LSB STANDARDS OF LENDING PRACTICE
BUSINESS CUSTOMERS

Business customers and green finance

April 2023

Contents

1. Introduction

The significant role the financial services sector can play in enabling the transition to a net zero economy has given rise to the concept of green banking and finance.[1] Green banking practices aim to improve the carbon footprint of customers of financial services providers by promoting positive environmental practices and reducing the carbon footprint linked to a firm's financial activities.

As financial services firms continue to develop green propositions across their lending and investment arms, they are doing so against a backdrop of legislative and regulatory developments. For example, the Bank of England and the Financial Conduct Authority (FCA) have identified environmental and sustainability as areas of focus for the financial services industry.

There are also economic factors driving change, as well as customers, whether personal or business, becoming increasingly focused on the impact of climate change, and how they can take positive steps to reduce their own environmental impact. Terminology plays an important role in this space too. Terms such as 'green' and 'sustainable finance' are being used interchangeably across financial services. As well as this, 'greenwashing' is being used to describe advertising that promotes environmental benefits that are not quite as they are made out to be. Therefore, this area of finance can be a challenging space for industry, and Small and Medium Enterprises (SMEs) alike, to navigate.[2]

The Lending Standards Board's (LSB) mission is to drive fair customer outcomes. To ensure that the LSB, as the primary self-regulatory body for the banking and lending industry, is able to support registered firms (firms) as they develop propositions to support customers looking to use finance for environmental and sustainability purposes, we have undertaken work to inform our understanding of the current landscape.[3] In doing so, we have considered the challenges firms and their SME customers face when providing and using sustainable products. We have also sought to understand how the LSB, through our Standards of Lending Practice for business customers, can support the delivery of good outcomes for customers using green or sustainability linked products.

The following report sets out the insight we have gained from our ongoing work in overseeing business lending, discussions with a range of financial services stakeholders and business representatives, and engagement with registered firms. This report provides an overview of where the industry is now, explores the challenges being seen by SMEs and firms as recipients and providers of green finance products, and sets out high level guidance for firms as to how they can use the Standards to maintain a customer focused approach when developing their green offering.

1 Net zero refers to a state in which the greenhouse gases going into the atmosphere are balanced by removal out of the atmosphere.

2 For the purposes of this report, SME refers to all business customers protected under the Standards of Lending Practice for business customers, and for Asset Finance. Further information is available here.

3 A list of firms signed up to the Standards of Lending Practice can be found on our website.

2. The role of the Lending Standards Board

As set out within our Mission and Strategy for the 2020s, the role of the LSB is to set and oversee Standards which improve outcomes for personal and business customers. To achieve this, we undertake regular reviews to ensure that our Standards and Codes keep pace with the changing financial services market and with rising customer expectations.

As the leading independent regulatory body overseeing business lending in the UK, we want to ensure the Standards of Lending Practice can be used to improve outcomes for all customers, including where they are looking to use lending or other finance to pursue environmentally positive objectives.

Our Standards of Lending Practice for business customers (the Standards) provide protections for business customers with a consolidated turnover of up to £25 million across loan, commercial mortgage, overdraft and credit card products.

Our Standards of Lending Practice for business customers – Asset Finance (the Standards – Asset Finance) provide protections for business customers with a consolidated turnover of up to £6.5 million when accessing asset finance, namely Hire Purchase and leasing products.

The Standards can be a key tool for firms to consider how they can support SME customers looking to use finance to make positive environmental changes.

The Standards, which are focused on achieving good outcomes throughout the lifetime of the relationship with the lender or finance provider, can be a key tool for firms to consider how they can support SME customers looking to use finance to make positive environmental changes. While our Standards do not specifically make reference to green products, they apply to the key products being accessed and used by SMEs.

In order to ensure firms can use the Standards as an effective tool to support SMEs accessing a range of finance options, it is important that we explore how green finance products are being offered in the UK. We have also sought to understand any challenges that SMEs, and firms providing green products, may be encountering.

2.1 Our approach to understanding the green finance landscape

Over the past six months, we have been engaging with registered firms, stakeholders, and business representatives involved in helping to drive positive environmental change through the financial services industry. This has informed our understanding of the current position of green lending in the UK, and the challenges firms and their SME customers face in providing and using finance, respectively, to deliver that change.

In particular, we have engaged with firms signed up to the business and asset finance Standards to inform our understanding as to what green lending products are being offered to SMEs, the information provided to support their understanding, and any monitoring and information requirements placed on customers using these products.

We also asked for views on areas where the LSB could seek to explore and develop good practice in relation to the treatment of SME customers accessing green finance.

