Safety in numbers

LEVELLING THE PLAYING FIELD FOR GREEN FINANCE

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Introduction

Over the past 18 months, financial services firms have turned up the volume on green finance, in the form of new commitments, new products/funds/investments, new job functions and data gathering.

While one would expect this to have been driven by government and regulatory pressure, our research reveals that it is in fact individual customers and investors pulling harder on those strings.

This leaves firms in a predicament – how to innovate when cost is a major barrier and without the risk-mitigating comfort of clear, minimum industry standards?

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> How to innovate when cost is a major barrier?

At COP26, the UK Chancellor claimed that London will become the world’s first “net-zero finance centre”. Our research reveals that more must be done to create an incubator for sustainable innovation. In the lead up to the conference, only 11% of industry leaders were “very optimistic” about the impact of recent government announcements on green finance, and when we asked what more is needed, their demands were clear: more financial incentives and regulatory support.

At the moment, the industry is stuck in a circular argument: green finance is necessary because it is the right thing to do, and it’s the right thing to do because it is necessary. There’s a proven model for spurring the market forwards, and that is to level the playing field and help reduce the risk by setting clear expectations. Firms then know what’s expected of them and what everyone else is doing.

While we may be at an impasse, the industry isn’t standing still. We hope this report gives a useful snapshot of how firms are responding to the demands for green finance, a benchmark for what comes next, and a summary of the barriers and risks that need to be overcome.

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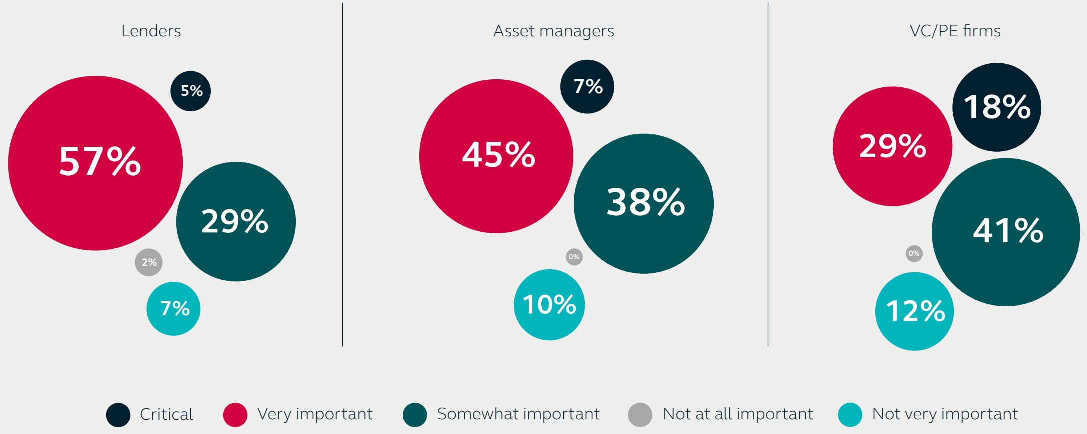
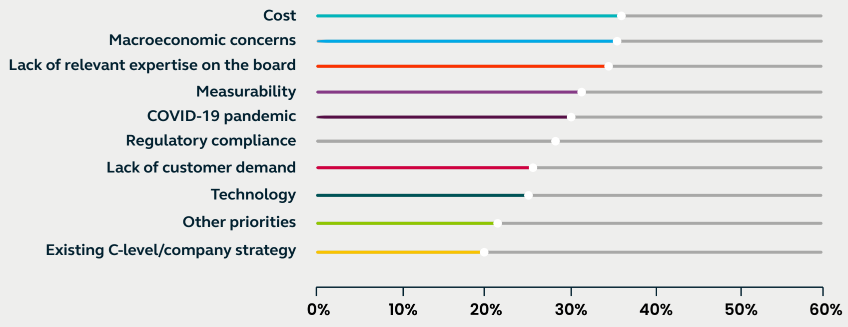
Data at a glance

