Welcome!

ESG beyond borders: international perspectives on financing market trends and regulatory oversight for Canadian issuers and financial institutions

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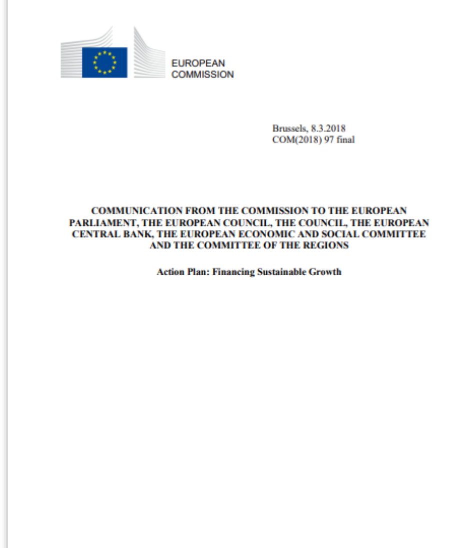
1. EU ESG Regulation

An overview of EU ESG regulation



EUROPEAN COMMISSION

Brussels, 8.3.2018
COM(2018) 97 final

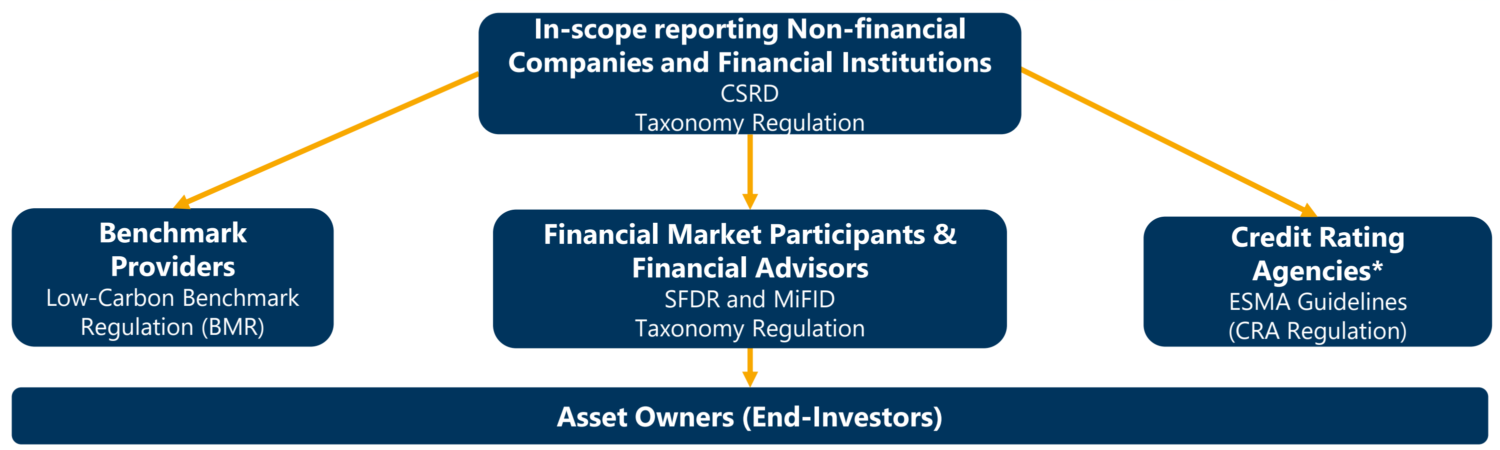
COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Action Plan: Financing Sustainable Growth

In March 2018, the EU published its "**Action Plan on the Financing of Sustainable Growth**" which laid out a master plan to be implemented by a variety of individual regulatory measures.

This sits alongside other EU initiatives such as "**The European Green Deal**" and "**Fit for 55**".

An overview of EU ESG regulation



- **NFRD** = Non-Financial Reporting Directive (Directive 2014/95/EU)
- **CSRD** = Corporate Sustainability Reporting Directive (Proposal COM(2021) 189 final)
- **SFDR** = Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088)
- **BMR** = Benchmark Regulation (Regulation (EU) 2016/1011)
- **CRA** = Credit Rating Agencies Regulation (Reg. (EU) No 462/2013)

* Reported data will also be required for ESG ratings. It is unclear whether and to what extent the EU will envisage a regulation for ESG ratings.

