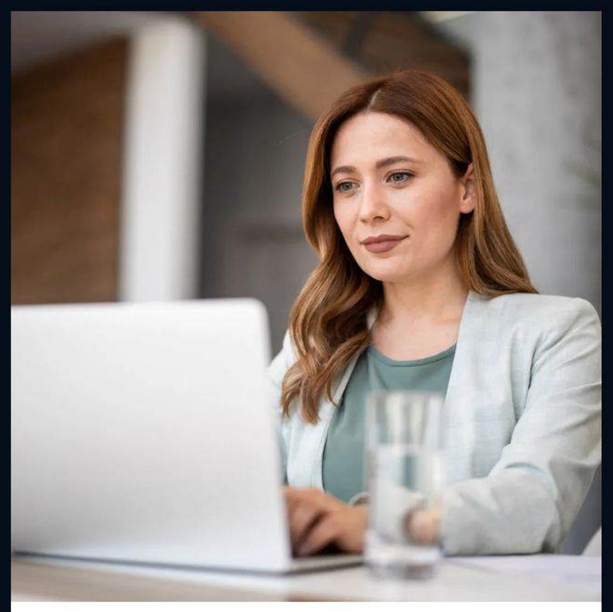


Photo: Philip Vile



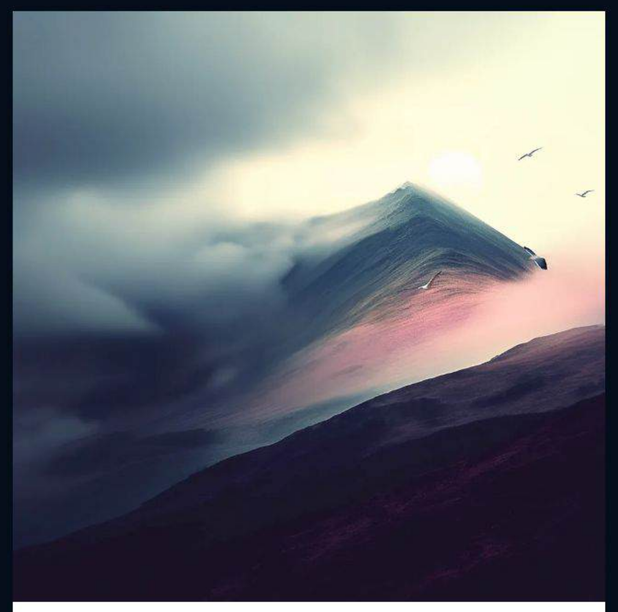
LMA Articles



Sustainability Coordinator Letter

This article summarises some of the key provisions contained in the LMA's new sustainability coordinator letter, and provides an explanation of the drafting position adopted by the LMA.

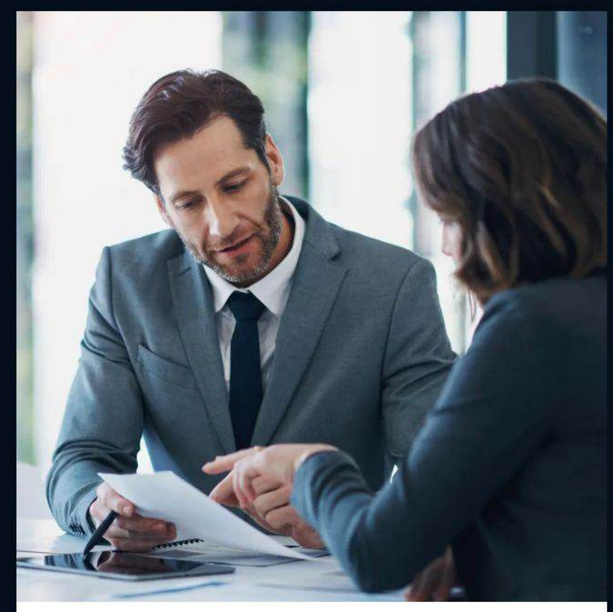
Read more



Climate Adaptation Finance

In this article, we explore how market led initiatives such as the “Guide for Adaptation and Resilience Finance” are looking to mobilise private finance for climate adaptation.

Read more



Guidelines for Sustainability-Linked Loan Financing Bond

In this article, we explore the new collaboration between the ICMA and LMA, which opens up another stream of liquidity for the SLL market.

Read more

LMA Sustainability Coordinator Letter:

Striking the Balance

Hannah Vanstone, Sustainable Finance Regulation Lead, LMA

A simple task – create a template letter for use when appointing a sustainability coordinator (SC) to align with the already published Draft Provisions for Sustainability-Linked Loans.

But how quickly the complexity became apparent. You see, whilst the SC role is one that has developed rapidly in recent years, it is one that remains multi-faceted and ever evolving – varying considerably from transaction-to-transaction and across different sectors and jurisdictions. Nonetheless, we at the LMA are never ones to shy away from a challenge!

Following considerable efforts from our dedicated task force and the LMA's Sustainability Committee, as well as Sukhvir Basran and her team who led on the drafting efforts, we were delighted to release our new recommended form of sustainability coordinator letter (the **SC Letter**) on 23rd April 2024. The SC Letter is intended to provide a starting point for negotiation where a SC is to be appointed.

Given that the SC role is continuing to develop, the SC Letter will be kept under review and updated periodically as required. We will also be looking to update our '*Introduction to the Sustainability Coordinator Role*' guidance later this year.

The SC Letter seeks to strike a balance between the different positions taken by market participants, and therefore includes extensive drafting notes for consideration. Below is a summary of some of the key provisions that were heavily negotiated and an explanation of the drafting position adopted by the LMA. For more detailed drafting notes, please see the SC Letter.

- Sole and exclusive appointment
- Appointment
- Conditions
- Information
- Confidentiality
- Publicity / announcements
- Definitions
- Role and the Sustainability Coordination Services
- Fees, costs and expenses
- Indemnity
- Non-reliance
- Termination

Driving Liquidity into Climate Adaptation and Resilience

By Gemma Lawrence-Pardew, Head of Sustainability, LMA

The growing number of extreme weather and climate-related natural hazards has dominated agendas at global conferences and put pressure on decision makers to establish adaptation and resilience targets.