The feedback we received through this engagement saw firms highlight the potential need for the development of industry wide standards to outline what constitutes green finance, how funds provided for these purposes should be used and the introduction of an industry framework which could build on green taxonomy and be applied to lending products being made available to SMEs.[4] Similarly, firms suggested there was a need for consistent product and labelling standards to help reduce the risk of greenwashing, and for standards covering the reporting and evidencing of the environmental benefits of finance provided to SMEs. Firms highlighted that such standards could help to ensure requirements placed on finance providers and their customers are not too burdensome.

While we set out some of the areas identified by firms in more detail in the report, it is clear from the feedback we received that, while firms are seeking to develop and build upon existing green lending propositions, there appears to be a gap in the availability of guidance and best practice on how to ensure firms can work towards good outcomes for their SME customers in this space.

Having consulted with a range of stakeholders and business representatives to understand how SMEs are using finance to support environmental spending and the challenges posed in using finance to make positive environmental change, it has become clear that there are also key considerations for firms as work in this space evolves. This is particularly pertinent in relation to customer education, product information and monitoring requirements.

Following engagement with firms and stakeholders, and recognising that the LSB and the wider financial services industry have important roles to play in supporting SMEs to invest and adapt to meet net zero targets, we have produced this report to:

• set out what we are seeing in the current regulatory and economic environment;

• bring together and highlight some of the key challenges facing finance providers and their SME customers; and

• highlight how firms can use the Standards to support good customer outcomes in this space.

We conclude by setting out some considerations and next steps for the LSB in relation to green finance and the development of the Standards of Lending Practice for business customers.

4 Green taxonomy is a framework to determine what activities or products are considered 'green'.

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• highlight how firms can use the Standards to support good customer outcomes in this space.

3. The green regulatory and economic environment

There are a range of factors driving a transition to net zero within the financial services sector and across businesses more generally. This includes changes within the regulatory and economic environment, an increasing focus on SMEs' roles in addressing environmental challenges, and a growing range of green finance products being made available to SMEs to support a transition.

3.1 Regulatory drivers for change

Approaches to green, sustainable, or environmental issues are captured under broader Environmental, Social and Governance (ESG) frameworks. These frameworks are a tool for businesses to set targets and measure the impact of a business on society and the environment. The ESG initiative provides firms and SMEs with a foundation to develop strategies to:

- meet future environmental legislation;
- reduce risk;
- lower business costs;
- improve their reputation; and
- attract new customers.

Many financial services firms have already taken steps towards reducing their carbon footprints by making changes to their operations, products, and technology. Some firms, in addition to this, are looking to foster or introduce green-focused company partnerships.

The approach to monitoring and reporting on environmental impacts and targets in the UK has been driven forward by legislative change. The UK government committed to becoming the first G20 country to make it mandatory for Britain's largest businesses to disclose their climate-related risks and opportunities, in line with Taskforce on Climate-related Financial Disclosures (TCFD) recommendations. Legislation was introduced from April 2022 that requires the UK's largest companies and financial services firms to disclose climate-related financial information.[5] In March 2023, the UK government also published a new Green Finance Strategy, which aims to reinforce and expand the UK's position as a world leader on green finance and investment.[6]

Further work on disclosure requirements is underway and, across the financial services industry, there is increasing focus on ensuring money has been invested and used in a manner that is environmentally friendly and sustainable. This has included the FCA undertaking work to ensure its rules are used to make the TCFD requirements mandatory for certain large businesses in the UK.[7] Many firms are similarly having to prepare for the upcoming requirements on mandatory reporting for the Corporate Sustainability Reporting Directive (CSRD).

New disclosure requirements are primarily aimed at investment products and at larger businesses and corporations, however, the direction of travel is clear, and the wider financial services sector needs to consider how products and services are being used to support green or sustainable initiatives. In turn, this is leading both firms and SMEs to take additional steps to improve their understanding of their environmental impact and how the products they offer, or use, impact on the environment.

Clarity around products and their impact is a key issue for financial regulators. The FCA has proposed new rules relating to green products. It has set out its concerns that, in light of the increase in the number of investment products marketed as green or with other sustainability labels, *exaggerated, misleading or unsubstantiated claims about ESG credentials damage confidence in these products.* The FCA wants to ensure that *consumers and firms can trust that products have the sustainability characteristics they claim to have.*

The FCA's proposed rules on greenwashing will cover such areas as product labelling, restrictions on the use of certain sustainability-related terms, consumer facing disclosures on sustainability-related features of a product and requirements for distributors of products. Consumer disclosures and product information will also be key areas of focus for firms in light of the FCA's Consumer Duty.

