FLEXSTONE PARTNERS 20 YEARS
AN AFFILIATE OF NATIXIS INVESTMENT MANAGERS

SUSTAINABILITY

NEWSLETTER – MARCH 2025

CONTENT

SUSTAINABILITY REGULATION
MARCH UPDATE – EUROPE & UK

01 The EU Platform on Sustainable Finance responds to the public consultation on the EU Taxonomy

The Platform's response to the draft EU taxonomy delegated act consultation welcomes the Omnibus proposal for simplifying reporting requirements, while raising concerns over the reduction of the Taxonomy's scope. The Platform's key recommendations include:

- The Platform strongly recommends aligning the scope of the Taxonomy reporting with the scope of the CSRD, while preserving CSRD's original scope. For non-SME companies with < 1,000 employees, reporting should focus on essential standards, including Taxonomy alignment.
- Introducing a mechanism for all companies to report partial alignment with the EU taxonomy, either through substantial contribution or Do No Significant Harm (DNSH) criteria.
- Alignment of the materiality thresholds for Taxonomy reporting with existing financial reporting standards, such as IFRS 8, to ensure consistency and reduce reporting burdens.
- Pausing, rather than excluding, reasonable assurance for CSRD reporting, including the EU Taxonomy entity-level reporting.
- Investing in capacity-building efforts to support reporting, particularly in sectors with complex business models.

Go to the full report

02 The FCA and the PRA drop plans to advance new rules boosting D&I in the financial services sector

UK's Financial Conduct Authority (FCA) and the Bank of England's Prudential Regulation Authority (PRA) have dropped their plans to proceed with new rules aimed at boosting diversity and inclusion (D&I) in the financial services sector.

- The FCA and PRA launched a consultation in September 2023 for a series of rules to introduce a new D&I regulatory framework in the financial sector, such as requiring firms to develop a D&I strategy with defined objectives and goals, a plan for meeting them, and placing boards in charge of overseeing these strategies.
- In letters sent to the government's Treasury Select Committee, the regulators dropped their plans for new D&I rules, with Industry respondents promoting alignment with existing initiatives to reduce regulatory burden on firms.
- Although the regulators highlighted benefits of D&I to firms, including improved governance, risk management, and long-term competitiveness, they do not plan to publish new rules on D&I. The announcement follows the rapid pull back in D&I policies and regulations in the U.S., driven by the Trump administration.

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SUSTAINABILITY REGULATION
MARCH UPDATE - GLOBAL

03

SEC votes to end the legal defense of its climate risk disclosure rules

On the 27th of March, the SEC announced that it has voted to end its legal defense of climate disclosure rules requiring disclosure of climate-related risks and GHG emissions.

- Mark T. Uyeda, SEC's Acting Chairman said that the climate change disclosure rules are 'costly and unnecessarily intrusive'. Trump's nominee for SEC Chair, Paul Atkins, has also opposed the climate reporting rule.
- Following the SEC's decision, SEC Commissioner Caroline Crenshaw criticized the Commission for not following proper procedures to rescind or amend the regulation, highlighting that investor demand for the climate reporting rule has not changed.
- The rules were adopted by the Commission in March 2024 and were challenged by many states and private parties, including a lawsuit against the rule by 26 republican state attorneys general. In August 2024, the SEC launched its defense of the rule in court, arguing that the proposed disclosures are directly relevant to determining the value of investments.

Go to the full article

04

Japan releases new IFRS-aligned sustainability reporting standards

The Sustainability Standards Board of Japan (SSBJ), which was formed in 2022, released its new sustainability disclosure standards in the beginning of March.

- The standards are aligned with the sustainability (IFRS S1) and climate (IFRS S2) reporting standards developed by the IFRS Foundation's International Sustainability Standards Board (ISSB).
- The SSBJ will issue a schedule of differences between its standards and the ISSB shortly, mentioning that all the requirements of the ISSB standards were incorporated into the new framework, with additional jurisdiction-specific alternatives that companies may choose to apply.
- The SSBJ's new publication includes 3 standards, including Universal Sustainability Disclosure Standard, Theme-based Sustainability Disclosure Standard No. 1 ('General disclosures') and No. 2 ('Climate-related disclosures).
- The standards were developed under the assumption that they would eventually be required under securities laws to be applied by entities listed on the Prime Market of the Tokyo Stock Exchange.