Despite the importance of adaptation and resilience finance[1] in reducing the risks of natural hazards, current levels are well below what is called for in response to the climate crisis. In this article, we explore how market led initiatives such as the "Guide for Adaptation and Resilience Finance"[2] (the Guide) are looking to mobilise private finance.

1. Adaptation and resilience are defined in the 'Guide for Adaptation and Resilience Finance' on page 8.
2. Standard-Chartered-Bank-Guide-For-Adaptation-And-Resilience-Finance-FINAL.pdf (sc.com).

A Growing Phenomenon

Extreme weather and climate-related natural hazards have had a devastating impact on livelihoods and businesses through damage to supply chains. As global temperatures rise so to do the frequency of natural hazards, contributing to the significant economic and social costs of climate change.

Borrowers are becoming increasingly aware of the risks of under investing in the climate change response, with the difference in losses between the 1.5°C pathway and business-as-usual scenario expected to grow to at least USD 1.266 trillion. This has driven interest in adaptation and resilience finance, but not fast enough.

January 2024 marked the first time that global temperatures exceeded 1.5°C above pre-industrialised levels for an entire year. This critical juncture suggested that finance for adaptation and resilience was likely to become much more pressing for corporates and public institutions.

Call for Collaboration

The Guide was produced by Standard Chartered, KPMG and the United Nations Office for Disaster Reduction, with the LMA acting as a secondary reviewer, in response to the COP28 call for collaboration to protect people from the impacts of climate change. It sets out a common reference for adaptation and resilience to support investment, alongside an indicative list of adaptation and resilience activities.

"Standard Chartered operates in over 50 markets, most of which are low income, and 90% of which are coastal. Capital just isn't flowing towards sustainability in emerging markets, and when it does, it is mostly earmarked for mitigation and not adaptation.

Adaptation and resilience are huge areas of risk for markets and financial institutions. But, it also presents a real opportunity with every USD 1 spent on adaptation this decade generating a potential economic benefit of USD 12 – highlighting the significant economic pay-off of early action towards adaptation and the potential gains for investors.

The Guide aims to unlock private sector capital flows into adaptation and resilience and build a common set of definitions of what the investable universe is. The Guide also sets out a process for assessing that there is both a substantial contribution to adaptation and resilience and also that potential for maladaptation and significant harm to other sustainability objectives is adequately mitigated. For the first time also, the multiple co-benefits of adaptation and resilience have been analysed and documented, allowing for large scale interoperability across different sustainability thematics including nature and social outcomes."

Alex Kennedy – Head of Sustainable Finance Solutions at Standard Chartered

Identifying the Barriers

The guide sets out two perceived barriers to private finance for adaptation and resilience including:

(a) limited revenue streams for many adaptation and resilience investments; and

(b) long investment horizon and size of adaptation and resilience projects.

The real barriers centre around the need for greater education on the benefits of investing in adaptation and resilience, and the barriers which have limited issuance of sustainable finance more generally, including a lack of data and standard definitions.

The Solution?

Integration of natural hazard risk management into the mandates and decisions of key stakeholders within the financial system; utilising a diverse range of financial tools; clear presentation of the business case for adaptation; engagement with governments and regulators; and blending the use of philanthropic, private and public capital is all vital to boost natural hazard adaptation and resilience.

The development of a framework for natural hazard and disaster information – including data, disclosures, metrics, and alignment strategies to promote market transparency and integrity is highlighted as a key issue. The Guide states that this should take the form of an adaptation and resilience taxonomy or classification system in order to provide a consistent and common language for investment activities.

The Guide goes on to set out high-level screening principles to aid the categorisation of natural hazard and resilience investments, and recommends that borrowers and issuers of adaption and resilience financial products should develop a framework to detail the use of proceeds for adaption and resilience activities. Most importantly, and likely helpfully, for the market, the Guide offers an indicative list of adaptation and resilience investments relevant to investors and financial institutions, to help determine eligible uses of proceeds to contribute to adaptation and resilience outcomes.

Looking Ahead

The market needs to mobilise finance into adaptation and resilience investments, a failure to do so resulting in substantial costs to the natural world and those that live within it. Now it is for market participants to utilise the Guide, and recognise the potential of adaptation and resilience as investable asset classes, to address the shortfall of finance on offer.

Guidelines for Sustainability-Linked Loans Financing Bond

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

Financial institutions, in particular lending banks, hold an influential position at the interface between financial markets and the real economy, engaging directly with borrowers through the provision of credit products.

There is an opportunity for lending banks to use this position of influence to engage borrowers in dialogue regarding their sustainability performance through instruments such as the sustainability-linked loan (SLL).

We were therefore delighted to partner with the International Capital Markets Association on a project that seeks to improve the robustness of, and open up another stream of liquidity for, the SLL market. And so were born the Guidelines for Sustainability-Linked Loans financing Bonds (SLLBG)[1].

Set out below is a brief overview of the new SLLBG.

1. https://www.lma.eu.com/download?p=626233701-66057

Definition

Sustainability-linked loans financing bonds (SLLB) are any type of bond instrument (i) where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance, in part or in full, a portfolio of new and/or existing eligible SLLs aligned with the Sustainability-Linked Loan Principles and (ii) which are aligned with the four components further detailed below in these SLLBG, directly inspired by the Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines.