The FCA has said that it is planning on stepping up its supervisory engagement on sustainable finance and enhancing its enforcement strategy. While the primary focus from the Regulator has been on green investment products, where it is already planning to look at how firms are meeting the Regulator's expectations, firms should expect that there will eventually be a read across to all product offerings.[8]

The FCA has also recently published a discussion paper entitled 'Finance for positive sustainable change: governance, incentives and competence in regulated firms'. The paper aims to open an industry-wide dialogue on firms' sustainability-related governance, incentives and competence.[9]

The Bank of England is continuing work on climate-related risks and regulatory capital frameworks, with a view to supporting an orderly transition to net zero. While focusing on broader prudential risk and the challenges on incorporating climate risks into capital frameworks, the Bank is looking to progress work to support initiatives to enhance climate disclosures.[10]

The combined regulatory focus on environmental, sustainable, and green financial services products is moving the industry to a point where it will, in due course, need to fully understand the environmental impact of the entire sector's product offering. It is also acting as a driver for firms to consider how they can support their customers to take steps to make more environmentally friendly choices.

5 'UK to enshrine mandatory climate disclosures for largest companies in law', HM Treasury and Dept. for Business Energy, & Industrial Strategy, 29 October 2021

6 Mobilising green investment: 2023 Green Finance Strategy, HM Government, March 2023

7 PS21/23: Enhancing climate-related disclosures by standard listed companies, FCA, December 2021

8 DP23/1: Finance for positive sustainable change, FCA, February 2023

9 DP23/1: Finance for positive sustainable change, FCA, February 2023

10 Bank of England report on climate-related risks and the regulatory capital frameworks, Bank of England, March 2023

3.2 The focus on SMEs' transition to net zero

The focus on reducing the environmental impact of SMEs, at the smaller end of the scale, within the UK is growing. This is driven in part by a focus from the UK government, and many other stakeholders, on how to ensure the UK can meet its international climate commitments. Small and medium-sized businesses account for 12% of emissions generated across UK business and it will be difficult for the UK to meet its commitments on climate change without addressing the role of SMEs.[11]

There are challenges that come alongside an increasing focus on the need for smaller businesses in the UK to begin reducing their environmental impact.

While larger businesses are more likely to have the capacity (or ability to build this), access to relevant internal and external resources and expertise, to develop strategies which enable them to report on and plan to reduce the environmental impact of their businesses, smaller businesses will find it much more difficult to take the steps necessary to support a transition to net zero.

As recently highlighted by Bankers for Net Zero, firms providing finance to SMEs *will play an important role in influencing the outcomes and effects of the net zero transition, by holding responsibilities around financing the transition, supporting skills development and place-based entrepreneurship across the regions of the UK.*

To fulfil this role, firms providing finance to SMEs looking to reduce their environmental impact need to ensure they can offer the support customers need to understand and use finance that is appropriate for their objectives. Understanding and addressing the concerns SMEs have around financing green initiatives and accessing green products will be a key challenge for firms looking to reduce the environmental impact of their lending.[12]

As the drive to transition to net zero intensifies, firms may seek to make finance more readily available and to further develop their green proposition for SME customers in order to drive a reduction in the carbon emissions associated with their customer portfolios.

To effectively support SME customers looking to transition to a greener economy, there has to be a focus from finance providers themselves on how they can support SMEs to ensure they can access the finance they need to take steps to reduce their carbon emissions.[13]

11 Mainstreaming Net Zero: mobilising SMEs for Climate Action, Bankers for Net Zero, May 2022

12 Scoping exercise: The role of banks in reducing GHG emissions of UK SMEs, Bankers for Net Zero, September 2022

13 Smaller businesses and the transition to net zero 2021, British Business Bank, October 2021

3.3 The current green finance offering

While there are increasing drivers for larger financial organisations to be focusing on going green, the drivers and the necessary financial support for SMEs looking to do the same is limited. These limitations are not just in terms of product availability but also in terms of the information and support made available to SMEs, and the level of take up amongst this customer group.

Though the supply of green specific products is currently limited, firms are continuing to develop the support they offer SMEs to transition to net zero. Some firms are offering a range of finance options along with a suite of tools to support those customers looking to measure and reduce their environmental impact.

Green products and support for business customers

Green loans are the most common type of product available and are offered by nine of the LSB's registered firms. These are primarily aimed at SMEs seeking to make changes to their business premises and/or travel arrangements (e.g., installation of solar panels, electric vehicle purchases).

Green Asset Finance is another product offered by firms. This is specifically for the purchase of lower emission vehicles and assets which will contribute toward making the business more sustainable.

Criteria to qualify for green lending can vary in complexity dependent on the levels of borrowing involved. Some firms have set out frameworks to focus their criteria for green lending and products. Many firms have drawn on principles set by international industry groups, such as the Sustainability-Linked Loan Principles.[14] While the criteria and the quality of information available to customers can vary between firms, firms generally provide an indication of their green or sustainable lending criteria alongside the products they are offering.

Alongside finance products, firms also offer online tools to help SME customers understand their environmental impact in more detail, generally by helping the customer to understand what their carbon footprint is and how this can be reduced.