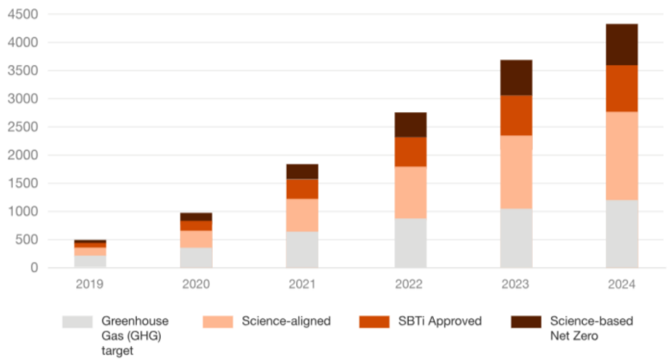
Go to the full article

ESG MARKET INSIGHTS
STATE OF DECARBONIZATION IN 2025 (1/2)

01 PwC's second State of Decarbonization Report shows that there remains a strong commitment to sustainability as a source of business value amidst current headlines

Growth in companies with decarbonization targets

(Cumulative number of companies)



Source: PwC analysis, CDP (2024)

PwC's research based on 6,895 companies reporting to the CDP in 2024 found that over 4,000 have indicated climate commitments, with 37% of companies reporting increasing climate ambitions, while 16% report decelerating their goals:

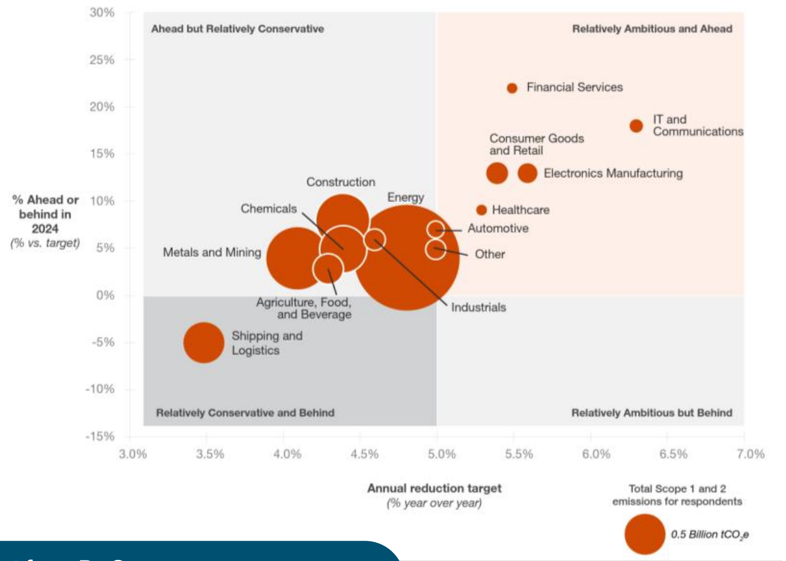
- Due to the current political environment, companies are avoiding publicizing climate pledges that lead to unwanted scrutiny and instead focusing on making 'quiet progress'.
- An increasing number of small companies are making climate commitments, driven by supplier engagement efforts as larger companies begin to address their scope 3 GHG emissions. The medium revenue of companies setting climate objectives decreased from $3.6 billion in 2020 to $1.3 billion in 2024.
- 83% of companies reported investing in R&D for low-carbon products and services, with products featuring sustainability attributes achieving a revenue increase of 6% to 25% over products without a sustainability emphasis.
- In line with last year's report, PwC found that many companies are struggling to make progress on their commitments, notably on Scope 3 targets (only 54% are on track to meet their Scope 3 targets). Although value chain emissions are harder to measure, influence, and abate, reducing Scope 3 emissions has the potential to unlock significant value through lower costs and improved margins.

Go to the full State of Decarbonization Report from PwC

01 Progress vs. Ambition – progress on scope 1 and scope 3 emissions remains slow

- Many companies are relying on renewable electricity generation and procurement to achieve Scope 1 & 2 targets. While 73% of companies are on track to meet their Scope 2 targets, only 46% are achieving their Scope 1 objectives.
- For Scope 1 and 2 emissions, companies with relatively more ambitious targets tend to also be on track. The ambition and progress various across sectors (companies in hard to abate sectors with challenging decarbonization paths tend to be conservative in their ambitions and behind in terms of progress).
- Scope 3 emissions, which are on average 11 times larger than Scope 1 and 2 emissions together, are also the most difficult to measure and reduce. Only 54% of companies are on track to meet their Scope 3 targets. However, the number of companies reporting on Scope 3 GHG emissions is increasing. In 2024, 3,600 companies disclosed Scope 3 emissions compared to ~2,000 in 2023.
- For Scope 3 emissions, the relationship between ambition and progress does not follow the same trend as for Scope 1 & 2, reflecting the relative lack of progress across industries.