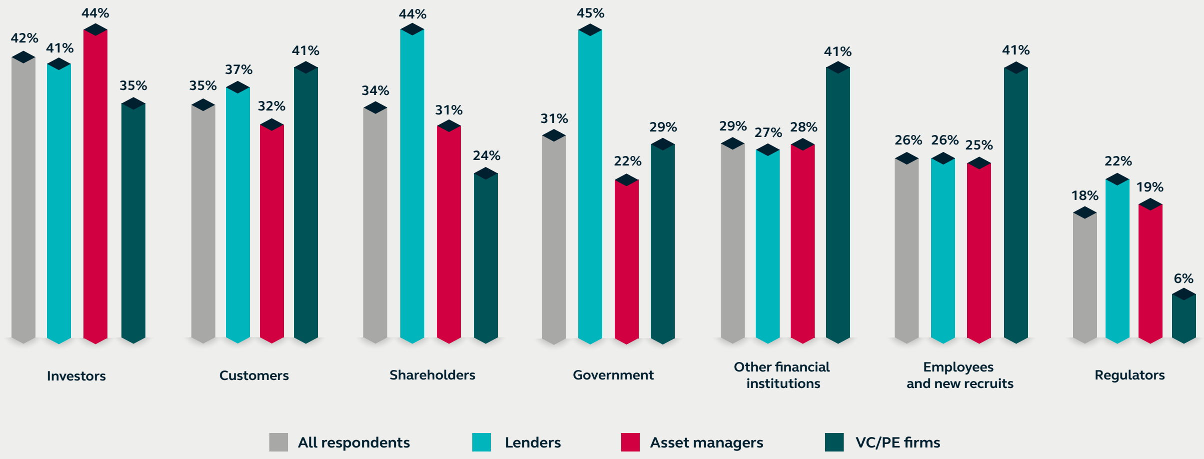
How important is green finance to your company's strategy?