2. Taxonomy

EU Taxonomy Regulation

- An investment is environmentally sustainable if it finances one or more **economic activities** that are considered environmentally sustainable under the Taxonomy Regulation (Art. 3)

- According to the Taxonomy Regulation, an **economic activity** is environmentally sustainable when it:
  - substantially contributes to one of the six defined **environmental objectives**
  - **does no significant harm** to any of the other five objectives
  - complies with **minimum safeguards**

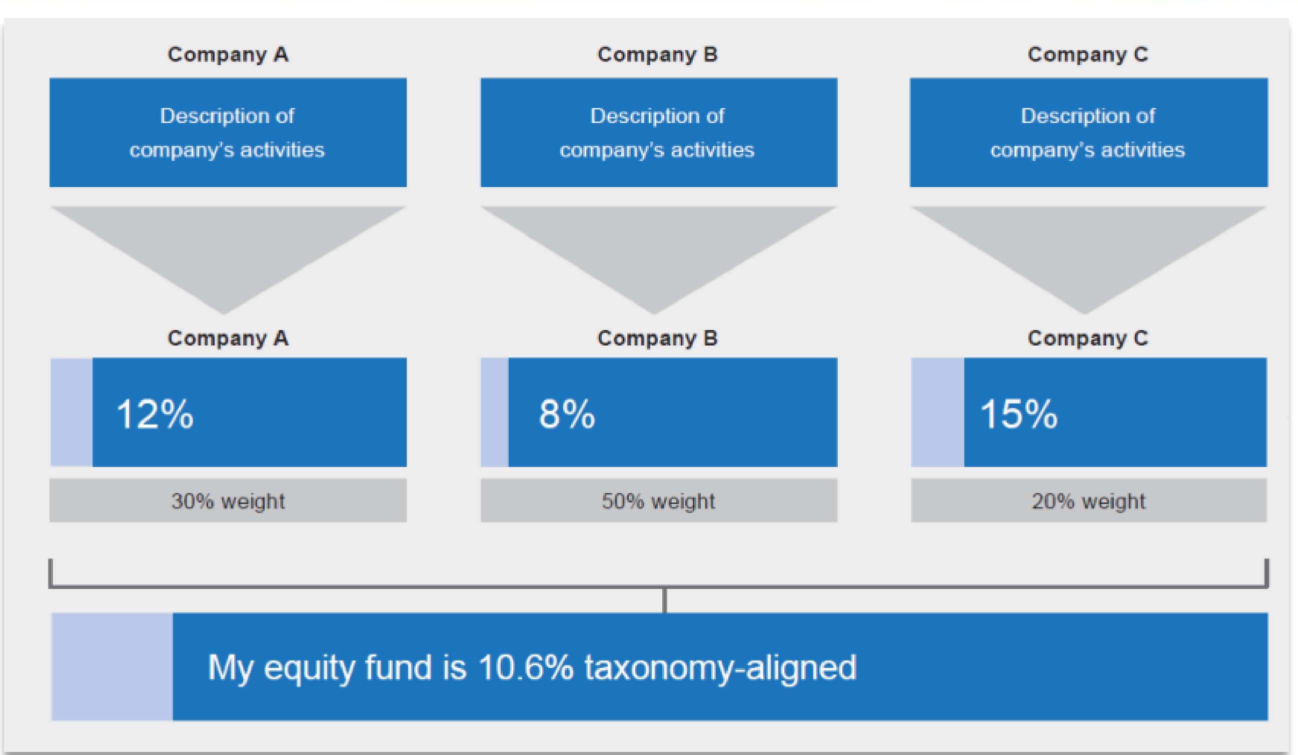
- For the time being, the regulation is limited to the determination of environmental sustainability (at a later stage the objectives "social" and "governance" may be included)

- Climate Change Mitigation and Adaptation objectives have been developed and in force. Remaining activities are under development.

THE SIX ENVIRONMENTAL OBJECTIVES UNDER THE TAXONOMY REGULATION

Climate Change Mitigation	Climate Change Adaptation	Sustainable Use and Protection of Water and Marine Resources
Transition to a Circular economy, Waste Prevention and Recycling	Pollution Prevention and Control	Protection of Healthy Ecosystems

EU Taxonomy Regulation – Hypothetical example



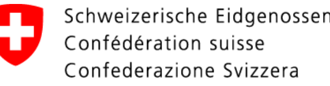
The Taxonomy and the concept of "**taxonomy alignment**" flows through a number of pieces of legislation e.g. CSRD, SFDR and the EU Green Bond Standard

3. CSRD

Sustainability reporting is a global theme

- Frameworks for sustainability-related reporting are becoming increasingly common and mandatory across the globe, including in the EU, UK, US, Japan and Switzerland.
- International initiatives, including the IFRS Foundation's International Sustainability Standards Board, aim to align these jurisdictional frameworks, many of which are based on the TCFD Recommendations.

Department for Business, Energy & Industrial Strategy



CSRD – In a nutshell

The CSRD will create new, detailed sustainability reporting requirements and will significantly expand the number of EU and non-EU companies subject to the EU sustainability reporting framework. The required disclosures will go beyond environmental and climate change reporting to include social and governance matters (for example, respect for employee and human rights, anti-corruption and bribery, corporate governance and diversity and inclusion). In addition, it will require disclosure regarding the due diligence processes implemented by a company in relation to sustainability matters and the actual and potential adverse sustainability impacts of an in-scope company's operations and value chain.

Source: Mayer Brown – "EU Corporate Sustainability Reporting Directive – New sustainability disclosure obligations for EU and non-EU companies" (November 2022)

CSRD – Who does it apply to?