Scope 1 & 2: Relative ambition vs. progress



Go to the full State of Decarbonization Report from PwC

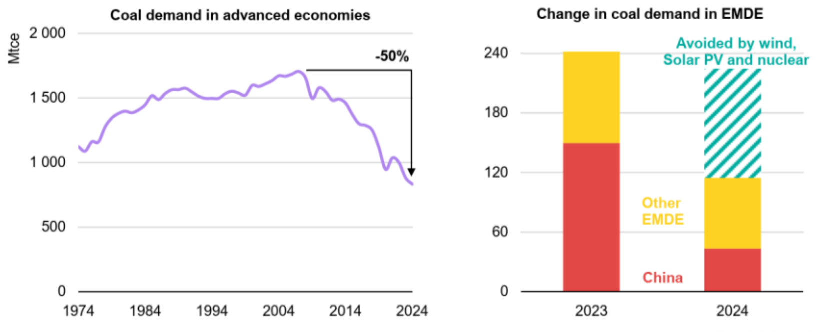
IEA GLOBAL ENERGY REVIEW FOR 2025 (1/2)

02 Global energy demand grew by 2.2% in 2024 across all fuels and technologies driven by record temperatures, electrification and digitalization, with renewables accounting for 38% of the growth in global energy supply.

The International Energy Agency's (IEA) Global Energy Review highlights the increasing global demand for energy, led electricity demand for cooling, industry, the electrification of transport, and data centers and AI. The report's key findings include:

- Emerging and developing economies accounted for **80% of global energy demand growth;** China still accounts for the largest demand growth in absolute terms – although demand has slowed significantly compared to previous years – followed by India.
- For the first time ever, **global oil demand growth fell below 30%** after peaking at 46% 50 years ago.
- From fossil fuels, natural gas had the highest growth in demand of 2.7% in 2024, rising by 115 billion cubic meters (bcm) compared with an annual average of ~75 bcm over the last 10 years.
- For coal, global demand increased by 1%, driven by increased electricity consumption for cooling as a result of intense heatwaves, notably in China and India. China remains the largest consumer of coal globally, accounting for **58% of global coal use.**

Coal demand in advanced economies, 1974-2024, and change in coal demand in emerging market and developing economies in 2023 and 2024



IEA. CC BY 4.0.

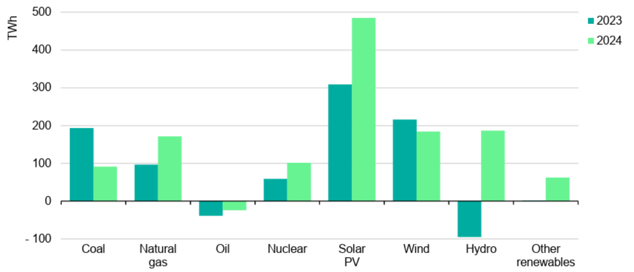
Go to the full Global Energy Review for 2025 from IEA

IEA GLOBAL ENERGY REVIEW FOR 2025 (2/2)

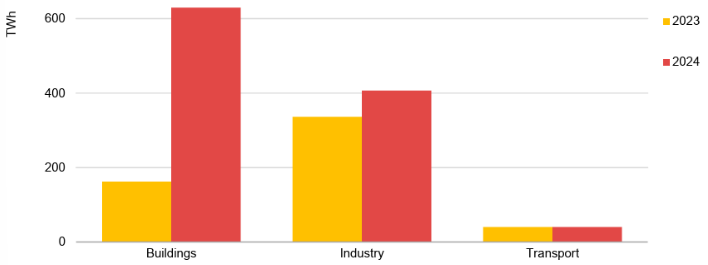
02 In 2024, 80% of the growth in global electricity generation was provided by renewable resources & nuclear power, contributing 40% of the total generation for the first time

- **The installation of renewables hit a record high for the 22nd consecutive year**, with ~700 GW of total renewable capacity added in 2024, of which nearly 80% of which was solar PV. In the European Union, the share of generation provided by **solar PV and wind surpassed the combined share of coal and gas** for the first time, while in the US, solar PV and wind's share rose to 16%, overtaking that of coal.
- **Electricity use from buildings accounted for ~60% of overall growth in 2024**, driven by rising demand for air conditioning and new data centers. The report highlights that if weather in 2024 had remained consistent with 2023, approximately half of the increase in global emissions would have been avoided.