Core Components

The four core components for alignment with the SLLBG are similar to the Green Bond Principles and Social Bond Principles:

1. Use of Proceeds
2. Process for SLL Evaluation and Selection
3. Management of Proceeds
4. Reporting

The key recommendations for heightened transparency are:

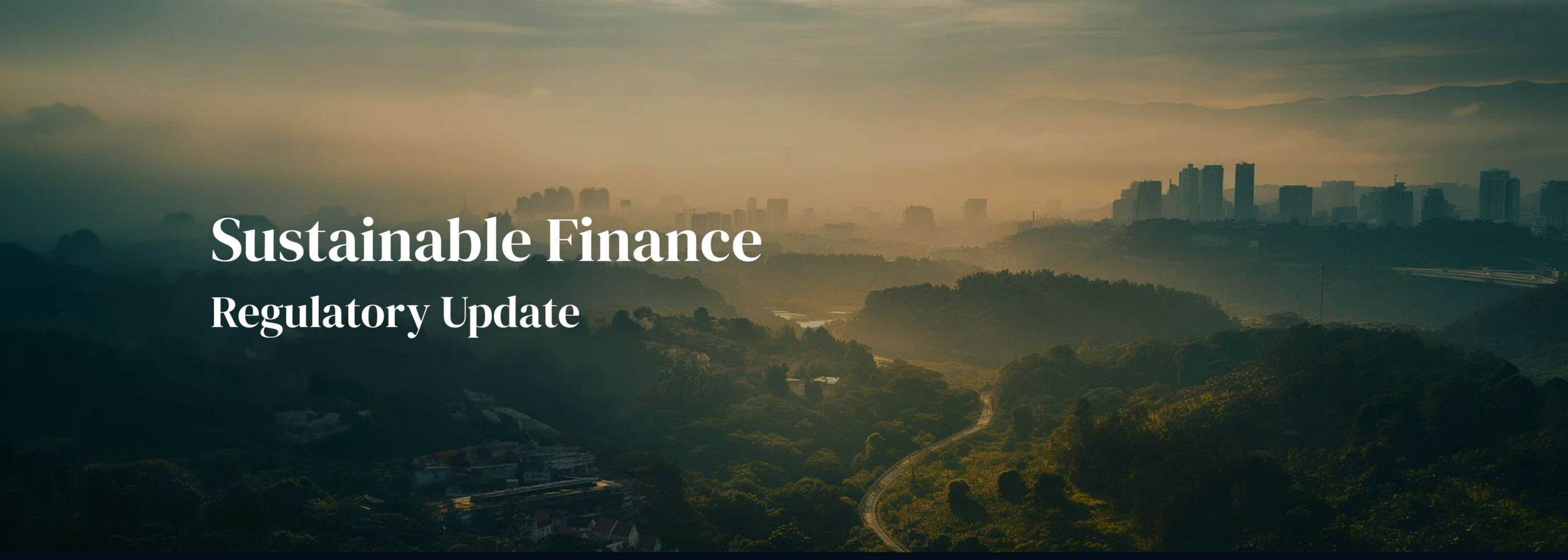
- SLLB Frameworks
- External Review

Issuers are also encouraged to provide information on their overarching entity-level objectives, strategy, policy and/or processes relating to environmental and/or social sustainability.

Looking Ahead

It is anticipated that any development of a market for SLLB will clearly reflect the evolution and issuance trends in the SLL market overall.

Work will now begin on a FAQ document to support the SLLBG so to the extent our readership have any questions they would like clarified, I would encourage you to contact me as soon as possible.



Sustainable Finance

Regulatory Update

Navigating the key sustainable finance regulations across EMEA

Sustainability Assembled

Integrity is a concept which underpins the efficient operation of loan markets globally. And integrity really matters when we talk about sustainability generally, and sustainable finance in particular.

The UK Financial Conduct Authority, for example, recently cited a survey in which 81% of respondents said they would like their investments to do some good as well as provide a financial return.[1]

It was with a view to ensuring the integrity of sustainable finance products globally that we first became involved in developing the Green, Social and Sustainability-Linked Loan Principles (the Principles). Since the development of the Principles, however, there have been concerns about greenwashing across all sectors, including the financial sector. According to the recent European Banking Authority Report on greenwashing, alleged greenwashing cases in the EU financial sector increased significantly up to 2022 (with around 206 cases reported in 2022 against 40 in 2018) and continued to grow in 2023 (with a 13.6% increase compared to 2022).[2]

Our Horizons regulatory tracker – Sustainability Assembled – looks at how greenwashing concerns have shaped the regulatory agenda in Q2 2024 and sets out some of the key implications of recent regulatory developments for market participants looking to mitigate greenwashing risks, particularly in relation to sustainability-linked loans.

Other key regulatory developments covered in Sustainability Assembled include the release of the European Supervisory Authorities Joint Opinion on the Sustainable Finance Disclosure Regulation, the LMA's response to the Transition Finance Market Review's Call for Evidence, the adoption of the Corporate Sustainability Due Diligence Directive and the publication of new implementation guidance relating to the European Sustainability Reporting Standards.

The LMA is looking to undertake work on a new insights paper which will explore the impacts of greenwashing risk in relation to sustainable lending. We would like to hear from you with your views! Please do contact me if you would be happy to speak with us (all responses will be anonymised) and/or if you would be interested in joining our dedicated Sustainable Finance Regulation Committee.

Hannah Vanstone
Sustainable Finance Regulation Lead, LMA

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1. FCA confirms anti-greenwashing guidance and proposes extending sustainability framework | FCA.
2. Report on greenwashing monitoring and supervision.pdf (europa.eu).

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Greenwashing risk

The second quarter of 2024 focuses our attention on greenwashing risk – with efforts to improve market understanding of greenwashing risks and to provide additional guidance to prevent, address and mitigate greenwashing risk.

In April, the UK Financial Conduct Authority (**FCA**) published its final non-handbook guidance on the anti-greenwashing rule (FG24/3) (**AGR Guidance**) aimed at assisting firms with compliance with the anti-greenwashing rule (ESG 4.31R) (**AGR**). The final AGR Guidance reflects FCA feedback to the guidance consultation (GC23/13) however remains principles-based for application across sectors. Both the AGR and AGR Guidance came into effect on 31 May 2024.

In early June, the European Supervisory Authorities – European Banking Authority (**EBA**), European Securities and Markets Authority and European Insurance and Occupational Pensions Authority (**ESAs**) – published their final reports on greenwashing in the financial sector.