Category	Definition
Companies currently subject to the NFRD	Large EU "public interest entities" with EU regulated market listed securities, EU credit institutions and EU insurance companies with more than 500 employees
"Large" EU companies and groups.	EU companies and EU consolidated groups meeting two of the following tests: a) balance sheet total exceeding €20 million, b) net turnover exceeding €40 million, and c) more than 250 employees.
Other EU and non-EU companies (excluding micro-enterprises) with securities listed on EU regulated markets.	EU and non-EU companies (excluding micro-enterprises*) with securities (but not debt securities with denominations of more than €100,000 or equivalent**) listed on an EU regulated market. It does not apply to securities listed on EU multilateral trading facilities.
Non-EU companies with a net turnover of more than €150 million in the EU and an EU branch or subsidiary.	Non-EU companies with: a) an annual net turnover at the consolidated or individual level in the EU exceeding €150 million for each of the last two consecutive financial years, and b) which have a qualifying EU subsidiary (which is either a large EU company, or an EU company listed on an EU regulated market which is not a micro enterprise) or a branch in the EU that generated an annual net turnover in excess of €40 million in the preceding financial year.

*Micro-enterprise =two of: balance sheet less than EUR350,000, net turnover less than EUR700,000 or less than 10 employees
** CSRD information is included in management reports. The Article 8 “wholesale” exemption from requirement to produce a management report on account of listing on a regulated market remains.

CSRD – Disclosure obligations

In-scope companies will be required to disclose a range of sustainability-related information, including:

- a brief description of the company's business model, strategy, sustainability risks and opportunities, and sustainability policies (including incentive schemes linked to sustainability matters);
- ESG targets (including greenhouse gas emission targets) and annual progress on these targets;
- transition plans, measures taken to limit global warming in line with the Paris Agreement and to achieve climate neutrality by 2050, exposure to coal, oil and gas-related activities;
- sustainability matters that affect the company and the impact of the company on sustainability matters;
- due diligence processes implemented by the undertaking in relation to sustainability matters and the actual and potential adverse impacts of the company's operations and value chain; and
- Taxonomy alignment reports

In-scope entities will be also required to disclose against new EU Sustainability Reporting Standards (**ESRS**).

CSRD – How will it apply?

- **Group reporting** - There are **exemptions** for in-scope companies where their parent company complies with the CSRD via a consolidated group report. Exempted subsidiaries must still include the following in their management reports:
  - the name and registered office of the parent undertaking that is reporting at group level;
  - the web links to the consolidated management report; and
  - a reference of this exemption in their own management report.
- **Differential rules for SMEs** - There are also exemptions to some of the disclosure requirements for small and medium sized institutions (**SMEs**)**.**
- **Equivalence** - There remains the possibility for the EU Commission to recognise the sustainability reporting of non-EU companies in **other jurisdictions** as equivalent. But it is currently unclear whether the EU Commission will recognise non-EU standards as fully equivalent given the expansive nature of the CSRD.
- **Transposition into local law** – It is an EU directive without direct effect. Important to verify how CSRD applies at national level.

CSRD – Implementation Timeline

The application of the CSRD will take place in four stages (for financial years starting on or after):

1 January 2024

Large EU "public interest entities" that are already subject to the NFRD and non-EU companies listed on a regulated market in the EU within the definition of large undertakings with more than 500 employees

Large EU organisations that are not presently subject to the NFRD and large non-EU companies listed on a regulated market in the EU

1 January 2026

Listed EU and certain small and medium sized enterprises ("**SMEs**") (including non-EU SMEs listed on a regulated market in the EU), small and non-complex credit institutions and captive insurance undertakings

1 January 2028

Non-EU companies falling within the rules solely on account of the EU Turnover Test.

CSRD – How to prepare

- **Scope** - take advice on the applicability of the CSRD to the EU and non-EU subsidiaries in their group. The scope and precise applicability of the CSRD is complex and will require detailed analysis
- **Gap Analysis** - complete a gap analysis and assess the overlap of CSRD with other EU and US, UK, international and other ESG reporting rules
- **Monitor** - review the EFRAG publications for further guidance on expected reporting requirements
- **Consider overlapping EU obligations** - look to the human rights and environmental due diligence requirements contained in the draft EU Directive on Corporate Sustainability Due Diligence, which are indicative of emerging regulatory and stakeholder expectations
- **Assess internal resource** - review the role, resources and expertise of their legal and compliance functions, who should play a key part in addressing the new challenges of this legislation
- **Effect on other workstreams** – E.g. Debt prospectus, disclaimers, website

4. EU Green Bond Standard

EU Green Bond Standard – The basics

- EU proposal to **fight greenwashing and harmonise capital flows**. **Voluntary EU standard but with implications on market practice globally**.
- The proposals build on existing market best practices from the **ICMA GBP**.
- **Key differences from the ICMA GBP**:
  - Use of proceeds to be EU Taxonomy aligned
  - Standardised Issuer reporting templates and fact sheets
  - Mandatory second party opinions from external reviewers
  - ESMA supervision of external reviewers
  - Voluntary disclosure requirements for any green bond or SLB issued in the EU