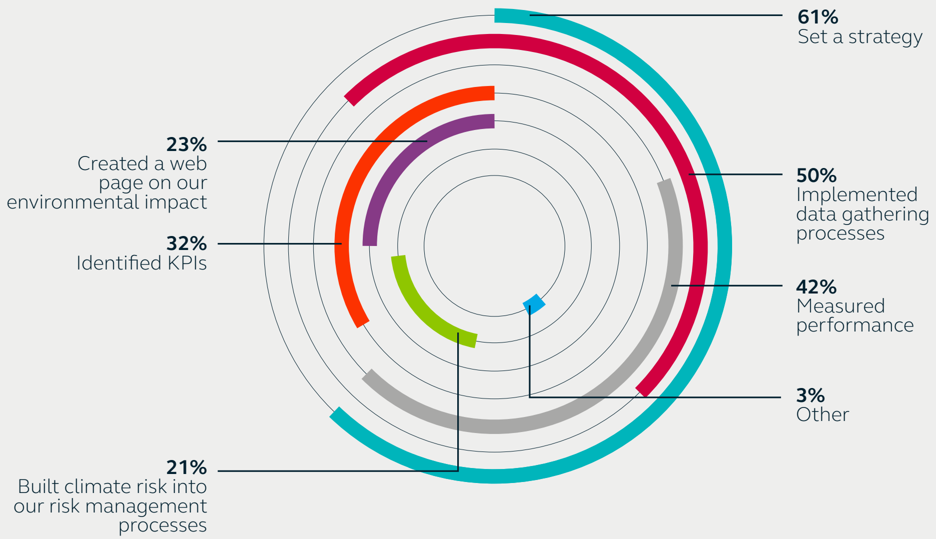
Barriers to adopting green finance



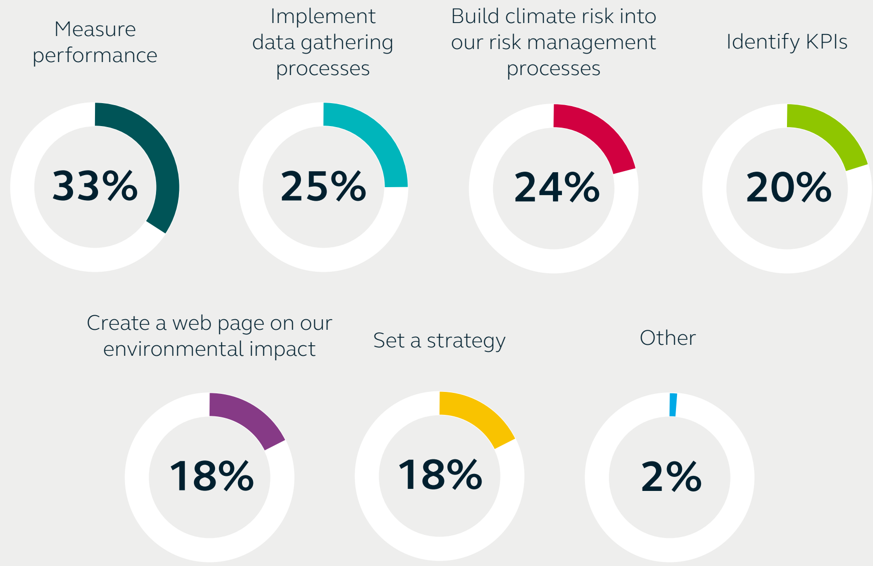
Where is demand for green finance options coming from? – Strong demand