Some firms have launched online tools and apps to support SME customers to score their sustainability and identify targets for improvement. Some firms also provide customers who use these tools insight into what financial products might be appropriate for them to fund positive changes. In some cases, this also includes an indication of their eligibility for the sustainable or green lending products being offered by the firm.

There are also partnerships in place with organisations who specialise in supporting businesses to improve their carbon footprint, to encourage customers to take steps to reduce their environmental impact.

Though the supply of green specific products is currently limited, firms are continuing to develop the support they offer SMEs to transition to net zero.

Take up of products

Currently, take up of green or sustainability-linked products by SMEs is low. The LSB identified around 15 products currently being offered to SMEs specifically for green purposes by registered firms. The number of customers accessing these products ranges across firms and product types from zero to 500.

Given that there are over 5 million SMEs in the UK,[15] and the British Business Bank estimates around 1 in 5 are willing to use finance to improve their environmental impact,[16] the demand for green labelled products has been limited. However, firms are also aware of the current economic challenges their business customers are facing, which is driven by a range of issues, as businesses recover from the pandemic, borrowing under government schemes is beginning to be repaid and the cost-of-living increases continue to squeeze incomes. Therefore, focus is likely to be on ensuring the day-to-day running of the business and it may not be feasible to make changes to their operations in the absence of an immediate benefit.

As outlined above, the changing regulatory environment, the particular focus on the role of SMEs in the move to net zero, and the growing product and information offerings from firms reflect the fact that there is an expectation that this is an area where things will continue to develop at pace. We have, therefore, given consideration to the challenges the industry and their SME customers face to inform our understanding of how to work towards ensuring good customer outcomes in the transition to net zero.

14 Sustainability-Linked Loan Principles (SLLP), APLMA, LMA and LSTA, February 2023

15 Business population estimates for the UK and regions 2022: statistical release, Dept. for Business, Energy and Industrial Strategy, February 2022

16 Small Business Finance Markets 2021/22, British Business Bank, February 2022

4. What are the challenges facing firms and their SME customers?

It is clear that while firms have made strides to improve their green offering, there remain challenges for firms as they look to support business customers in the transition to net zero. Within this section we have sought to explore some of the areas raised through our engagement with firms and stakeholders. While not all firms are currently providing green products or services to customers, firms should consider whether they are in a position to understand and support their customers in reducing their environmental impact.

4.1 SME customers

There are a range of reasons for SMEs seeking to make positive environmental changes. These include:

• it makes financial sense;

• it is part of the business strategy or purpose to be a low-carbon business;

• responding to customer opportunities;

• keeping up with competitive trends; and

• keeping up with regulatory or tax direction.[17]

Firms should consider whether they are in a position to understand and support their customers in reducing their environmental impact.

Research conducted by the British Business Bank (BBB) found that around half of SMEs are open to improving their environmental impact. However, they face a range of barriers when seeking finance for this purpose. The BBB found that, while 47% of SMEs are open to reducing their environmental impact and 22% are prepared to use finance to invest in changes, there are key barriers from a business perspective which include:

• costs – business customers are reluctant to incur any additional expense in the current economic environment;

• feasibility – many businesses do not believe that changes to their business operation are feasible at present;

• capacity/willingness – businesses are already stretched to capacity, without adding additional strain to their workload;

• uncertainty – uncertainty over the improvements any changes will deliver and the uncertainty over the future economic outlook; and

• information – a lack of information on the types of finance that is available.[18]

Taking this into account, there are key challenges for firms to consider when seeking to offer products to, or to provide information for, SMEs that wish to use finance to improve their economic impact.

The economic environment

The UK economy has been hit by a series of major disruptions over the past few years, including the UK's departure from the European Union, the coronavirus pandemic, the energy market disruption caused by Russia's invasion of Ukraine, and increases in costs across the board. These shocks, and the expected slow growth of the UK economy, create additional uncertainty for SMEs seeking to keep their businesses operating.

In this context, many SMEs' priorities may not, understandably, be focused around improving their impact on the climate or supporting a transition to net zero. Given the economic uncertainty, this may not shift significantly in the shorter term. Businesses of all sizes are facing rising costs which is likely to impact significantly on SMEs' appetite for borrowing more generally as well as the way they are using finance. Therefore, as the primary focus of SMEs is likely to be on navigating the current economic uncertainty, seeking finance to improve their carbon footprint is likely to be less of a priority.

The complexity associated with green finance

Given the complexity of factors driving decisions around net zero for SMEs, it is perhaps unsurprising that organisations the LSB has engaged with reported that, even when looking to make changes that would reduce a SME's environmental impact, business owners are more likely to look to acquire funding through more standard forms of finance. This was, in the main, due to the less complex nature of standard products when compared to green products, which typically have a wider set of terms and conditions associated with the product, for instance additional reporting requirements.