EU Taxonomy alignment

Enhanced Issuer reporting requirements

Mandatory external reviews

ESMA supervision of external reviewers

EU Green Bond Standard – Provisional Agreement

Key issues	EC	Council	EP	Provisional Agreement
Nature of the EU GBS	Voluntary	Voluntary	Voluntary with a review clause	Voluntary
Scope of the EuGB Reg.	EU GBS + External Reviewers (ERs) of EuGBs	EU GBS + ERs of EuGBs	EU GBS + all ERs (practically) + Mandatory disclosures for all green UoPs bonds and environmental SLBs	EU GBS + ERs of EuGBs + Voluntary disclosures for all green UoPs bonds and environmental SLBs
TSC flexibility	No	Up to 20% : for (i) activities with no TSC and (ii) internationally reported green finance flows)	No, but a "Taxonomy equivalency" mechanism has been proposed.	Up to 15%: for (i) activities with no TSC and (ii) (potentially) internationally reported green finance flows)
Grandfathering	Partial 5-years (with EC stating that it concerns unallocated proceeds).	Full	Partial 5 years for UoPs other than debt (with no forced re-allocation of already allocated proceeds) and 10-years (under portfolio-based approach)	Some reports referring to an agreement on 7 years grandfathering, but no clarity yet on the treatment of already allocated / committed proceeds.

Source: ICMA

EU Green Bond Standard – Provisional agreement

- **Timeline** – **On 28 February 2023**, the Council of the European Union and the European Parliament reached a provisional agreement on the creation of the European Green Bond Standard.
- For further details: Alert – Council of the EU and European Parliament reach provisional agreement on European Green Bond Standard | Perspectives & Events | Mayer Brown
- **Timeline** – Text not yet available but expected in coming days. Needs to be verified by Council and Parliament and will apply 12 months after entering into force.
- **Key points clarified** – For sectors not yet covered by the Taxonomy and for certain specific activities, it has been agreed there will be a flexibility pocket of 15%. In addition, and importantly, it appears that sustainability disclosures for non-EU GBS, but otherwise sustainable bonds or sustainability-linked bonds, will be via voluntary (rather than mandatory) disclosure templates
- **Key points pending release of provisional text** – Grandfathering, liability regime, disclosure templates, securitisations
- **Usability concerns remain –** Particularly for non-EU Issuers and in light of the complexity of the EU Taxonomy

5. SFDR

EU Sustainable Finance Disclosure Regulation

SFDR harmonises and standardises sustainability disclosures relating to ESG risks and issues impacting certain financial products and financial entities. SFDR breaks down the "financial products" into 3 categories by reference to the way in which the financial products take into account sustainability risks, sustainability factors and sustainable investments.

- **Sustainability risks** are defined as “an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment”.
- **Sustainable investment** is defined as “an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance”.
- **Sustainability factors** are defined as “environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters”.

What is SFDR?

- **Article 6 products:** An Article 6 product is one (i) that integrates sustainability risks into the investment decision making process and those which do not and (ii) that is not an Article 8 or Article 9 product. Most non-ESG financial products will fall into this category. Products which consider sustainability risks as part of a general set of **risks (but are not marketed with any ESG focus) will also fall into this category.**
- **Article 8 products:** This is a financial product that promotes investments with environmental and/or social characteristics (i.e. sustainability factors), provided that the companies in which the investments are made follow good This is governance practices. These products are also known as "light green" products.
- **Article 9 products:** a financial product that has sustainable investment as its objective and will usually use an index as a reference benchmark to measure how the sustainable investment objectives are achieved. There is also a requirement that the investee companies follow good governance practices. These are also referred to as "dark green" products.

Most of the substantive requirements under SFDR came into force on 10 March 2021.

SFDR does not apply in UK. UK is consulting on its own sustainable finance disclosure framework.

Which entities and products are in scope?

- The **scope of SFDR is wide**; but its impact has predominately been in the asset management industry.
- The entity scope includes **financial market participants ("FMPs") and financial advisers ("FAs") located within the EU and outside of the EU**, where the non-EU FMP or non-EU FA is marketing (or proposes to market) their financial products to EU based clients.
- FMPs are defined to include, among others, **asset managers, UCITS management companies, pension companies, insurance companies, certain venture capital fund managers and firms providing portfolio management services** (managed portfolios and sub-advisory mandates) under EU MIFID.
- The product scope includes, among other things, **UCITS, alternative investment funds (("AIFs") which will incorporate most fund structures), insurance based investment products (“IBIPs”) (e.g. fund linked insurance products)**, certain pension products and certain managed portfolios. SFDR does not apply to debt and equity securities.
- The disclosure obligations under **SFDR will be triggered where in-scope products are marketed**, or otherwise made available, to clients in the EU.
- The FAs which fall into scope include insurance intermediaries, insurance companies, banks and investment firms, asset managers and UCITS companies – each **when providing investment or insurance advice**. Investment advice will be given where there are personal recommendations made to clients within the meaning of the MIFID II. Insurance advice is provided by insurance/reinsurance companies or intermediaries as defined under the EU Insurance Distribution Directive.