Annual change in global electricity generation by source



Annual change in electricity consumption by sector



Go to the full Global Energy Review for 2025 from IEA

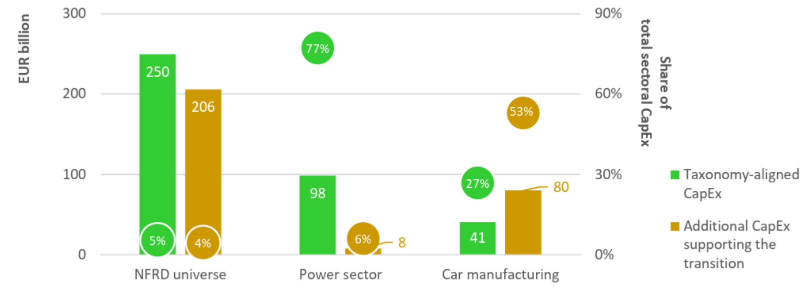
NEW IN RESEARCH
CAPITAL FLOWS TO SUSTAINABLE INVESTMENTS

01 The Platform on Sustainable Finance report on capital flows to sustainable investments finds that sustainable investments are gaining momentum

The EU Platform on Sustainable Finance analyzed 2180 large listed European companies based on their first two years of disclosures of Taxonomy data. Key findings:

- **Taxonomy-aligned CapEx reached EUR 250 billion in 2023, representing a 34% increase from the previous year.** Enabling activities represented approximately half of this growth (activities directly enabling other activities to make a substantial contribution to an environmental objective), while investment in transitional activities more than double, representing 11% of total taxonomy-aligned CapEx.
- Transition financing varies significantly across sectors. **Electric utilities and grid operators are leading Europe's energy transition**, accounting for a third of all Taxonomy-aligned CapEx. In comparison, clean energy investments, which were at EUR 200 billion in 2024, are still 30% below the levels needed to meet the EU's 2030 targets.
- To close the investment gap, **significant private capital is needed**. The European Commission estimates that at least 7-8% of annual GDP must be allocated to green investments to meet Europe's 2030 and 2040 climate targets.

A snapshot on the status of transition finance in Europe, 2023



Source: Own analysis based on Bloomberg, Orbis, CDP.

Go to the report from the Platform on Sustainable Finance

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NEW IN RESEARCH
GLOBAL RESPONSIBLE INVESTMENT TRENDS 2025

02 This analysis charts the development of global responsible investment practices, based on responses from 3,048 signatories in the UN PRI's latest reporting cycle.

Data collected from over 3,000 Principles for Responsible Investment signatories across 88 countries, representing €89trn AUM, offers a big sample of the investing industry - and that is the basis for PRI's third annual report on the global responsible investment marketplace. **Investor signatories are expanding their RI practices with the aim of enhancing risk-adjusted returns.**

- **C-suite priorities** – most senior leaders identify value creation, long-term value and risk management as key to the investment case for responsible investment.
- **Analysis of material issues** – four fifths of signatories with combined AUM of US$82.7 trillion1 identify climate-related risks and opportunities
- **Action on outcomes** – a significant proportion (65%) of signatories take action to address sustainability outcomes, with almost 50% identifying financial materiality as the key investment case

Action in private markets is continuing to expand.

- **Growth in private market assets** – in the last five years, PRI signatories have increased allocation to private markets, resulting in the increasing frequency of private equity terms such as 'value creation' in signatory responses.
- **Contractual agreements** – a large and increasing number of private markets investors incorporate RI commitments within limited partnership agreements (LPAs), with infrastructure investors leading the way.
- **Stewardship** – the data shows widespread stewardship activities being undertaken by LPs and GPs in private markets, with common steps including implementing 100-day plans, introducing roadmaps and using benchmarks

Go to the full UN PRI Global Responsible Investment Trends report

02 IISD's new State of BCAs 2025 report reviews how countries are addressing concerns over carbon leakages through border carbon adjustments

Carbon leakage is a phenomenon where climate mitigation policies and the resulting emissions decreases in one country are partly offset by emissions increases in countries with less ambitious policies which may occur if costs related to climate policies drive businesses to transfer their production to other countries.