The steps being taken by industry to develop green products are positive. However, these products tend to entail a more complex criteria than a standard product might, such as continued demonstration by the customer of environmental linked changes. This can be a barrier for some SMEs as they may, depending on the size, structure, and sophistication of the business, be less likely to have relevant monitoring processes or an ESG strategy in place to allow them to readily meet the reporting requirements of the product. SMEs may also lack capacity, resource, or processes to evidence the required environmental change. There may also be a lack of understanding of the product requirements themselves and why they are needed, especially when balanced against the time it may take to collate and supply the data required.

Without a clear benefit, or if there are significant barriers to using green products, those SMEs that can may find it easier to use more standard forms of finance to achieve their environmental objectives and may seek to avoid any additional reporting requirements.

Customer net zero awareness and education

The size, sophistication and complexity of entities captured within the SME customer base can vary widely. Some smaller business customers may lack understanding of how they can monitor their environmental impact and help achieve a transition to net zero. SMEs at the smaller end of the scale may also be less likely to understand the potential benefits of taking steps to reduce their environmental impact, such as longer-term energy cost savings. For instance, in an environment where income, and any profit margin, may be volatile, customers may consider the immediate monthly cost of the loan ahead of any longer-term reduction in energy costs that the product will deliver.

The differing degrees of understanding are likely to be reflected in a balancing of priorities for businesses, with smaller businesses having limited resources available to focus on understanding environmental considerations. While firms have taken steps to provide information about the transition to net zero on their respective websites, this approach relies on SMEs having the resource available to discover and digest this information, which, in many cases, can be difficult to find.

Firms should consider how they are providing relevant information to smaller SMEs in relation to green products, without making the product offering appear overly onerous. The continued increase in the use of digital and online channels means there may be less opportunity for the customer to ask questions to support their understanding of how the product works. These discussions, which may have previously taken place verbally between SMEs and their finance provider via, for example, relationship managers or business specialists, are now often replaced with an expectation that customers will be able to take onboard any necessary information through digital channels and self-serve journeys. Firms have the dual challenge of ensuring customers can access and take on board information about sustainability and green financing, and of ensuring customers can access and utilise the information and products effectively through the channels that are made available.

Customer understanding of products

As with all forms of lending, firms must ensure that the customer understands the conditions of their borrowing prior to entering into the agreement.

With green and sustainable finance terms being used interchangeably across financial services and terms such as 'greenwashing' being used to describe advertising that promotes environmental benefits that are not quite as they are made out to be, understanding exactly what green finance is, can be a challenge for many SMEs.

With the implementation of the FCA's Consumer Duty (the Duty) in July 2023, firms offering regulated lending will have to do more to make sure they are communicating product information clearly and concisely and in a way that customers can understand to help them make informed decisions about the products they choose. While focussed on retail customers and regulated lending, the implementation of the Duty will have prompted many firms to look across their product offering and to ensure they are fit for purpose and suitable for their intended target market.

The level of information currently available on firms' websites varies. Some have dedicated sections of their websites to their sustainability offering and partnerships, while others have chosen a more subtle approach, with less prominent information available, relying more on engagement with the customer to set out information around products. The green products available are also primarily aimed at medium to large businesses, with a lesser focus on those SMEs at the smaller end of the scale.

Product understanding is an issue which has also been raised by representatives of business customers. The Federation of Small Businesses set out that *awareness of financial products and lenders is a limiting factor* for business customers looking to access finance and highlighted that firms need to be aware that the average SME owner is not going to be a finance expert.[19] This view highlights the importance of information being easily accessible and understandable for business customers.

There are increasing drivers for firms to understand the environmental impact of the finance they provide.

17 Small Business Finance Markets 2021/22, British Business Bank, February 2022

18 Small Business Finance Markets 2021/22, British Business Bank, February 2022

19Credit Where Credit's Due, The Federation of Small Businesses, December 2022

4.2 Registered firms

As set out earlier in this report, there are increasing drivers for firms to understand the environmental impact of the finance they provide to their SME customers. They will also need to ensure they are doing this in a way that supports good customer outcomes.

Preparing to meet regulatory expectations

In line with ESG requirements, registered firms offering green products will have processes in place to monitor the impact of these products. Initiatives are underway to help financial services providers take a consistent approach to measuring the impact of financial products. However, there is still work to be done to ensure the industry is doing this effectively and is able to support SME customers, who are not required to meet ESG requirements, to monitor and report on their environmental impact.

The absence of definitive guidance and standards relating to green finance, particularly when it comes to non-regulated lending, is a challenge for firms. Despite there being a plethora of high-level net zero commitments made by those in the financial services industry, the lack of industry direction has created challenges for firms looking to develop their own lending propositions to support good environmental outcomes.