What are the key disclosure requirements under SFDR?

SFDR mandates disclosures in three categories **(1) website disclosures (2) pre-contractual disclosures and (2) periodic reporting disclosures**. The disclosures apply at entity level and, in certain circumstances, at the level of the financial product. Standardised templates have been put in place pursuant to related delegated acts.

Website Disclosures

Article 3 – Sustainability risk policies – on comply or explain basis

Article 4 – Principal adverse sustainability impacts and indicators (PAI) at entity level

Article 5 – Sustainability remuneration policies

Article 10 – Promotion of environmental or social characteristics or sustainable investment (Article 8 and 9 products only)

Pre-contractual disclosures – prospectus and other pre-contractual information provided to clients

Article 6 – Sustainability risks integration (if any) at entity level – comply or explain

Article 7 – PAIs at financial product level

Article 8 – Promotion of ESG characteristics – how are characteristics met, are benchmarks used, how are objectives achieved

Article 9 – Sustainable investments – how is benchmark aligned with sustainable objective, how is the objective achieved

Periodic reports – annual reports issued by FMPs, periodic reporting to clients

Article 11 – Explanation of how are ESG characteristics met for Article 8 products and taxonomy alignment for Article 9 funds. Explanation of overall sustainability related impact on financial product for Article 9 products by means of relevant sustainability indicators.

What are the key disclosure requirements under SFDR?

PAI disclosures – Annex I

The PAI statement is intended to show investors and prospective investors how investment decisions made by a financial market participant are (or are not) impacting a prescribed set of mandatory sustainability indicators, and several voluntary ones. Requiring all relevant financial market participants to report against the same indicators and to use a standardised template form will encourage investors to compare asset managers' approaches to sustainable investment.

MANDATORY ADVERSE SUSTAINABILITY INDICATORS

Climate and other environment indicators

- GHG Emissions (Scope 1,2,3 & Total)
- Carbon Footprint
- GHG Intensity
- Fossil fuel sector
- Non-renewable energy consumption and production
- Energy consumption intensity per high impact climate sector
- Biodiversity sensitive areas
- Emissions to water
- Hazardous waste ratio

Social and governance indicators

- Violations of UN Global Compact principles and OECD Guidelines
- Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines
- Gender pay gap
- Board gender diversity
- Exposure to controversial weapons

6. The UK perspective

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UK ESG Regulation - Overview

Legislation	What is it?	Who does it apply to?	In force?	Applicability to DCM
		UK		
Taxonomy	Dictionary of what constitutes a "sustainable economic activity"	Currently N/A	No	Taxonomy was onshored post-Brexit but operative provisions not in force. GTAG are currently developing a UK Taxonomy but final shape not yet clear, see: REPORT (greenfinanceinstitute.co.uk)
Corporate Reporting	Sustainability reporting requirements for companies	UK PIEs and companies with standard UK equity listing	Yes	Companies Act 2006 s414, 414CA and 414 CB; Listing Rules (Disclosure Climate-Related Financial Information) (No 2) Instrument 2021. 2023 is first financial reporting year
SDR	Potential equivalent of EU SFDR	Buy-side	No	New rules to be planned to be published by 30 June 2023. Note, a new anti-greenwashing principle for all FCA Regulated firms expected in force by 30 June 2023. Communications on sustainability related claims must be "clear, fair and not misleading".
GBS	N/A	N/A	N/A	No current plans for a UK GBS
MiFID ESG	N/A	N/A	N/A	Equivalent ESG amendments to MiFID were not included in UK MiFIR
Due Diligence	N/A	N/A	N/A	N/A
Prospectus Reform	Reform of the UK PR	Issuers of PR compliant securities	No	TBD as part of UK PR reforms.
ESG Ratings	Currently unregulated	N/A	No	FCA have said they plan to bring ESG rating agencies "within the regulatory perimeter"

ESG in the United States

ESG scrutiny on the rise

Major European bank's claims re sustainable investing practices probed by US and European regulators, leading to CEO departure

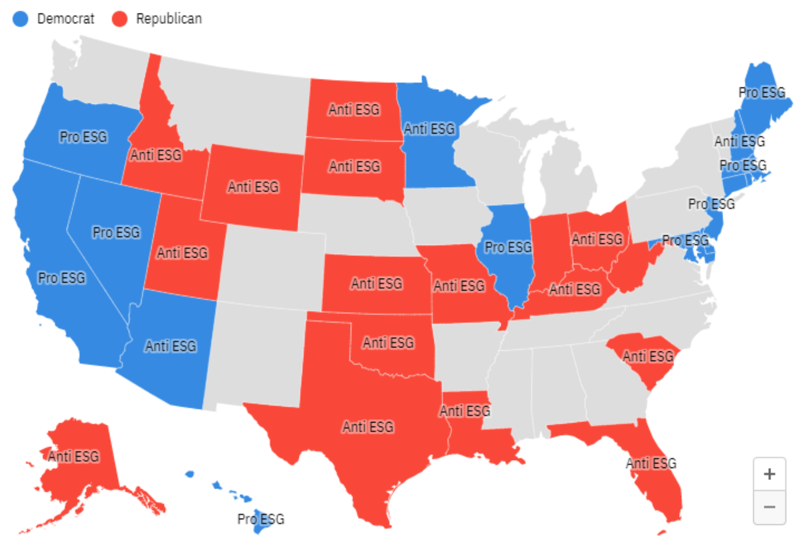
Major European bank's head of responsible investing suspended due to remarks dismissing climate risk