Steps already taken to support green finance

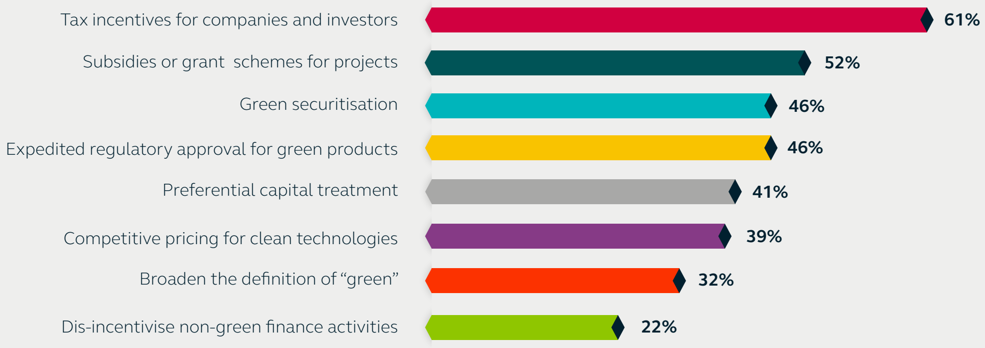


Planned next steps on the green finance journey

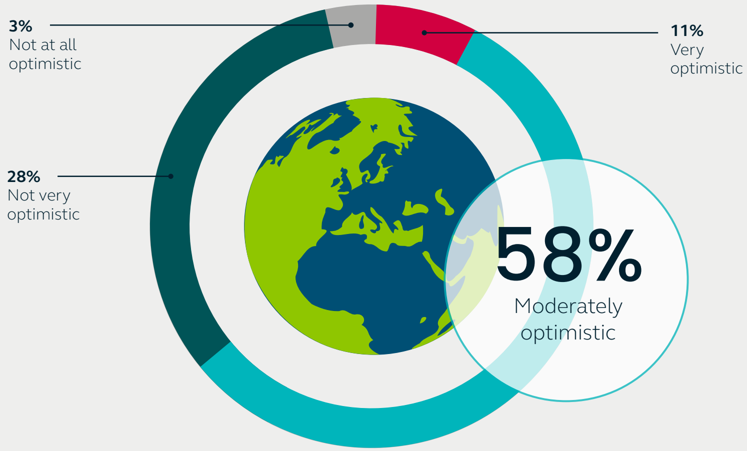


Launching a green finance product/offering

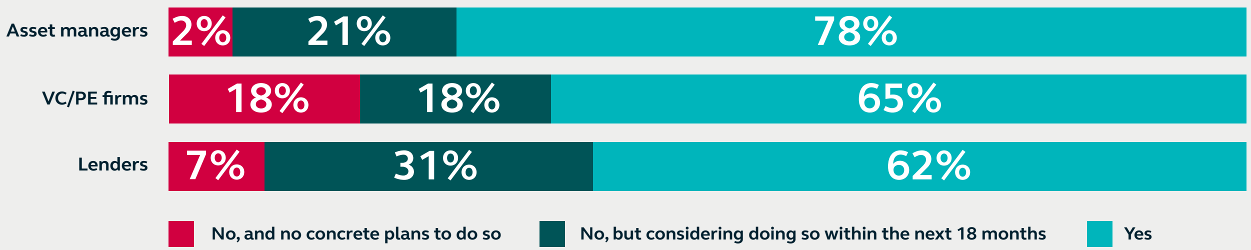
What should regulators/policymakers do to boost the green finance market?



COP26 and recent UK policy announcements will stimulate the green finance market in 2022



Is your organisation exploring new technologies to support its green finance strategy?



Regulation: the great equaliser

From the cost of being green to the cost of doing business

More than half (55%) of financial services firms say green finance is "critical" or "very important" to their business. This rises to 62% of lenders, which coincidentally are also feeling the biggest pressure from government, falling to 52% of asset managers and 47% of VC and PE firms.

While VC and PE firms are significantly more likely to say green finance is "critical" to their business (18%), they are also the most likely to say it's "not" or "not at all" important (12%), suggesting greater divergence of opinions and progress on the sustainable economic recovery.

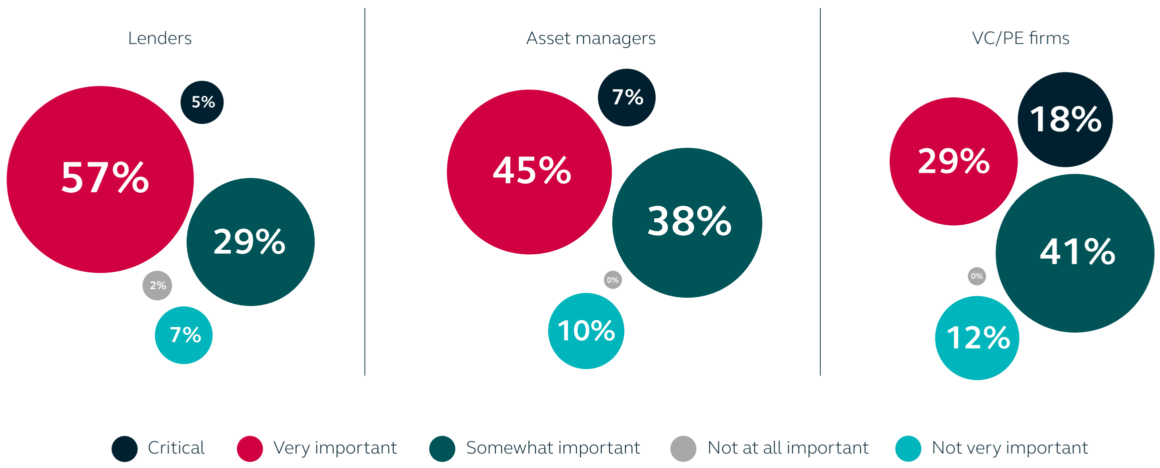
The biggest pressure on the industry as a whole is coming from individuals, including investors (42%), customers (35%) and shareholders (34%). The biggest pressure for lenders is coming from the government (45%), for asset managers from investors (44%) and for VC and PE firms from their employees and future recruits (41%).