There is space for industry standards to be developed, to help firms improve customer outcomes, in areas such as the use of terminology, product criteria, and monitoring requirements. This could help make language and product information more consistent and ensure green finance can be more easily explained to customers. There is work underway, including some being led by Bankers for Net Zero and supported by the UK government, to help develop a consistent industry approach to reporting the environmental impact of small business in a way that does not create unnecessary burdens for firms or their SME customers.[20]

Reporting requirements for SMEs

A prominent challenge for firms is addressing the barriers that are in the way of SMEs obtaining green lending.

As highlighted earlier, SMEs are much less likely to have dedicated resources to be able to collate, understand, and produce the type of information that is required by firms to be able to monitor and report on the environmental impact of their lending. Collating and supplying relevant information on the environmental impact delivered by the funding, will be a significant challenge for many SMEs. Particularly without further support being provided to enable them to understand how to do this, and importantly, having capacity to do so.

There may also be further barriers to SME customers fully understanding what type of expenditure can be funded through certain products and having the tools and internal expertise in place to be able to measure the impact a product has had.

Firms should be, therefore, considering what they know about their customers, the structure and sophistication of their customers' businesses, and the impact that any monitoring or reporting requirements may have on the business.

The difference in sophistication between SMEs and large businesses can often be vast and firms face challenges in bridging this gap with appropriate products designed to meet the needs of smaller business models. Overly burdensome monitoring and/or reporting requirements may prove difficult to manage for smaller businesses, which may result in customers breaching terms of the lending or being put off from green lending altogether.

20 Perseus: unlocking financial support for SMEs by automating greenhouse gas reporting, Bankers for Net Zero, February 2023

4.3 Addressing the challenges

Collaboration between firms, stakeholders, business representatives, and regulators is critical to address some of the more complex challenges being seen in the green finance space. This is also key in addressing areas such as those that relate to monitoring and reporting requirements. When looking at those issues, it is vital that there remains a focus on ensuring fair outcomes for SMEs and that the needs of these customers are central to the development of any industry or regulatory approaches.

Firms, however, can begin to address some of the challenges faced by their smaller business customers now. Across all finance products, firms should be considering how they can help customers to achieve their green objectives. For customers looking to borrow or use finance to make changes that are positive for the environment, firms should be understanding how their products – whether they are labelled as green or sustainable, or not – can support the SME's objectives. Firms should also be considering how they can provide information to customers to support them to access and use finance in a way that is suitable and appropriate for them.

For firms signed up to the Standards of Lending Practice for business customers, the following section sets out some additional guidance that firms may wish to take account of when thinking about their green proposition.

Collaboration between firms, stakeholders, business representatives, and regulators is critical to address some of the more complex challenges being seen in the green finance space. This is also key in addressing areas such as those that relate to monitoring and reporting requirements.

5. A customer focused approach to green finance

The Standards of Lending Practice provide a framework to enable firms to consider how to support SME customers seeking green or sustainable finance.

The Standards of Lending Practice for business customers, and asset finance, are focused on achieving good outcomes for customers. They provide a framework to enable firms to consider how to support SME customers seeking green or sustainable finance to reduce their environmental impact. While the Standards do not yet make specific reference to green products, if the product being provided would otherwise fall within scope of the Standards, the relevant requirements apply.

Some key examples of the relevant areas of the Standards firms should take into account when lending to customers to support them in reducing their environmental impact, are set out below.

5.1 Product information

Where firms are providing products with criteria linked to environmental change, customers should understand any additional requirements or restrictions related to that product.

Firms should consider the following requirements of the Standards:

Firms should ensure that employees/agents are trained and knowledgeable about the range of products, across all channels, on offer to customers. (Product information, paragraph 2).[21]

Firms should recognise that SME customers will want to use the limited time they have in the most efficient way, receiving information in a concise and clear manner to enable them to make an informed decision. In relation to green finance, customers may be less familiar with the requirements of the product(s), for example any reporting or monitoring which may be required or restrictions on how the product can be used. Therefore, conversations with customer facing employees may play an important role in enabling SMEs to understand the product offerings and firms should provide appropriate training to enable employees to respond to enquiries on green lending. Firms should focus on ensuring the customer receives relevant information to inform their decision as to whether a product is suitable for the needs of the business.

Firms should ensure that customers are provided with clear and understandable information which enables them to decide whether the product they are considering applying for meets their needs and is appropriate for the type of business they are engaged in. (Product information, paragraph 3).[22]

Firms should ensure that any product requirements, particularly those that an SME customer might not be used to, are clearly documented and accessible for the customer looking to determine whether the product is appropriate for them. Where firms are offering green products, it is also important for SME customers to be able to understand how the product works, the benefits and any additional requirements compared to other available products, to enable them to make an informed decision around what is right for their business.

Firms should also consider, for those customers for whom a sustainability linked product may not be suitable, whether they can be signposted or supported to access alternative products that may be better suited to the needs of the business.