Major US asset manager fined by SEC for misstatements and omissions relating to ESG reviews of funds

"Investor Democracy Is Expected Act" introduced in Senate in May 2022; would require managers of passive investment funds to pass through voting where position exceeds 1%

SEC charged Vale with making false and misleading statements about the safety of its dams prior to the January 2019 Brumadinho dam collapse

NAIC requires insurers that respond to the NAIC Climate Risk Disclosure Survey to comply with TCFD reporting by November 2022



Source: Mayer Brown Presentation on 2023 Proxy Season

ESG coalitions under stress

Glasgow Financial Alliance for Net Zero (GFANZ, launched 2021), includes sub-groups:

* Net Zero Asset Managers initiative (NZAM) ~275 asset managers with ~$60 trillion AUM

* Net Zero Banking Alliance (NZBA) ~120 banks with ~$70 trillion in assets

GFANZ is accredited by the UN's Race to Zero initiative, the overarching campaign, which has increased demands on its members, leading to tensions among NZAM and NZBA members, with large NZBA members threatening to withdraw, including B of A, JP Morgan and Morgan Stanley (*see Banking Dive* Oct. 10, 2022) https://www.bankingdive.com/news/gfanz-jpmorgan-chase-bank-of-america-morgan-stanley-un-race-to-zero)

Such coalitions draw heightened scrutiny and raise concerns regarding anti-trust violations (see *Fin. T.* Feb. 27, 2023 https://www.ft.com/content/f5ca94f5-2fab-451c-981c-e6e0e54fc3ba).

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Source: Mayer Brown Presentation on 2023 Proxy Season

SEC initiatives

- 2010: SEC publishes Commission Guidance Regarding Disclosure Related to Climate Change
- 2020: Human capital added as a line item to Regulation S-K
- 2021: Commissioner Lee becomes Acting SEC Chair and announces all-agency focus on ESG
  - Division of Corporation Finance comment letters
  - Enforcement Task Force focused on public company ESG material misstatements and omissions
- 2022: Rulemaking agenda
  - Climate change
  - Human capital
  - Diversity

Key considerations for US public companies

- Keep up to date with SEC disclosure rules, comment trends, and proposed rules
- Engage with investors on ESG topics and compare voluntary disclosures and commitments to those being made by competitors
- Evaluate board of director oversight of ESG matters and management's role in assessing and managing ESG matters
- Assess whether ESG commitments made by the company are sustainable and whether its disclosures are tied to effective disclosure controls and procedures
- Involve outside counsel to review public statements before release and consider engaging ESG experts or consultants to help the company set measurable policies and actions

Overview of the SEC climate disclosure proposal

- The proposed rule includes extensive required reporting by covered companies of climate-related financial and non-financial disclosures and related attestation
- Notably, and subject to certain exceptions and transitional provisions, the proposed SEC rules would require that covered companies disclose:
  - Direct greenhouse gas (GHG) emissions (Scope 1) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2); and
  - Indirect emissions from upstream and downstream activities in a company's value chain (Scope 3), if material, or if the company has set a GHG emissions target or goal that includes Scope 3 emissions
- Requires "short-, medium- and long-term" climate-related risk assessments
- Includes potentially significant practical consequences for corporate governance, business strategy and risk management

Proposed amendments to Regulation S-X

- Required in filings that require audited financial statements and corresponding Regulation S-K climate-related disclosure
- Notes to the financial statements
- Three categories of information:
  - Financial impact metrics
  - Expenditure metrics
  - Financial estimates and assumptions

Proposed amendments to Regulation S-K

- Governance: board oversight and management's role in assessing and managing climate-related risks
- Strategy, business model, and outlook
- Risk management
- GHG emissions metrics
- Scope 1 and Scope 2 emissions disclosure attestation
- Targets and goals

Practical considerations

- Review and, as necessary, “upskill” Board and management climate risk assessment/reporting capabilities
- Invest as needed in people, software and systems to support climate-related risk assessment and reporting
- Embed climate risk assessment in traditional business management, including M&A
- Consider and use, as needed, third-party assistance
- Review disclosure controls and procedures, internal control over financial reporting and committee charters and revise as appropriate
- Be sure any other climate disclosure is consistent with what is disclosed pursuant to new rules

ESG activism shows volatility

- In the U.S., the number of “conservative” proposal submissions doubled 2021 to 2022
- Increasing coordination among “progressive” proponents
- BlackRock climate bulletin – declining to support prescriptive proposals
- Throttling traditional energy companies (halting finance, killing assets)
- Civil rights audits, racial equity audits, anti-arbitration
- Abortion on the corporate ballot