Imogen Benson, associate at TLT, says: "A lot of progress has already been made in terms of putting green finance on the banking agenda, but this has mainly been driven by individuals, who play an important role but don't necessarily have the power to make a wholesale market change. There's a huge role for regulation to play in setting clear market standards and enabling firms to move forward."

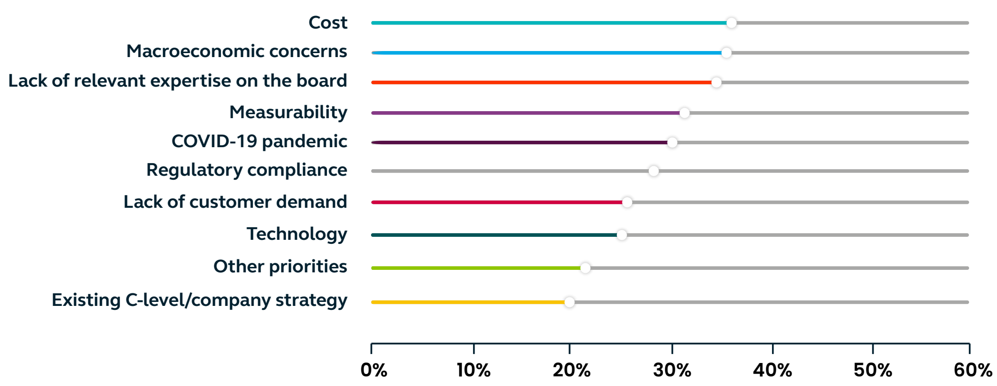
Cost is the biggest barrier to firms adopting green finance, with 8% calling it a "critical" barrier and 36% saying "critical" or "significant". This is followed by macroeconomic concerns (36%), a lack of relevant expertise on the board (34%) and challenges with measurability (32%).

Benson adds: "None of these challenges are insurmountable, but they also cannot be properly addressed by firms acting alone. As soon as something becomes mandatory, the cost of change becomes the cost of compliance or of doing business. Of course, firms still face the challenge of balancing competing demands, but all the signs suggest sustainability is only going to go up the agenda, and that the market for green financial products will continue to grow."

How important is green finance to your company's strategy?



Barriers to adopting green finance

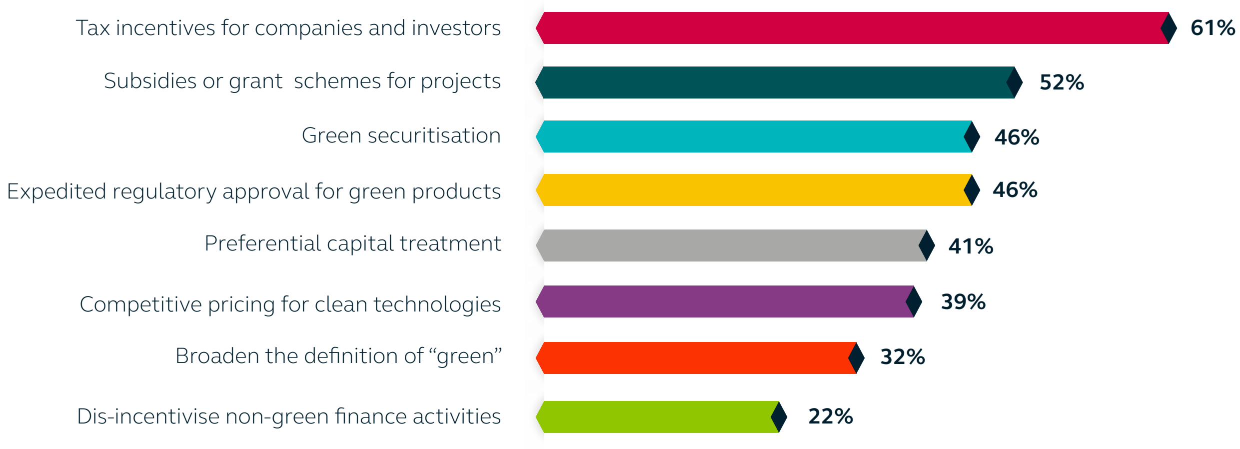


Almost a third (30%) of firms say the Covid-19 pandemic has also held them back from adopting green finance, highlighting the difficulty with balancing competing priorities.