The EBA Final Report refers to a "clear increase in the total number of potential greenwashing cases across all sectors, including EU Banks, from 2012 to 2023 with the total number of alleged cases continuing to increase in 2023." Unsurprisingly, climate change, impact on landscape and biodiversity and impact on local communities are cited as the most common factors subject to greenwashing claims in the EU financial sector.

Both the AGR Guidance and the EBA Final Report emphasise existing general rules and principles that can address and sanction misleading sustainability claims.[1]

Sustainability-linked loans (**SLLs**) are specifically referenced in the EBA Final Report and have also previously been the subject of an FCA letter published in June 2023. However, the comments made are not new and should not come as a surprise. The Green, Social and Sustainability-Linked Loan Principles emphasise the importance of ensuring the credibility and integrity of sustainable loan products setting out core components for the design of relevant loan products. The EBA Progress Report referred to these industry standards and guidance as the most relevant tool to mitigate greenwashing at the product level.

In this section we take a closer look at the AGR Guidance and EBA Final Report and examine application to the sustainable loan market.

Sukhvir Basran, Partner

1. See the EBA's Progress Report for an overview of national legislative frameworks relating to greenwashing.

Financial Conduct Authority publishes final anti-greenwashing guidance

The AGR requires firms to ensure that any references to the sustainability characteristics (i.e. environmental and/or social characteristics) of a product or service are consistent with the sustainability characteristics of the relevant product/service and are fair, clear and not misleading. The AGR applies to all communications and the AGR Guidance refers to references which include (but are not limited to) "statements, assertions, strategies, targets, policies, information and images relating to a product or service".

Highlights of AGR Guidance

The AGR Guidance sets out four key requirements for sustainability references and includes non-exhaustive examples (including of good practice) to support firms in applying the key requirements in the context of their business, products and services. Sustainability references should be as follows:

- Correct and capable of being substantiated: Sustainability-related claims should be factually correct, firms should not exaggerate or overstate the sustainability impact that a product or service has and firms should note that claims can be misleading if conflicting or contradictory information is provided. Firms should be able to support any claims at the time they are being made with robust and credible evidence and review of claims and supporting evidence should continue so long the claims are being communicated.

- Clear and presented in a way that can be understood: The FCA requires all firms to ensure that claims are transparent, straightforward and easily understood highlighting that the broad and general terms may be unclear and confusing and technical terms may require further clarification. The overall impression of a visual presentation should also be taken into account.

- Claims should be complete: Claims should be representative of the relevant product or service, and important information should not be omitted. The AGR Guidance specifically refers to relevant conditions and limitations of information, data or metrics and information which could result in a negative sustainability-impact. Firms are required to consider the entire life-cycle of the product or service rather than cherry pick relevant information.

- Comparisons to be fair and meaningful: Comparisons to previous or alternative offerings should be fair and meaningful in order to enable the audience to make an informed choice with all aspects of the comparison being clear.

The LMA's response to the AGR Consultation can be found here.

ESAs publish final reports on greenwashing in the financial sector

The ESAs provide a common high level understanding of greenwashing as:

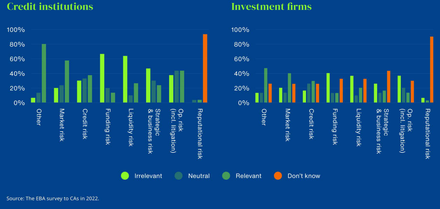
"a practice whereby sustainability related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. This practice may be misleading to consumers, investors, or other market participants."

The ESAs have also identified several core characteristics of greenwashing to help support the understanding of greenwashing which demonstrate the breadth and scope of greenwashing risk.

EBA Final Report – Highlights

The EBA Final Report builds on the EBA Progress Report with further analysis and data regarding key trends across companies, sectors and geography, outlining the types of greenwashing and also the impact of greenwashing on financial and other risks.

Figure 1.1: Impact of greenwashing on financial risks



Source: The EBA survey to CAs in 2022.

Greenwashing concerns relating to SLLs are specifically set out in the EBA Final Report. These refer primarily to the issues set out in the FCA letter published in June 2023 and claims of the SLL product being used as a marketing tool. Given that the SLL market is unregulated however the scale of any potential greenwashing in the SLL market is difficult to measure. The report also highlights the risk of greenwashing in the context of transition finance and sustainability-linked products arising as a result of mislabelled products and misrepresentation of strategies, trajectories and targets. In this respect, the EBA suggest that the policy framework for green loans (see Horizons01) could also investigate general purpose transition finance loans (such as SLLs for example) with the aim of providing greater clarity in the markets and reducing greenwashing.

The EBA Final Report also outlines practices which can be applied at product level and used by institutions to mitigate greenwashing risk. These include institutions adapting governance arrangements and internal processes, aligning with market standards (such as the LMA principles) and utilising external verification processes and providing clear and granular information about sustainability targets.

Commentary

In the Green, Social and Sustainability-Linked Loan Principles and related guidance, the LMA emphasises the importance of integrity and credibility of sustainable loan products. The LMA's Draft Provisions for SLLs go further in providing users with SLL terms along with detailed drafting notes referring to relevant market guidance, toolkits and standards. Both the AGR Guidance and the EBA Final Report highlight the use of market standards to assist lenders and borrowers in structuring, designing and drafting green, social and sustainability-linked loan facilities.

In Horizons01, we also included and analysed the latest market guidance, tools and resources and demonstrated how these materials could be used to support the design, structuring and drafting of sustainable loan products. The AGR Guidance and the EBA Final Report[2] provide further detailed examples, best practice and resources which can be used to prevent, address and mitigate greenwashing risk and address challenges around data, usability and consistency of information. As indicated in Horizons01 and emphasised in the EBA Final Report, market participants should also leverage voluntary guidance and regulation such as the EU Taxonomy to support the credibility and integrity of sustainable loan products and safeguard against greenwashing risk. In light of the AGR Guidance and the EBA Final Report, it is clear that the range of terms used by market participants to refer to and/or label sustainable loans must be very carefully considered. The terms "sustainability-linked loans", ESG-linked loans, KPI-ratchet, for example, are all used to describe a loan product which may align with all or some of the LMA Sustainability-Linked Loan Principles to varying degrees. Green and social loans may align with the LMA's Green and/or Social Loan Principles and/or a lender's internal framework (see Horizons03). Market participants should provide clearer and more complete information regarding the basis on which such terms are used, the framework that the loan product is aligned to and, regardless of the label, provide supporting evidence of the relevant claims.