21 For the equivalent within the business Standards – Asset Finance see Product information, paragraph 5

22 For the equivalent within the business Standards – Asset Finance see Product information, paragraph 8

5.2 Product sale

The Product Sale section of the Standards requires firms to ensure business customers will only be provided with a product that is deemed affordable and which meets the requirements of the business. With this in mind, firms should refer to the following requirements when discussing green finance options with SME customers:

Firms should ensure that customers are provided with clear guidance on the information and documentation they will need to submit during the application process. (Product Sale, paragraph 1).

Business customers may find it challenging, or be reluctant, to apply for green finance due to the reporting requirements associated with certain products, which may be prohibitive for some customers as they will not be able to provide the necessary information. In addition to usual lending criteria, green finance has the added requirement for a business to demonstrate how the funds will be used. This in itself can create additional work for the SME and has the potential to detract from the day-to-day running of the business. Firms should ensure that clear information is provided to the customer on any associated reporting requirements and that consideration is given to the type and form of information is required. This could also be tailored to the size of the SME and level of lending to ensure that it does not become prohibitive or overburdensome for the customer.

Firms should consider whether the customer may need more information than might be required for standard lending products to help them fully assess whether the product is right for them. Where, for instance, a customer may need to be able to demonstrate that the borrowing is being used to purchase or invest in a product or service that meets certain environmentally friendly criteria, firm should look to clearly make customers aware of the consequences of not providing the requested information.

At the point of sale, firms should provide clear information to the customer regarding the key features of the product and any breakage or early repayment fees/costs associated with it. This information should be made available to the customer upon request, throughout the lifetime of the borrowing. (Product Sale, paragraph 7).

The features of the product, such as benefits for customers meeting environmental criteria or reporting requirements, or costs associated with a product, which may vary depending on how the finance is used, should be clearly explained. This might be the case, for example, where the customer may be able to receive a lower rate of interest if they meet certain criteria or may incur a higher rate of interest if they fail to meet certain criteria. Firms should ensure that extra care is taken when presenting key product information to customers at the point of application to ensure the customer has a sufficient understanding of the product they are applying for.

Recognising that reporting and monitoring requirements around sustainability and ESG are likely to continue to evolve, firms should ensure that as reporting requirements change, appropriate processes are in place to capture any new product features or requirements.

5.3 Credit monitoring and risk management

A key requirement for firms offering, and customers using, green finance relates to the ongoing monitoring of the use of funds provided. While we recognise there continue to be developments across the industry that may support firms looking to standardise their approaches to monitoring, reporting, and ensuring customers use funds for green purposes, firms should consider the credit monitoring section of the Standards in developing their approach. The Standards state:

Firms should ensure that the customer understands what information will be required to allow the firm to monitor the business' performance and how and when this should be provided (Credit Monitoring, paragraph 1).

Registered firms should already be ensuring product requirements are being clearly explained to their SME customers. By doing this firms are able to better manage customer expectations, enabling them to understand what is expected of them throughout the lifecycle of the agreement.

Green products may have additional or different information and monitoring requirements. Therefore, firms should ensure the information being provided is appropriate for the product, taking into consideration the type, form and frequency of information required and whether, based on the firm's knowledge of the business, this can be provided by the customer.

Given the nature of green finance, firms should consider how appropriate, and relevant, MI can be obtained from the customer in a way that does not become overburdensome or impossible for the customer to manage. Firms could consider the needs of customers and whether additional support or tools can be provided to support the customer to provide the required information.

5.4 Product execution

Firms may also face challenges relating to the treatment of customers that fail to or, are unable to use the finance and report information as required under the product terms.[23] The treatment of customers where funds are not being utilised in accordance with product terms and conditions may pose challenges, as product requirements and criteria for green products are still evolving both across industry and within firms.

The Standards set the following requirement on firms:

Firms should ensure that any changes to the terms of the customer's agreement are fair and transparent. The customer should be provided with clear information regarding the reason for the changes and provided with a reasonable amount of time to seek further clarification, or where appropriate, alternate sources of finance. (Product execution, paragraph 9).[24]

Where a customer fails to use the product in line with the terms of an agreement or reports that they are unable to meet the reporting requirements associated with the product, firms should give consideration to the full circumstances as to why the relevant term has been breached and the reason this has occurred.