Firms have clear demands from the government and regulators to help the green finance market flourish. Their top requests are tax incentives for companies and investors (61%), subsidies or grant schemes for projects (52%), green securitisation (46%) and expedited regulatory approval for green products (46%), followed by preferential capital treatment (41%), competitive pricing for clean technologies (39%) and broadening the definition of "green" (32%).

In October 2021, two groups of businesses – the 300-strong Glasgow Financial Alliance for Net Zero (Gfanz) and signatories to a letter with £4.5tn in assets, including Santander, Aviva and Legal & General Investment Management – called on the government to align regulatory frameworks with net zero emissions targets and for mandatory disclosures of net zero transition plans respectively.

What should regulators/policymakers do to boost the green finance market?



Building expertise

The majority (58%) of firms have already appointed an experienced, dedicated, C-level or non-executive expert in green finance. While this is higher (75%) for VC and PE firms, recruitment plans will see asset managers and lenders leading the way within the next year.

Robin Penfold, partner at TLT, says: "The traditional route to market for executive knowledge and expertise is to find people who have held relevant roles in multiple organisations over a long period of time. With climate-related risk, this is a relatively new subject area and non-executive directors who do know about this will be in short supply and high demand. Firms ought to be thinking about the talent pipeline and what their board composition needs to look like moving forwards."

Nina Searle, partner at TLT, adds: "Firms must also be wary of where people's passions lie. For example, if someone is given responsibility for environmental, social and governance issues, which are often talked about together but cover a wide variety of issues, can they cover these equally?"

> "Firms ought to be thinking about their talent pipeline

Data: the great differentiator

Firms are prioritising product launches and data gathering

The key priorities for firms so far have been to set a strategy (61%), data gathering (50%) and performance measurement (42%), more so than launching green finance products/offerings.

This reflects the need to understand the base line of what firms are doing and their exposure to climate-related risks, in anticipation of further regulatory and stakeholder scrutiny and obligations around this in the near future – as well as the time it takes to put these systems in place.

However, around two fifths (39%) of firms have already launched a green finance product/offering, enabling them to test the waters and learn valuable lessons. A further 53% plan to do this in the next twelve months, with the final 8% extending this to 24 months.

> Firms will need to carefully consider how they are communicating

As a result, the market for these products/offerings is set to become increasingly competitive. Firms will need to carefully consider how they are communicating with customers and intermediaries and how these products are being managed, particularly as the regulatory landscape evolves.

While half of firms have implemented data gathering as part of their green finance journey, only 42% are measuring their performance and 32% have identified KPIs. Fewer still (23%) are publishing their environmental impact on a public website, although around a fifth are planning to look at each of these areas next.

A quarter (25%) of firms are planning to implement data gathering processes as a next step, bringing the total proportion of firms engaged in this activity to 75%.

Steps already taken to support green finance

While a third (32%) of firms say measurability is one of the biggest barriers to adopting green finance, this again is not insurmountable. Mandatory climate-related financial disclosures have driven the emergence of independent ratings companies, and greater clarity on what "good" looks like. These developments in climate-related risk and performance data will help firms identify both what to measure and how.

Robin Penfold, partner at TLT, says: "Firms have made a lot of progress, but everyone is still looking around the room wondering what everyone else is doing. This kind of information sharing is crucial to driving the green finance market forward and we've seen it work brilliantly elsewhere. It's perfectly possible to do this within the boundaries of competition law. There are a number of groups forming, and some of the regulatory updates have been useful, highlighting what has and hasn't worked, but the industry needs more closed door sharing, toolkits and examples of practicable ideas."