In addition, assessing sustainable loan products from a regulatory and internal governance and control perspective is essential. This requires well informed due diligence and investment processes, the use of green, social and SLL frameworks which set out robust internal standards regarding relevant data, strategies and terms. Market participants should also therefore ensure that internal processes reflect claims in a systemic way including when referring to, for example, "ESG integration", "SDG alignment", "client engagement and support" etc.

It is also worth pointing out the breadth and scope of greenwashing risk (set out in detail in both the AGR Guidance and the EBA Final Report). Greenwashing can be unintentional and is not limited to marketing or syndication materials, can occur at any stage of the business/investment cycle and extends to relevant communications across the sustainable value chain.

2. Chapter 4 (Addressing greenwashing through the EU Regulatory Framework) and Chapter 5 (Practices to mitigate greenwashing risks by institutions)

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Regulatory Updates

In this section, we highlight the significant progress made in the second quarter with updates to sustainability-related regulation included in Horizons01, new developments and new resources which provide essential practical guidance for market participants complying with sustainability-regulation.

Corporate Sustainability Due Diligence Directive

Following the shaky events of Q1 2024, the Corporate Sustainability Due Diligence Directive was finally formally adopted by the European Parliament on 24 May 2024. No further changes have been made to the text endorsed in March 2024. Member states will have two years to implement the regulations and administrative procedures to comply with the new rules. For more information see the European Council's press release and Horizons01.

"Large companies must take their responsibilities in the transition towards a greener economy and more social justice. The Corporate Sustainability Due Diligence Directive will give us the possibility to sanction those actors that violate their obligations. It is a concrete and significant step towards a better place to live for everyone."

Pierre-Yves Dermagne, Belgian Deputy Prime Minister and Minister of the Economy and Employment

Corporate Sustainability Reporting Directive

ESRS: Two year delay published in Official Journal of the EU

As highlighted in Horizons01, the European Parliament and Council previously agreed to a two-year delay for sector-specific European Sustainability Reporting Standards (**ESRS**) and those for non-EU companies. In April 2024, the European Parliament and Council formally adopted the proposal and the Directive was published in the Official Journal on 8 May 2024. The decision of the Council will postpone the adoption of sector-specific sustainability reporting standards for EU companies and general sustainability reporting standards for non-EU companies to 30 June 2026.

ESRS Corrigendum

In April, a corrigendum to Set 1 of the ESRS was published in the Official Journal of the EU. The corrigendum makes a number of minor corrections primarily to rectify typographical errors, incorrect references, and other evident inaccuracies within ESRS Set 1.

EFRAG: ESRS Implementation Guidance and compilation of explanations

In May 2024, EFRAG announced the finalisation of the first three Implementation Guidance (**IG**) Documents (EFRAG IG1: Materiality Assessment, EFRAG IG2: Value Chain, EFRAG IG 3: Detailed ESRS Datapoints and accompanying Explanatory Note). As set out in Horizons01, the draft IG were open for consultation until early February 2024.

EFRAG has also usefully included a feedback statement with each final IG explaining the main changes made to the relevant IG to reflect public feedback. In addition, a compilation of explanations relating to sector-agnostic ESRS was also published at the end of May. The explanations are non-authoritative in nature and are grouped by topic (ESRS general requirements and general disclosures, environmental ESRS, social ESRS and governance ESRS). Taken together this provides essential additional guidance to questions frequently raised when considering the Corporate Sustainability Reporting Directive (**CSRD**) and ESRS.

CSRD Essentials

A joint working group comprising of GRI, Pascal Durand, Member of the European Parliament and CSRD Rapporteur, and the Lefebvre – Sarrut Group has published a new practical resource, CRSD Essentials. CSRD Essentials aims to explain CSRD in "accessible language". Key areas of focus include the scope, timing and interactions with existing standards, reporting format, legal interconnections, auditing rules and internal supervision, SMEs and implementation procedures and penalties.

Sustainable Finance Disclosure Regulation

In September 2023, the European Commission launched a targeted consultation and public consultation to seek feedback on the Sustainable Finance Disclosure Regulation (**SFDR**). The LMA's response to the targeted consultation can be found **here**.

In early May 2024, the European Commission published a summary report of the open and targeted consultations on SFDR assessment providing the useful insights into market views on key questions including the following:

- **greater coherence**: as anticipated and emphasised in the LMA's response to the targeted consultation, respondents have called for greater coherence in the wider sustainability framework citing challenges and an increase in operational costs caused by misalignment between SFDR, the EU Taxonomy and CSRD;
- **uniform disclosures:** 56% of respondents supported uniform disclosure requirements for all financial products regardless of sustainability claims with additional disclosures for products making sustainability claims; and
- **voluntary categorisation system**: there is strong support for a voluntary categorisation system regulated at the EU level although no clear preference for the proposed approach. An outline of commonly agreed principles however refer to (i) 72% of respondents support a specific category of products with a transition focus and (ii) the need for the underlying criteria to be asset neutral and applicable to all financial products.

The report does not provide an indication of the approach that the Commission intends to take going forward and there is currently no indication as to timing for any new rules.

ESMA: Final Guidelines on Funds' names using ESG or Sustainability-related terms

ESMA has published its final report on Guidelines on Funds' names using ESG or Sustainability-related terms. The content remains broadly in line with the previous version, a summary of which was included in Horizons01. The guidelines will be translated into all of the EU languages and subsequently published on ESMA's website applying three months after that date. The transitional period for funds existing before the application date will be **six months** after that date. Any new funds created after the application date should apply these Guidelines **immediately** in respect of those funds.