- The European Commission has defined an official list of sectors and sub-sectors considered to be at significant risk of carbon leakage based on production costs and trade intensity (e.g., cement production is estimated to have a 'leakage' rate of 23%, while for steal this is only 3%).
- The EU and the UK are working on implementing Carbon Border Adjustment Mechanisms (CBAM) in the next few years for key sectors, including aluminum, cement, fertilizers, iron, and steel.
- The CBAM frameworks vary greatly in design, influencing their impacts on the jurisdictions implementing them as well as their trading partners (based on sectors, emissions coverage, CBAM rate, etc.)

The EU CBAM *Implementation in 2026*	• Under the current Emissions Trading System (ETS), carbon leakage risk is
The UK CBAM *Implementation in 2026*	• The UK adopted its ETS in 2020 and similar to the EU, has been addressing its carbon leakage risk through free allocation of emissions allowances. • The UK has not announced plans to fully phase out

Go to the full report from IISD on the State of BCAs in 2025

IN FOCUS: THE DEFENSE SECTOR
SUSTAINABILITY RISKS IN THE DEFENSE SECTOR (1/2)

01 Sustainability considerations for the defense sector

There are several drivers that explain why investors are increasingly re-assessing their defence positions. Changing geopolitical risks, national security threats, and policy makers looking to bolster the defence sector mean that investors could be anticipating high expectations to invest and strong financial performance. However, reputational and legal risks associated with weapons manufacturing, arms embargoes, international human rights standards and other breaches of international humanitarian law give rise to caution.

Total global military expenditure reached US$2443 billion in 2023, an increase of 6.8% in real terms from 2022, and the steepest year-on-year increase since 2009. In particular, the geopolitical risks driven by the invasion of Ukraine has recently triggered an increase in European defence investments.

While public investment has been increasing, a European Commission report from March 2024 highlighted the defence sector's challenge related to accessing private financing from an investment industry increasingly conscious of ESG issues. As of March 2024, only 29.8% of EU and UK-domiciled ESG funds had exposure to the aerospace and defence sector (although there was a 4.6 percentage points increase since January 2022) and 36.4% for US domiciled ESG funds ('Aerospace and defence' is the categorisation commonly used (GICS).

Well-known ESG risks related to the defence sector include :

- **impacts on human rights** – such as irremediable harm caused by end use, and application by governments or other groups in breach of international humanitarian law throughout the lifecycle of products;
- **political instability** – increasing risk of civil war in purchasing countries over time;
- **corruption** – high proportion of countries with risk of corruption in their defence and security sectors;
- **metal pollution** – metal emissions of weapon use and related environmental and health consequences;
- **organic contamination** – such as land contamination through military infrastructure and armed conflicts, and use of chemicals such as potentially toxic compounds and chemical warfare agents; and
- **high levels of carbon emissions** – the world's armed forces and the industries supplying them are estimated to cause 5% of global carbon dioxide emissions

Go to the full article from the UN PRI

IN FOCUS: THE DEFENSE SECTOR
SUSTAINABILITY RISKS IN THE DEFENSE SECTOR (2/2)

01 Sustainability considerations for the defense sector

Abiding by international conventions and norms :

Investors typically screen their portfolios for weapons, **including chemical and biological weapons, cluster munitions and antipersonnel landmines**, which are regulated under international humanitarian law.

While the Treaty on the Prohibition of Nuclear Weapons has not yet received broad ratification by states, many investors also exclude nuclear weapons. As of December 2023, 70% of Article 8 funds and 90% of Article 9 funds in the EU had no exposure to controversial weapons.

In the Principle Adverse Impact categories of the EU Sustainable Finance Disclosure Regulation, “). **controversial weapons” are defined as anti-personnel mines, cluster munitions, chemical weapons and biological weapons.**

A number of countries are under arms embargoes by the UN Security Council, the EU or other multilateral entities.

Investor risk management :

The UN PRI finds a growing number of investors use environmental and human rights due diligence to manage related financial risks (see PRI guidance on how to identify human rights risks). For the defence sector, investors commonly consider the following steps:

- **Assess defence companies** in relation to their products and services, including companies involved in the end-delivery of weapons or weapons systems and the supply of essential components throughout their manufacturing, to determine whether any of these are regulated by international treaties and / or conventions.
- **Review the business relationships of defence companies** with states subject to international arms embargoes.
- **Identify ESG risks and engage to determine if defence companies are managing risks and impacts**, including in their business relationships and throughout the full product lifecycle. Heightened human rights due diligence should be conducted for companies exposed to conflict and high-risk areas, and with risks of breaches of international humanitarian law.

Go to the full article from the UN PRI

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