Source: Author & Mayer Brown Presentation on 2023 Proxy Season

SEC's Proposed Naming Rule

- May 25, 2022, the SEC approved a proposed "names rule" for funds
  - Would modernize the "names rule"
  - Expand its scope to apply to any fund name with terms suggesting that the fund focuses on investments that have, or whose issuers have, "particular characteristics"
  - Especially concerned with fund names that include terms such as "growth" or "value"
  - Also concerned with fund names that indicate the fund's investment decisions incorporate one or more ESG factors, with terms such as "sustainable," "green" or "socially responsible"

SEC's Proposed Naming Rule *(cont'd)*

- Amendment also seeks to clarify the rule's application to derivatives--stating that, in applying the 80 percent requirement, a fund should use a derivative investment's notional amount and not its market value
- Specifies circumstances under which funds may depart from the 80 percent investment policy (such as sudden changes in market value of the underlying investments) and sets forth specific time frames in which the fund must return to the 80 percent threshold (in most cases, 30 days)
- Proposal retains the requirement that, in most cases, notice of any changes in the fund's 80 percent investment policy must be provided to shareholders

SEC's Proposed Naming Rule *(cont'd)*

- Proposal would require that all funds that must adopt an 80 percent policy under the Names Rule include fund prospectus disclosures that define the terms used in a fund's name, and amendments to Form N-PORT would require greater transparency on how a fund's investments match its stated focus
- There would also be certain record-keeping requirements related to a fund's ongoing compliance with the rule
- Proposal also addresses so-called "Integration Funds," which consider ESG factors alongside (but no more centrally than) other, non-ESG factors
- Proposal would prohibit Integration Funds from using ESG terminology in the fund's name on the basis that doing so would be materially deceptive or misleading because the ESG factors would not be determinative in decisions to include or exclude any particular investment in the portfolio

ESG Disclosure Proposal

- On same day, the SEC also adopted a proposed rule for comment that focuses on additional ESG disclosures by funds and would propose increased disclosure requirements in a few areas:
  - By requiring additional disclosure regarding a fund's or adviser's ESG strategies;
  - By implementing a layered, tabular disclosure approach for ESG funds to allow investors to better compare like investments across like funds; and
  - By requiring certain environmentally focused funds to disclose greenhouse gas (GHG) emissions associated with their investments

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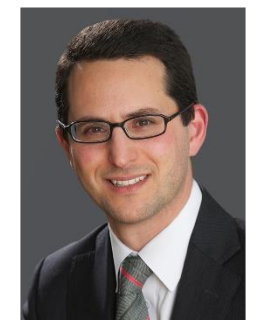

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April 2023

PRODUCTS IN THE MARKET: Green Bonds and Green Loans

- **Green Loan/Green Bond:** A loan or bond **whose proceeds are to be used exclusively** to finance or re-finance new and/or existing eligible green projects.

- **Project selection** and **management of debt proceeds** are fundamental.

- Green Loan/Green Bond Principles (GLP/GBP) establish a framework which sets out **four core components** plus a **fifth optional component**.

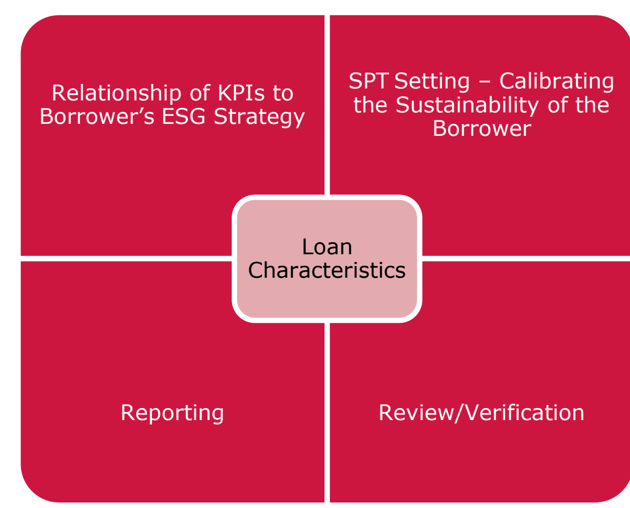
- Fifth optional component is **external review, which is recommended**. External reviewer will confirm alignment of the loan/bond with the GLP/GBP.

PRODUCTS IN THE MARKET: Green Bonds and Green Loans

- **Examples of Green Loan Projects:**
  - Renewable energy and energy efficiency
  - Pollution prevention and control
  - Clean transportation
  - Sustainable water and waste management
  - Biodiversity conservation
  - Environmentally sustainable management of natural resources
  - Climate change adaptation
  - Production of environmentally friendly goods
  - Green buildings (e.g., LEED certification)

PRODUCTS IN THE MARKET: Sustainability-Linked Loans - The Principles

- **Sustainability Linked Loan:** Any type of loan which **identifies key performance indicators (KPIs)** and **incentivizes achievement of ambitious, predetermined sustainability performance targets (SPTs)**.
- The loan **use of proceeds is not a determinant**.
- Sustainability Linked Loan Principles (SLLP) establish a framework which sets out **five core components**.
- The **selection of KPIs** and **calibration of SPTs** should **direct the loan characteristics** and be supported by **recurring reporting** and **external verification**.