Perhaps to assist with data analysis, 70% of firms are exploring new technologies to support their green finance strategy, while a further 24% are considering doing so in the next 18 months.

Asset managers are the most likely to be exploring this (78%), followed by VC and PE firms (65%) and lenders (62%), although 18% of VC and PE firms also say they have no plans to do this.

Nina Searle, partner at TLT, says: "ESG performance will have an impact on a company's value, so VC and PE firms need to be able to measure this as part of their standard monitoring and address any shortcomings well in advance of a sale. At the moment, this is often a last-minute consideration, but buyers will increasingly expect to see long-term strategies in place. Firms need to make sure they have a good understanding of ESG criteria and what good looks like."

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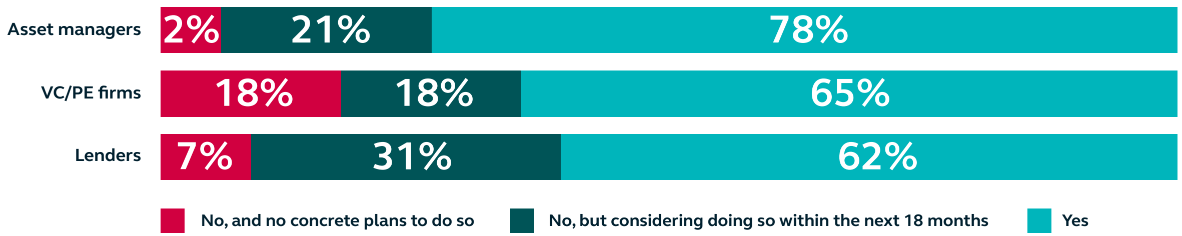
> ESG performance will impact a company's value

Is your organisation exploring new technologies to support its green finance strategy?



Conclusion

It is widely believed that all finance will one day have an element of green. However, COP26 made it clear that faster progress is needed, which can only come from bold ambitions, clear rules and expectations, accurate measurement and greater industry collaboration.

As well as high level agendas, the financial services market needs more pragmatism – and a framework within which firms can innovate in the knowledge that they are pulling in the same direction and that what they're working on will achieve the right outcomes.

The industry is preparing for a year that feels markedly more revolutionary than the last, with more practical conversations that allow for unfettered progress on financing green and greening finance – and practical solutions that sit below that high level agenda, from what a product information sheet should look like to what these financial products need to do.

While only 11% of firms are "very optimistic" about recent events stimulating the green finance market in 2022, 69% are "very" or "moderately" optimistic and only 3% are "not at all" optimistic. There are various proven models for bringing about significant change in the financial services industry. What's needed now is clear direction, strong incentives and collaboration.

Research methodology

The research was designed and commissioned by UK law firm TLT and conducted by Fintech Futures in Q3/4 2021. We spoke to 119 senior decision-makers across banks/credit unions/lending (collectively referred to as "lenders" in the report), investment/wealth management/asset management ("asset managers") and venture capital/private equity.

About TLT

For what comes next

TLT is a UK law firm delivering strategic and day-to-day legal support across the green finance market.

As a full service commercial law firm with regional, national and global reach, we support clients with their ESG strategies, including the UK's major banks, building societies, fintechs, investment funds, asset managers, private equity and venture capital firms, pension funds and corporates.

We specialise in the clean energy; digital; financial services; leisure, food & drink; real estate; retail & consumer goods; and public sectors, offering tailored, commercial advice rooted in experience.

We advise on EU and UK green finance policy and regulation through our involvement with organisations such as the Green Finance Institute, Aldersgate Group and UK Finance.

Able to advise across the three UK legal jurisdictions of England & Wales, Northern Ireland and Scotland, TLT has six UK offices in Bristol, London, Manchester, Glasgow, Edinburgh and Belfast.

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