

ESG Financing

Sustainability-Linked Bonds

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- 2014 – the first law firm member of the International Capital Market Association (ICMA) Green Bond Principles
- 2016-2017 – member of the legal advisory committee to the Climate Bond Initiative (CBI) in establishing its climate bond certification guidelines
- Have acted on several green bond and sustainability-linked loan financings
- 2020 – 2021 – member (only law firm) of the CSA Transition and Sustainable Finance Working Group developing the Canadian guidelines and taxonomy for transition and sustainable finance – soon to be released by the banks

What are Sustainability-Linked Bonds (SLBs)

- SLBs are any type of bond instrument where the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability/ESG objectives within a predefined timeline
 - Coupon
 - Maturity
 - Repayment Amount
- ESG objectives typically at the issuer level (as opposed to projects)
- Typically use of proceeds is general corporate purposes, including repayment of indebtedness
- Issuers commit to **future improvements** in sustainability outcomes

Some Terminology

- KPI – Key Performance Indicator – quantifiable metrics used to measure the performance of selected indicators
- SPT – Sustainability Performance Targets – measurable improvements in KPIs on to which the issuer commits to a predefined timeline

Deal Examples

- Enbridge- KPI is carbon emission intensity reduction (scope 1 and 2) and representation of racial and ethnic minorities in workforce (as reported in Bloomberg)
- Telus- KPI is absolute GHG emissions (scope 1 and 2)
- NRG Energy – KPI is absolute carbon emissions (scope 1, 2 and 3 (limited to business travel))

Deal Examples

- Enel – KPI is renewable power installed capacity
- Chanel – KPI is carbon emissions (scope 1 and 2), value chain GHG emissions (direct) and % of electricity needs from renewables
- Schneider Electric – KPI is avoided carbon emissions, gender diversity among leadership team, training of underprivileged individuals in energy management

Deal Examples

- SLBs issued
 - 2019 Q1 - \$0
 - 2020 Q1 - \$150 million
 - 2021 Q1 - \$8.8 billion
- SLB/Green Bond “Combos” issued
 - 2019 Q1 - \$0
 - 2020 Q2 - \$0
 - 2021 Q1 - \$690 million

Sustainability Goals (KPIs and SPTs)

- Typically expressed in an Issuer's Sustainability Report or Sustainability-Linked Bond Framework
 - Net emissions
 - Emissions intensity
 - Employee and contractor injuries
 - Board and workplace representation by gender, indigenous, ethnic and racial groups
- Sustainability Accounting Standards Board (SASB)
- Global Reporting Initiative (GRI)
- United Nations Sustainable Development Goals - 2015

Sustainability-Linked Bond Principles (SLBP)

- Sustainability-Linked Bond Principles (SLBP) – June 2020
 - Voluntary process guidelines
 - Best practices
- Sustainability-Linked Bond Principles Related Questions – February 2021
 - FAQs
- Climate Transition Finance Handbook Guidance for Issuers- December 2020
- International Capital Markets Association (ICMA)
- Standardization, Transparency, Acceptance

Sustainability-Linked Bond Principles (SLBP)

- Five core components
 - Selection of Key Performance Indicators (KPIs)
 - Calibration of Sustainability Performance Targets (SPTs)
 - Bond Characteristics
 - Reporting
 - Verification

SLBP - Key Performance Indicators (KPIs)

The KPIs should be:

- relevant, **core and material** to the issuer's overall business, and of high strategic significance to the issuer's current and/ or future operations;
- measurable or **quantifiable** on a consistent methodological basis;
- externally **verifiable**; and
- able to be benchmarked, i.e. as much as possible using an external reference or definitions to facilitate the assessment of the SPT's level of ambition.

Issuers are encouraged, when possible, to select KPI(s) that they have already included in their previous annual reports, sustainability reports or other non-financial reporting disclosures to allow investors to evaluate historical performance of the KPIs selected. In situations where the KPIs have not been previously disclosed, issuers should, to the extent possible, provide historical externally verified KPI values covering at least the previous 3 years.

SLBP - Sustainability Performance Targets (SPTs)

SPTs should be **ambitious**, i.e.:

- represent a material improvement in the respective KPIs and be **beyond a "Business as Usual"** trajectory;
- where possible be compared to a benchmark or an external reference;
- be consistent with the issuers' overall strategic sustainability / ESG strategy; and
- be determined on a predefined timeline, set before (or concurrently with) the issuance of the bond.