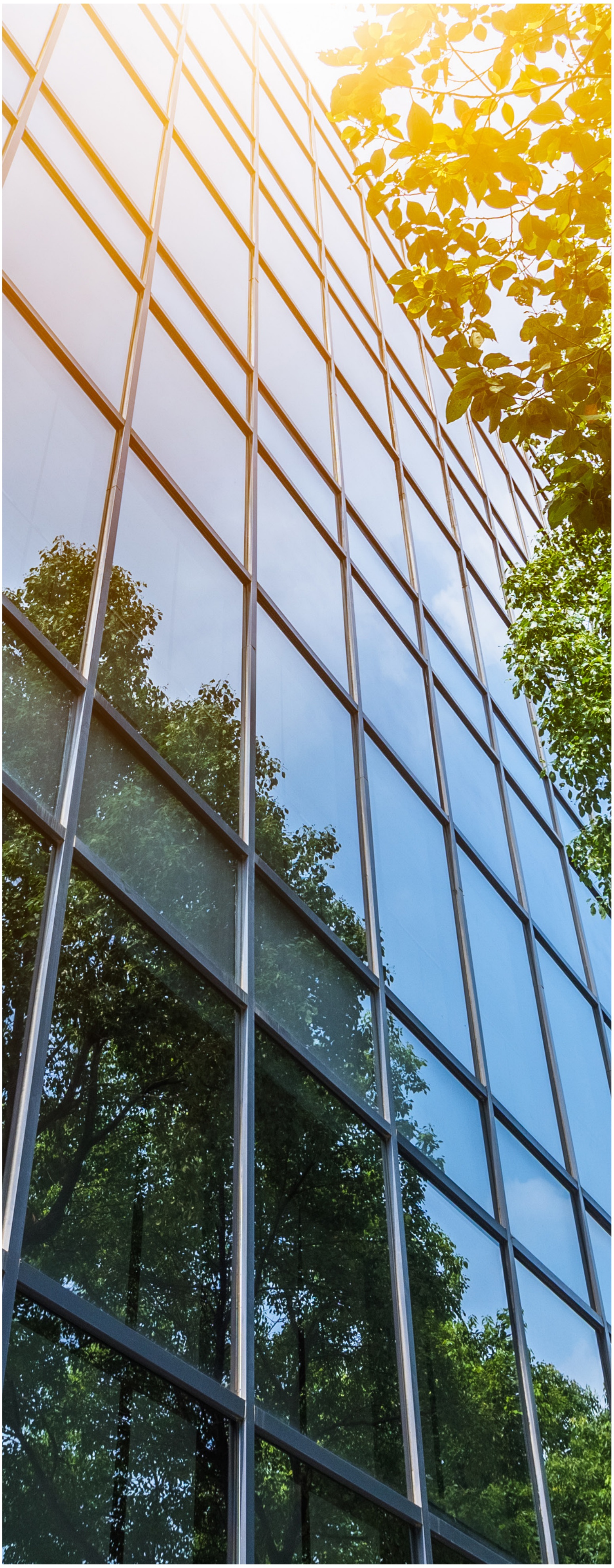
Firms should consider whether the product provided may need to be changed or transferred into an alternative with different terms and conditions that are more suitable to the business's needs and/or operating model.

Firms should ensure that when providing a product and throughout its lifetime, customers are aware of what is required of them. They should be made aware of what steps may be taken if, for example, they fail to adhere to the terms of their agreement, such as the firm calling in the full balance of the lending if reporting requirements are not met. Where changes are required, firms should assess their customers' ability to repay any alternate form of lending in a way that will not cause unnecessary disruption to the continued operation of the business, ensuring the business is not at a detriment as a result of the changes applied.

23 Not to be confused with the collecting of arrears, the approach for which is already set out within the Treatment of customers in financial difficulty section of the Standards.

24 For the equivalent within the business Standards – Asset Finance see Product execution, paragraph 5

Firms could consider the needs of customers and whether additional support or tools can be provided to support the customer to provide the required information.



6. Next steps

The role of the LSB, as the lead regulatory body for business lending, is to ensure there are appropriate protections in place for business customers.

The LSB is pleased that there are initiatives underway to support a collaborative approach to some of the challenges facing the industry when it comes to monitoring and reporting the environmental impact of providing finance to SMEs. We will continue to engage with stakeholders, regulators and registered firms to help ensure a focus on fair customer outcomes remain central to business lending in the UK. We will also continue to monitor industry developments to ensure the Standards, and any guidance we produce, reflect appropriately industry best practice.

Our business Standards focus on delivering fair customer outcomes. In addition to the guidance provided for firms here, we will give consideration to the feedback received from firms and stakeholders to understand where the LSB may be able to provide additional guidance and support to ensure SMEs are supported as we transition to a net zero economy.

Beginning in Spring 2023, we will conduct a formal review of our business Standards, which will involve seeking views from registered firms, regulators, business representatives and other key stakeholders.

The purpose of this review is to inform the development of the Standards to ensure that they continue to set a robust framework of protections for business customers and continue to reflect industry best practice. Alongside other recent economic and regulatory developments, we will give consideration to how this work on green finance can support the development of new guidance or changes to our Standards as part of the review. We will also consider how the LSB, and the review of our business Standards, can support industry efforts to improve sustainability reporting for firms and their business customers.