MARKET CONTEXT: Stakeholder Interests

- **Stakeholder Interest:** A broader definition of stakeholder has expanded institutional focus on channeling capital toward sustainable objectives
  - Shareholders/Investors
  - Employees
  - Customers
  - Local Communities
  - Regulators
  - Credit Providers
  - Rating Agencies

PRODUCTS IN THE MARKET: Definition of Sustainability

- **Sustainability:** No single definition
- Parties must:
  - Define the Borrower's stated ESG objective
  - Confirm that the selected KPI incentivizes / contributes to such ESG objective
  - Assess any significant negative impacts of such objective or the activity being financed/incentivized
- KPIs should be **ambitious and credible, core to the Borrower's business** and a **demonstrable marker of sustainability**.

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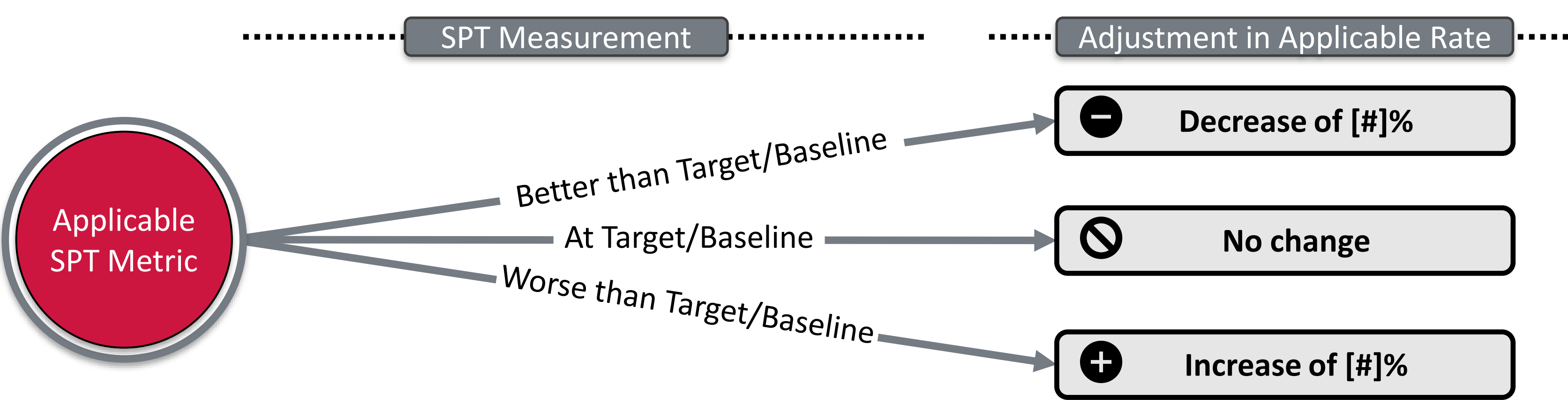
Canadian Market Perspectives

Canadian Context

Sustainability Performance Targets (SPTs) and Key Performance Indicators (KPIs)

- Applicable Margin is increased or decreased by the Applicable Sustainability Adjustment



- Some Canadian SLLs may have multiple KPIs that address different environmental, social and governance

Examples of KPIs include: GHG Intensity, Percentage of Green Buildings, and Percentage of Racial and Ethnic Minorities/Women in the Workplace and on the Board of Directors

Canadian Context

Role of Lender as "Sustainability Coordinator"

Role of Sustainability Coordinator

- Often there may be more than one bank who plays the role as Sustainability Coordinator
- The Sustainability Coordinator is often the Administrative Agent

Annually, the Borrower shall deliver a "Sustainability Certificate" setting forth:

- (i) SPT Performance for the previous Fiscal Year as reported in its Annual Sustainability Report or equivalent; and
- (ii) the KPI Metric Auditor's assurance report confirming the verified and audited SPT Metrics for the previous Fiscal Year.

Sustainability Adjustment can often be controversial as could sometimes be out of the control of the borrower

There may be provisions in the Credit Agreement that contemplate that the parties may negotiate changes to the SPT metric after the acquisition or disposition of a subsidiary

Canadian Context

Defaults and Impacts

- Failure to achieve target typically not an Event of Default (EoD) (and Credit Agreement is explicit on that)

- Reporting inaccuracy is an EoD consistent with standard info reps and covenants

- If the parties become aware of a material inaccuracy in the Applicable Sustainability Adjustment or the SPT Metric as reported on a Sustainability Certificate, then the borrower will be either

  (1) obligated to pay the excess interest and fees if the calculation would have resulted in an increase in the Applicable Margin; or

  (2) credited the excess interest and fees actually paid if the calculation would have resulted in a decrease in the Applicable Margin.

Today's OSLER Team

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