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INDOS is proud to provide a range of services for clients who incorporate environmental, social and governance (ESG) considerations into their investment businesses. Our monthly newsletter ‘ESG Insight’ will provide you with the latest news and views on ESG, helping you to stay on top of developments in this increasing area of focus.

What is happening with the Sustainable Finance Disclosure Regulation?

The Sustainable Finance Disclosure Regulation, or SFDR as it referred to, was initially outlined in our July edition of Insight. It forms part of several new regulations which put sustainability at the heart of the EU financial system.

SFDR will be implemented using a staggered approach. Level 1, which will require managers to publish policies on their website about how sustainability risks are integrated into their investment processes, will apply from 10 March 2021. However, the European Commission has sent a letter to a number of trade associations advising the implementation of the more detailed Level 2 disclosures (known as Regulatory Technical Standards or “RTS”) will be delayed, possibly to January 2022.

Notes
1) https://www.simmons-simmons.com/en/publications/ckfy0n7sz6yal0a25lk4acasc/european-commission-delays-application-of-sfdr-level-2-rts
2) https://www.aima.org/resource/q-a-on-sustainable-finance-disclosure-regulation.html

Pending further clarification from the European Commission it is expected SFDR will still be legally binding as of the 10th March 2021, but managers will find adhering to the Articles which require further clarification from the RTS challenging.

Specifically, this applies to:

- Article 4, detailing the Principle Adverse Impacts

- Articles 8 and 9 detailing the product disclosures

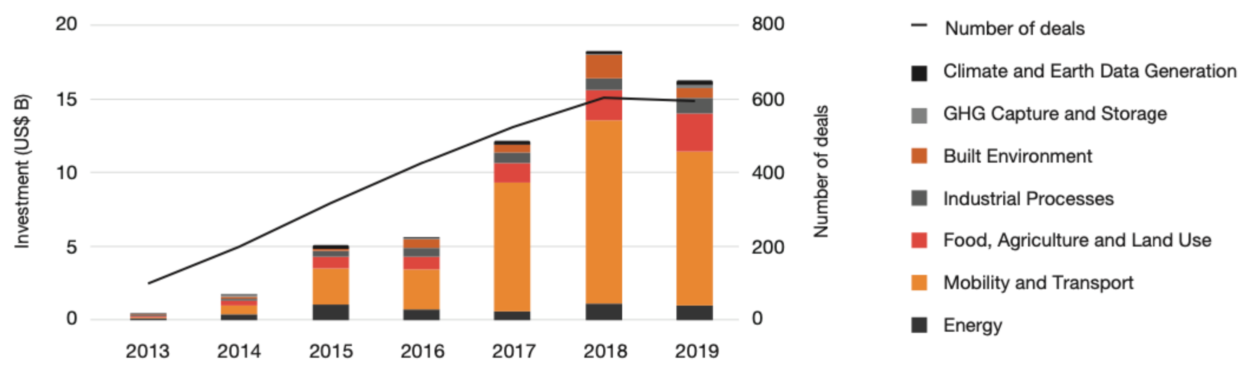
In response to this a number of legal firms are suggesting managers update their fund documentation with principles and high level disclosures by March 2021 and when the Level 2 measures come into effect.

Climate-tech and ESG shorts

A cautionary tale of governance in Climate-Tech start-ups

The investor focus on ESG issues has made climate-focused industries a capital fertile land with investors flooding in, leading to a significant increase in ESG-driven start-ups. Many of these start-ups are within the 'climate-tech' industry which encompasses a broad set of sectors aiming to decarbonise the global economy by 2050. Climate-tech covers multiple diverse industries such as energy, mobility and agriculture. This emerging industry has received $60bn in venture capital funds between 2013-2019 according to the PwC State of Climate-Tech report (1). The most well-funded sector is mobility and transport, likely due to its 25% contribution to global emissions, taking $37.4 billion between 2013-2019.

VC investment in Climate Tech and number of deals



Source: PwC analysis on Dealroom data

As with any sector undergoing significant growth in a short time, governance and oversight has become an issue for investors. Previously, we have highlighted how taking a short position in a company can be a useful behaviour to root out bad actors. In the case of climate-tech start-ups, Hindenberg Research (2) has levelled allegations against Nikola and Loop, suggesting that Nikola's hydrogen-fuelled truck is not operational and Loop’s recycling technology does not work at scale. Despite denying these allegations, stock prices plummeted at the news.

There has been debate over how shorting can be balanced with ESG and long-termism. Last year the world’s largest pension fund stopped lending out securities because it’s then head, Hiro Mizuno, believed shorting was incompatible with his mission of long-term value creation. Further, to counter short term volatility the practice was banned in 6 EU countries during the pandemic.

If the information released by Hindenberg Research proves to be true this could be a sign shorting, if used correctly, is able to have strong ESG uses by countering poor corporate governance by highlighting potential weaknesses in ESG practices in an organisation.

Notes
1) https://www.pwc.com/gx/en/services/sustainability/assets/pwc-the-state-of-climate-tech-2020.pdf
2) https://hindenburgresearch.com/nikola/

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