SLBP – Sustainability Performance Targets (SPTs)

The target setting exercise should be based on a combination of benchmarking approaches:

- **main focus** - the issuer's own performance over time for which a minimum of 3 years, where feasible, of measurement track record on the selected KPI(s) is recommended and when possible forward-looking guidance on the KPI, and
- the issuers' peers, i.e. the SPT's relative positioning versus its peers' where available (average performance, best-in-class performance) and comparable, or versus current industry or sector standards, and/or
- reference to the science, i.e., systematic reference to science-based scenarios, or absolute levels (e.g. carbon budgets), or to official country/regional/international targets (Paris Agreement on Climate Change and net zero goals, Sustainable Development Goals (SDGs), etc.) or to recognised Best-Available-Technologies or other proxies to determine relevant targets across environmental and social themes.

SLBP - Bond Characteristics

The cornerstone of a SLB is that the bond's financial and/or structural characteristics can vary depending on whether the selected KPI(s) reach (or not) the predefined SPT(s), i.e. the SLB will need to include **a financial and/or structural impact involving trigger event(s)**.

- Coupon is most common
- Could involve other structural aspects

SLBP - Reporting

Issuers of SLBs should publish:

- up-to-date information on the performance of the selected KPI(s), including baselines where relevant;
- a **verification assurance report** relative to the SPT outlining the performance against the SPTs and the related impact, and timing of such impact, on the bond's financial and/or structural characteristics; and
- any information enabling investors to monitor the level of ambition of the SPTs (e.g., any update in the issuers sustainability strategy or on the related KPI/ESG governance, and more generally any information relevant to the analysis of the KPIs and SPTs).

This reporting should be published regularly, **at least annually**, and in any case for any date/period relevant for assessing the SPT performance leading to a potential adjustment of the SLB's financial and/or structural characteristics.

SLBP - Verification

Issuers should seek independent and external verification (for example limited or reasonable assurance) of their performance level against each SPT for each KPI by a qualified external reviewer with relevant expertise', such as an auditor or an environmental consultant, at least once a year, and in any case for any date/period relevant for assessing the SPT performance leading to a potential adjustment of the SLB financial and/or structural characteristics, until after the last SPT trigger event of the bond has been reached.

The verification of the performance against the SPTs should be made publicly available.

As opposed to the pre-issuance external review such as a Second Party Opinion, which is recommended, **post issuance verification, is a necessary element of the SLBP.**

Documentation

- Relevant offering documents
 - Consider location of ESG strategy disclosure
 - Prospectus - Full true and plain disclosure of all material facts relating to securities
 - Private placement documentation
- Trust indenture
- Supplemental indentures
- Appointment of an external verifier

SLB Drafting Issues - SPTs

- Number of SPTs
- Term and alignment with SPTs in issuer's strategy– interim SPTs
- Trigger events – involve external verifier
- Need visibility on status as issuer moves towards the target
- Any adjustments for various factors (re-baselining) – M&A, measurability of KPIs and other adjustments, if any
- Recognize that measurement methodology for KPIs can change or subject to varying methods within published standards

SLB Drafting Issues – Coupon Rates

- Interest rate step ups - 25bps is most common “standard” but not required - viewed as starting point for analysis
- Step up or step down of coupon rate - step up is current standard
- Higher step ups tends to be for lower rated bonds
- Step up - for last interest period pre-target and/or then go forward period so no retroactive “top up payments” are required
- Post - target step up periods range from 6 months to 6 years
- Optional early redemption interest rate payable - function of whether SPT satisfied

SLB Other Issues

- Use of proceeds of SLB – if to pay other indebtedness that is not labelled sustainable then will this taint the SLBs? – technically not, but is there this perception?
- SLB essence is a forward-looking commitment.
- SPTs – be mindful of potential for future “tightening” of issuer’s SPTs – will old bonds remain “sustainable”? – potential issue re use of proceeds re future issues.- consider “most ambitious target” clauses
- Alignment with (consistent) Issuer’s sustainability-linked loans
 - Sustainability-linked financing framework
- SLB also Green Bond or Transition Bond compliant – consider framework compliance

Thank you

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