

A year on for Poseidon Principles

Now **Kate Silverstein** and **Emily Widdrington**, of Watson Farley & Williams, take a look at the first annual report on the Poseidon Principles

The Poseidon Principles are a global framework for assessing and disclosing the climate alignment of financial institutions' shipping loan portfolios. They establish a common baseline to quantitatively assess and disclose whether those portfolios are in line with adopted climate goals, namely, the IMO's goal of reducing shipping's total annual greenhouse gas emissions by at least 50 per cent by 2050 (taking 2008 emissions as the baseline).

The Poseidon Principles launched on 18 June 2019 with 11 founding signatories including Citi, DNB and Societe Generale, and are a reflection of the desire by many ship financiers to contribute to the shipping industry's decarbonisation challenge. Signatories to the Poseidon Principles are required to assess and report on, on an annual basis, the climate alignment of their ship finance portfolio. Currently there are 22 signatories representing a shipping loan portfolio of approximately US\$150 billion – more than a third of the global ship finance portfolio. The 11 additional signatories are made up of nine additional banks including BNP Paribas, Credit Suisse and SEB, and two export credit agencies – Bpifrance Assurance Export and Export Credit Norway.

The Poseidon Principles Steering Committee's expectation is that many more financial institutions will join, and with China's recent pledge to achieve carbon neutrality by 2060 the hope is to also see more Asian institutions becoming signatories to the Poseidon Principles.

On 16 December 2020 the first Poseidon Principles Annual Disclosure Report was published marking an important moment for the initiative with 15 signatories reporting on the climate alignment of their ship finance portfolios. (Note that not all signatories were required to report as there is no obligation to do so in the first year of a signatory joining.)

What are the key takeaways from the first Poseidon Principles Annual Disclosure Report?

Climate alignment scores

The report and published results make for interesting reading, with a climate alignment score being attributed to each reporting lenders' shipping portfolio. A score of 0 per cent or a negative score indicates a ship finance portfolio is "carbon aligned" and is in line with or lower than the required decarbonisation trajectory

set out in the Principles, while a positive score means that any given portfolio is "misaligned" with the applicable trajectory.

The report highlights a wide range of scores from the 15 reporting banks with individual scores ranging from -44.94 per cent to +32 per cent. Three of the shipping portfolios are "carbon aligned" and report a score of 0 per cent or lower, while 12 portfolios are "misaligned". The average reported alignment score across all reporting signatories was +1.2 per cent (meaning that the 2019 greenhouse gas emissions in respect of the reporting signatories' shipping portfolios were on average 1.2 per cent above the relevant decarbonisation trajectory).

“The first Poseidon Principles Annual Disclosure Report marks a significant milestone for global ship finance and for climate finance reporting as a whole. I commend my fellow Signatories for their pioneering efforts to be transparent and accountable for their role in promoting responsible environmental behavior. Together, we will review the Principles to ensure that they are practical and effective, and that further adverse impacts are identified for inclusion in due course”

Michael Parker, chairman, global shipping, logistics and offshore, Citi, and chair of the Poseidon Principles Association

Key trends in the report

Delving deeper into the results reveals that whether or not a ship finance portfolio is "carbon aligned" can be impacted by a number of factors such as a signatory financing a high number of energy-efficient ships or, conversely, lending higher amounts to a small number of very energy-efficient ships. It therefore follows that a highly leveraged portfolio comprising a small

number of ships can significantly impact results and a large loan on a misaligned vessel in a portfolio could have a substantial effect on the overall result.

A huge amount of data has been reported on by the founding signatories and certain trends have been identified which will no doubt be further analysed. Interestingly, the results (anonymised with no individual vessel being able to be identified) did not always reflect a correlation between the age of a vessel and its carbon alignment, highlighting that other factors affect carbon intensity – for example, vessels on long-haul routes are more carbon efficient than those involved in short sea trading routes due to speed of sailing and time in port.

This data emphasises what is already known, that to achieve the IMO’s 2050 carbon emissions goal there needs to be a focus on both existing vessels and how these can be operated in a more carbon-efficient way as well as on newer more energy-efficient ships. This is important given that the required decarbonisation trajectory under the Poseidon Principles falls by a further 11 per cent in the next five years and financiers and shipowners will need to work together to achieve these targets.

Will the report encourage new signatories to join?

The report noted that there was positive participation from ship owners providing the necessary information in respect of more than 90 per cent of the relevant debt to the signatories for them to meet the required reporting requirements which resulted in the reporting process progressing smoothly. It is likely that going forward the process will become even more streamlined, paving the way for new signatories to join a more established regime.

For any financiers who may be concerned that their portfolio score will reflect a carbon misalignment, given that 12 out of the 15 portfolios are misaligned it now seems to be an excellent time to take steps to become a signatory. More importantly, the focus is not on the day one results; the intention is to focus on the ability to improve and the steps taken in time to meet or improve on the decarbonisation trajectory.

How was information collated and how might this change in the future?

The first reporting process was clearly a success and the procedure for reporting the data is set to be made easier. For the first annual report each signatory wrote to their customers and requested the relevant data and statement of compliance. Going forward the hope is to streamline the process by creating an independent data exchange platform which would make the data collection and calculation process simpler for all concerned. With the data potentially appealing to other commercial sectors like insurance, and given similar data is required to be provided

to signatories to the Sea Cargo Charter, the demand for such a platform is certainly there.

It was at the request of shipowners in the drafting group that the Principles should include a standardised covenant. This covenant language was prepared with the help of Watson, Farley & Williams and is now being incorporated into most new financings that the firm are seeing. It is encouraging that, even without this covenant, owners have generally been willing to share their data for reporting purposes which, after all, is the same information required to be shared with the IMO. Changes are also being made to the confidentiality provisions in financing agreements to expressly permit disclosure of relevant data for calculation purposes where signatories use third-party providers to run the calculations. These third-party providers are, in some cases, offering to carry out an informal assessment of potential signatories’ portfolios based on currently available data so that potential signatories have a rough idea of the climate alignment score they are likely to report – this will hopefully lead to further signatories to the Principles.

What does the future hold?

It has been suggested that the scope of the Poseidon Principles could be expanded to include other greenhouse gases or, if ratified, any expansion of the Principles may also look to cover the requirements of the Hong Kong convention on sustainable ship recycling. The Poseidon Principles Association has suggested that any expansion will be in line with applicable worldwide legal and regulatory developments (eg future IMO regulations) but should also be driven by the signatories with cooperation from ship owners so that a level of control and self-regulation that is fit for purpose is maintained.

The methodology behind the Poseidon Principles ensures that no type or size of vessel is put in an unfavourable position; it is the carbon intensity of those vessels relative to their respective carbon trajectory that is important. Now that the results from the first year of reporting have been received, there is scope for the assumptions underpinning the trajectories to be revisited having the benefit of seeing the first cycle complete.

Summary

However the Poseidon Principles may develop in time, one thing is clear from the first annual report – a transparent approach to reporting on the fundamental issue facing the industry has been successfully achieved by a cooperative and collaborative approach between financiers and ship owners. Although there is work to be done to achieve a more aligned climate score across the board, this reporting process will continue to be an important annual feature in the shipping space. *MRI*



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