UK Government moves forward on Sustainability Reporting Standards

On 16 May 2024, the UK Government published:

- a Framework and Terms of Reference for the Development of UK Sustainability Reporting setting out (i) a summary of the work required for the creation of UK Sustainability Reporting Standards (**UK SRS**) (including the endorsement of IFRS Sustainability Disclosure Standards and implementation of UK SRS through UK legislation and FCA rules for listed companies); (ii) terms of reference for the Technical Advisory Committee and UK Sustainability Disclosure Policy and Implementation Committee; and
- an update - "Sustainability Disclosure Requirements: Implementation Update 2024" relating to sustainability disclosure requirements (**SDR**) including timeframes and milestones for the core elements.

Key updates

Joint Opinion of the European Supervisory Authorities (ESAs) on the Sustainable Finance Disclosure Regulation

On 18 June 2024, the Joint ESAs Opinion on the Assessment of the Sustainable Finance Disclosure Regulation (SFDR) was released.

The Opinion includes a key recommendation from the ESAs to the Commission to consider extending SFDR to introduce a product classification (labelling) system for sustainable finance products. The ESAs have suggested that any such categories should be simple with clear objective criteria or thresholds, to identify which category the product falls into.

Importantly, the ESAs also encourage the inclusion of the concept of "transition investment" in the SFDR to allow for the development of a 'transition financial product category'. Given the vital importance of transition finance to meeting net zero commitments, and our ongoing work at the LMA to support transition finance, we will be closely following further developments in this area.

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ESG Reporting Standards

This past quarter we have continued to see the development of research projects, tools and guidance.

These include:

- confirmation by the International Sustainability Standards Board's (**ISSB**) that it will add two research and standard-setting projects to its two year plan: (1) risks and opportunities associated with biodiversity, ecosystems and ecosystem services; and (2) risks and opportunities associated with human capital. Each research project will focus on the information needs of investors when assessing how these risks and opportunities may affect a company's prospects. The ISSB intend to build on relevant existing materials (including SASB Standards, CDSB Framework guidance and TNFD) and promote interoperability between ISSB disclosures and other relevant standards and frameworks; and
- EFRAG and the IFRS Foundation have published an interoperability guidance relating to the ESRS and the IFRS Sustainability Disclosure Standards (**ISSB Standards**). The guidance sets out alignment of disclosure requirements and information between the two standards with the aim of reducing complexity, fragmentation and duplication and enhancing efficient compliance with both sets of standards.

Commentary

According to the IFRS Foundation, jurisdictions representing more than 50 per cent. of the world's GDP have decided to use or are taking steps to align their sustainability disclosure standards with those of the ISSB. This is a significant step towards establishing a harmonised baseline of reporting standards since IOSCO announced its endorsement of the ISSB standards last year. In May 2024, IFRS Foundation released a guide – the Inaugural Jurisdictional Guide for the adoption or other use of ISSB Standards. Market participants are encouraged to familiarise themselves with the various tools, guides and educational materials summarised in the Regulatory Implementation Programme. Additional analysis and information on the use of ESG standards in loan products can be found in Horizons01.

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Nature-related Risks and Opportunities

Nature-related financial risks continue to be highlighted in Q2 of 2024 with an ever increasingly emphasis on the need for market participants to understand the impact of nature-related loss to impact the financial and business sectors.

In Horizons01, we outlined the important role that sustainable loan products can play in addressing biodiversity loss including, for example, through selection of KPIs in sustainability-linked loans and green loans.

The report led by the Green Finance Institute – Assessing the Materiality of Nature-Related Financial Risks for the UK – emphasises the need for early action by market participants to assess, disclose, price in and manage nature related risks and impacts. The content clearly demonstrates the potential adjustments in average loan values of sectors affected by higher levels of nature-related financial risk.

In order to address this risk, market participants are required to have a deeper and broader understanding of biodiversity risks. A proactive and intentional approach is required to risk management, the investment process and specific loan terms to allow banks and credit funds to assess the potential impact of nature-related risk on loan portfolios. An approach which is better informed and intentional has the potential to either steer capital flow away from activities that damage nature or more accurately assess and mitigate such risk. Just as importantly however, a greater understanding of nature-related risk will enable market participants to analyse nature within their own transition plans, support and engage their client base and thereby identify nature-positive opportunities and services.

We outlined in Horizons01, resources and tools which market participants can utilise to increase deepen knowledge of nature-related risk and opportunities, address nature-related risk and identify opportunities. As well as the TNFD framework and guidance, this quarter has seen more strategic collaborations and partnerships in the market resulting in much needed educational material, guidance and toolkits for finance professionals.

In this section, we highlight some of the most recent reports, materials and innovations including the tools, definitions and benchmarks in the report led by the Green Finance Institute as well as the guide for investors published by Ceres on behalf of Nature Action 100. The technical guide published by the PRI is a very useful starting for any market participant looking to put in place a biodiversity policy. For further analysis how biodiversity issues can be taken into account in loan products see Horizons01.

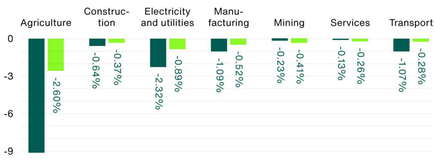
Assessing the Materiality of Nature-Related Financial Risks for the UK

An innovative report – Assessing the Materiality of Nature-Related Financial Risks for the UK – analyses the materiality of nature degradation on the UK's economy and financial sector in the near and long term. The report, led by the Green Finance Institute with a technical team of leading researchers and direction from Department for Environment, Food and Rural Affairs, HM Treasury, the Taskforce on Nature-related Financial Disclosures and the UK Financial Conduct Authority has developed a number of innovative tools, definitions and benchmarks.

The UK is one of the most nature-depleted countries in the world with three-quarters of the country affected. This could reduce GDP by 12% – a loss greater than that caused by the 2008 financial crisis or the Covid-19 pandemic.

Potential adjustments in average loan values of up to -9.5% for the agriculture sector in the domestic scenario, -2.3% for electricity and utilities and around -1% for manufacturing and transport.

Adjustment in Loan Value in 2028



Key Documents & Supplementary Materials

Nature Action 100: New guide for investors

On 26 March 2024, Ceres on behalf of Nature Action 100 published a new guide, "Exploring Nature Impacts and Dependencies: A Field Guide to Eight Key Sectors," to support investors to engage with companies in their portfolios on nature impacts and dependencies, thereby reducing overall portfolio risk. The guide includes eight individual fact sheets (focussing on biotechnology and pharmaceuticals, chemicals, consumer goods retail, food, food and beverage retail, forestry and packaging, household and personal products, and metals and mining). Each factsheet sets out a sector overview and value chain breakdown, nature related impacts and dependencies and includes key questions for investor engagement.

Background - Nature 100 Action

Nature 100 Action: Since September 2023, 200 institutional investors (representing over $28 trillion in assets under management and advice) are engaging with companies on nature and biodiversity loss. Companies are called on to take the steps needed to protect and restore nature and ecosystems in line with the Nature Action 100 Investor Expectations of Companies.

PRI Guidance for asset owners and investment managers: Developing a biodiversity policy

On 26 March 2024, the Principles for Responsible Investment (**PRI**) published a Technical Guide for Asset Owners and Investment Managers - Developing a Biodiversity Policy

The guide is based on a review and analysis of PRI signatories' biodiversity policies and sets out:

- the case for investor action on biodiversity referring to both physical and transition risks;
- guidance to support investors to integrate and build a strategic approach to biodiversity loss;
- an outline of the different policies that investors can consider;
- key issues to consider before writing a biodiversity policy;
- the key components of a biodiversity policy; and
- PRI reporting framework indicators allowing signatories to provide relevant information within the 2024 PRI Reporting Framework.

The guide refers to examples of investment managers and asset owners committed to biodiversity-related policies. The following additional guidance is also available: Developing and updating a responsible investment policy: A technical guide, PRI resources on biodiversity and An introduction to responsible investment: Biodiversity for asset owners.

Sustainability Assembled

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Spotlight on Transition

The critical role of the private sector in transitioning to a sustainable future is emphasised by the Transition Finance Market Review in the UK and the Clean Transition Dialogues in the EU.

Transition Finance Market Review

The Transition Finance Market Review (the **Review**) will consider which market tools are most impactful, how to create the conditions for scaling credible transition focussed capital and how to maximise the opportunity for UK based financial services and position the UK's professional services as a global hub. The LMA's response to the Review's Call for Evidence can be accessed here.

Clean Transition Dialogues

The Commission's Communication – "The Clean Transition Dialogues – Stocktaking" (published in April 2024) emphasises the crucial role of private capital in strengthening and supporting the European Clean Deal contributing to what is referred to as a reinforced industrial approach. To date, nine clean Transition Dialogues have taken place with easier access to finance being highlighted as key building blocks including:

- the continued need to mobilise private sector capital including facilitating cross-border investing and emphasising the need for European institutions to strengthen their engagement with institutional players to mobilise private funding;
- reduce the cost of capital; and
- focus on diversity of funding options, propose new innovative financial tools and use public funds to catalyse private investment.

NGFS: Transition Plan Reports

On 17 April 2024, the Network for Greening the Financial System unveiled three significant reports for banks developing transition plans to meet mandatory prudential requirements. The publications delve into the critical role of transition plans in facilitating the mobilisation of capital within the financial system, managing climate-related financial risks, and their relevance to micro-prudential supervision.

The cover note summarises the key findings of the work based on the following three reports:

- Tailoring Transition Plans: Considerations for EMDEs: the needs and challenges of emerging markets and developing economies related to transition plans;
- Connecting Transition Plans: Financial and non-financial firms: links between the transition plans of real economy and financial institutions; and
- Credible Transition Plans: The micro-prudential perspective: the credibility of the transition plans of financial institutions from a micro-prudential perspective.

TPT publishes sector-specific guidance on climate transition plan disclosures

The Transition Plan Taskforce (**TPT**) has issued the final versions of its sector specific guidance. The TPT Sector Deep Dive Guidance provides sector-specific guidance for preparers to interpret the Disclosure Framework for seven sectors – asset managers, asset owners, banks, electric utilities and power generators, food and beverage, metals and mining, and oil and gas. In making its selection, the TPT sought to identify sectors for which additional guidance would be beneficial in kickstarting transition plan disclosures, while also identifying opportunities to leverage existing sectoral guidance and consolidate it into the context of the Disclosure Framework.

The package of measures also includes:

- TPT Sector Summary: provides an overview of transition plan guidance for 30 financial and real economy sectors. The guide includes a brief "Sector Summary", including recognised decarbonisation levers, metrics & targets, and key sources of guidance for a transition plan in that sector;
- TPT Transition Planning Cycle: an illustrative guide to continue transition planning journey which sits alongside the TPT Disclosure Framework; and
- a paper on the opportunities and challenges relating to the use of private sector transition plans in emerging markets and developing economies.

The sector-specific guidance is intended to build on and be complementary to the TPT Disclosure Framework and related implementation guidance and users are advised to review those materials. All TPT guidance and material can be accessed here.

Ben Caldecott, Co-Head, Secretariat, TPT:

"We need to back up net zero targets with firm plans. Climate transition plans, if suitably ambitious and delivered with appropriate actions and with proper accountability, can help society allocate capital to companies and assets that are actually contributing to meeting the aims of the Paris Agreement, and away from those that aren't. The Transition Plan Taskforce has made available a globally applicable set of resources to help companies to build their transition plan and successfully raise transition finance."

Target Setting Protocol

In April 2024, the UN-convened Net-Zero Asset Owner Alliance (**NZAOA**) comprised of 89 institutional investors and managing $9.5 trillion assets has released the fourth edition of its Target-Setting Protocol (the **Protocol**). The Protocol is a comprehensive guide setting out a pathway for investors to reduce portfolio emissions in line with the Paris Agreement. The fourth edition of the Target-Setting Protocol features a revised structure in two key parts: (1) Target-Setting Protocol (consolidating all pertinent information for NZAOA members regarding target setting and reporting requirements) and (2) the Background Document (a supplementary resource, providing additional insights on content related to target setting for NZAOA members, allowing for detailed explanations and discussions not directly reflected in target setting requirements).

With this latest iteration of the NZAOA target-setting protocol, the alliance is leveraging on Assessing Sovereign Climate-related Opportunities and Risks database (ASCOR database).

Background

ESG and micro-prudential supervision

For the first time, from next year, banks will be required to draw up transition plans under the prudential framework which are consistent with sustainability commitments undertaken under other law and regulation (such as CSRD). Bank supervisors will, for the first time, oversee how banks handle ESG risks and include ESG considerations in the context of annual supervisory examination review. In addition, ESG reporting and disclosure requirements will apply to all EU banks and co-legislators have agreed to allow banks to enjoy a favourable risk weight treatment where they finance an infrastructure project that has a positive or neutral environmental impact.

Transition Planning and Transition Plans

The NGFS defines "*transition planning*" and "*transition plans*" as follows:

"**Transition planning**": the internal process undertaken by a firm to (i) develop a transition strategy to deliver climate targets that firms may voluntarily adopt or that are mandated by legislation or the appropriate authority, and/or (ii) prepare a long-term response to manage the risks associated with its internal strategic planning and risk management processes undertaken by a financial institution to prepare for risks and potential changes in business models associated with the transition to a low emission and climate-resilient economy.

"**Transition plans**": a key product of the transition planning process and are an external-facing output for external audiences, such as investors, shareholders and regulators.

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 Guidelines for Sustainability-Linked Loans Financing Bond	Model Provisions for Use of Proceeds Transactions 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

Termination

The SC Letter contains the most common termination events but parties should consider whether any other termination events are appropriate on a case-by-case basis. The SC Letter is currently drafted on the following basis:

(i) the termination provisions are drafted to align with the LMA's Draft Provisions for SLLs so that the appointment falls away on signing or earlier where relevant; and

(ii) additional termination provisions have been included (such as no fault termination) and the option for extending the appointment of the SC is included (for example for a sleeping SLL).

Conditions

The SC Letter sets out some of the conditions attaching to the SC role however there was a lack of consensus regarding this point. Users will need to consider the suitability of these conditions and whether any additional conditions should be included on a case-by-case basis.

Indemnity

The SC Letter includes an indemnity from the Company in favour of the ‘Indemnified Persons’ which includes the SC but also includes optional drafting which could include ‘Affiliates’ of the SC.

Non-reliance

Given that the SC role is typically a non-reliance role, the SC Letter has been drafted to include non-reliance provisions.

Sole and exclusive appointment

Sole Appointment

The SC Letter is based on the appointment of a single SC. Multiple SCs may be appointed in the market - however based on feedback provided, the SC Letter envisages a single SC being appointed. Therefore, users will need to make additional changes to the SC Letter in circumstances where more than one SC is to be appointed.

Exclusive Appointment

The SC Letter deals with the appointment of the SC as the exclusive SC for the Facility/ies. The SC Letter also contains optional drafting providing for a restriction on the appointment of any other sustainability-related parties. Parties will need to consider whether this restriction is appropriate on a case-by-case basis and consider whether any other/additional appointments in respect of sustainability matters should be explicitly carved out of the general restriction.

Role and the Sustainability Coordination Services

The role of the SC is defined under the SC Letter by reference to the Schedule (Sustainability Coordination Services). Careful consideration will need to be given by users to the scope of the services to be provided. Whilst the SC Letter seeks to cover to the services most frequently carried out by SCs in the market at the time of publication, it is not intended to be a comprehensive list. The SC Letter also includes wording which is intended to limit the liability of the SC, given that this role is typically a non-reliance role.

The Schedule to the SC Letter contains a list of the most common services carried out by SCs in the market as at the date of publication of the SC Letter. These include, amongst other things, assisting the Company:

(i) in applying its sustainability strategy for the purposes of agreeing the sustainability-linked loan terms;

(ii) with the selection of key performance indicators and the calibration of sustainability performance targets; and

(iii) in responding to any questions, and coordinating and providing sustainability information, as appropriate.

Publicity/announcements

The SC Letter contains certain restrictions on the ability of the Company to refer to the Facility/ies as being “sustainability-linked” without the consent of the SC. Users are encouraged to refer to the LMA's Draft Provisions for SLLs for further guidance. The SC Letter may require further amendment in order to align with the approach taken to declassification and publicity in the relevant facility agreement.

Appointment

The SC Letter deals with the appointment of the SC as the exclusive SC for the Facility/ies. The SC Letter also contains optional drafting providing for a restriction on the appointment of any other sustainability-related parties. Parties will need to consider whether this restriction is appropriate and whether any appointments in respect of sustainability matters should be explicitly carved out of the general restriction.

Information

The SC Letter includes, amongst other things, a representation and warranty from the Company that all Sustainability Information (as defined therein) is true, complete and accurate in all material respects as at the date it is provided (or as at the date (if any) at which it is stated) and is not misleading in any material respect. Users should note that the definition of Sustainability Information and this representation and warranty is intended to align with the corresponding definition and term of the LMA's Draft Provisions for SLLs.

Definitions

The SC Letter contains optional drafting for use where mandate documents have already been entered into. Users will need to consider whether mandate documents are already in place and to update the SC Letter where appropriate on a case-by-case basis. Users may also want to consider whether Part 8C of the Term Sheet (containing SLL terms) should be appended to the SC Letter in order to outline the SLL terms that the SC is assisting with.

Fees, costs and expenses

The SC Letter envisages that fees will be set out in a separate fee letter.

Confidentiality

The SC Letter includes a confidentiality undertaking from the Company. Parties will need to consider whether the letter needs to be disclosed to any other parties.

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

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.