

Morgan Lewis

# RECENT TRENDS IN SUSTAINABILITY FINANCING

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# Presenters



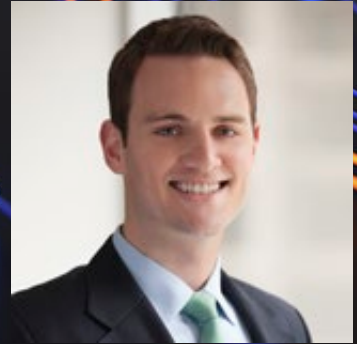
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# What are Sustainable Bonds?

- Green bonds
- Social bonds
- Sustainability bonds
- Sustainability-linked bonds

# Why issue Sustainable Bonds?

Some of the reasons why issuers issue sustainable bonds include:

- demonstrate significant ESG investments the company is making (such as in renewable energy)
- pricing advantages as increased demand from ESG-focused investors can result in better pricing than may otherwise be the case

# What are the terms of Sustainable Bonds?

The International Capital Market Association (ICMA) is the primary authority for the terms of various sustainable bond financings in the United States.

The ICMA has notably developed the following principles and guidelines:

- Green Bond Principles
- Social Bond Principles
- Sustainability Bond Guidelines
- Sustainability-Linked Bond Principles

The principles and guidelines are available at [www.icmagroup.org](http://www.icmagroup.org)

# What are the core components for alignment with the ICMA Green Bond Principles?

The four core components for alignment with the ICMA green bond principles are:

- Use of Proceeds
- Process for Project Evaluation and Selection
- Management of Proceeds
- Reporting

# Standalone Issuances v. Framework Issuances

- Standalone Issuances –
  - early issuances
  - single project or group of projects
- Framework Issuances –
  - evolved to create flexibility
  - broad set of eligible projects – green and social
  - longer time horizon for allocation of proceeds

# What is a Standalone Issuance?

- Discrete Project or Group of Projects
- Use of Proceeds –
  - limited to that project or group of projects
  - includes specific facts of project(s)
  - timeframe for full allocation – as short as 1 year
- Management of Proceeds –
  - allocation to that project or group of projects
- Reporting –
  - limited time frame
  - through completion of project or group of projects



# What is a Framework Issuance?

- Frameworks Contemplate Broad Set of Eligible Projects –
  - both green and social
- Timing –
  - lookback and forward
  - lookback 1-3 years
  - forward 1 year through maturity
- Management of Proceeds –
  - cross-disciplinary team
  - evaluating projects, approve expenditures, oversee allocation and reporting
- Reporting –
  - through life of securities
  - management attestation
  - auditor supporting report

# Who is involved in Developing a Framework?

- Multi-disciplinary Team
- Investor Relations
- Independent Accountants
- Lawyers
- Second Party Opinion Giver

# Disclosure and Frameworks

- Frameworks v. Offering Documents
  - corporate websites
  - second party opinions
  - offering documents
- Frameworks – Evolving?
  - corporate sustainability discussion
  - framework details
  - shorter form

# Benefits of Framework Issuances

- Flexibility around Timing
- Broad scope of Eligible Projects
- Telegraph Importance of Commitment to Sustainability
- Single Investor Presentation

# Benefits of Standalone Issuances

- Shorter Timeline
- Fewer Parties
- Reduced Cost
- Less Involved Ongoing Reporting Obligation

# Disclosure Considerations

- **Form 8-K**

- Item 1.01 – Entry into a Material Definitive Agreement
  - Required Disclosure:
    - Date of agreement or amendment
    - Identity of the parties to the agreement or amendment
    - Brief description of any other material relationship between the company and any of the parties
    - Brief description of the terms and conditions of the agreement or amendment that are material to the company
  - Company may redact portions of the agreement that are not material and would likely cause competitive harm if publicly disclosed

# Disclosure Considerations

- **Form 10-Q or Form 10-K**

- Financial statement footnotes
  - Short-term or long-term financing/debt
- MD&A and Liquidity
  - Material source of liquidity?

# Disclosure Considerations

- KPIs used as part of sustainability-linked financing
- 2020 guidance on disclosing KPIs in MD&A is intended to cover KPIs that management uses in evaluating the company's business and performance, which may not be the same as the KPIs used in financing
- Be cautious and intentional when disclosing KPIs as part of sustainability-linked financing to clarify scope of the KPIs



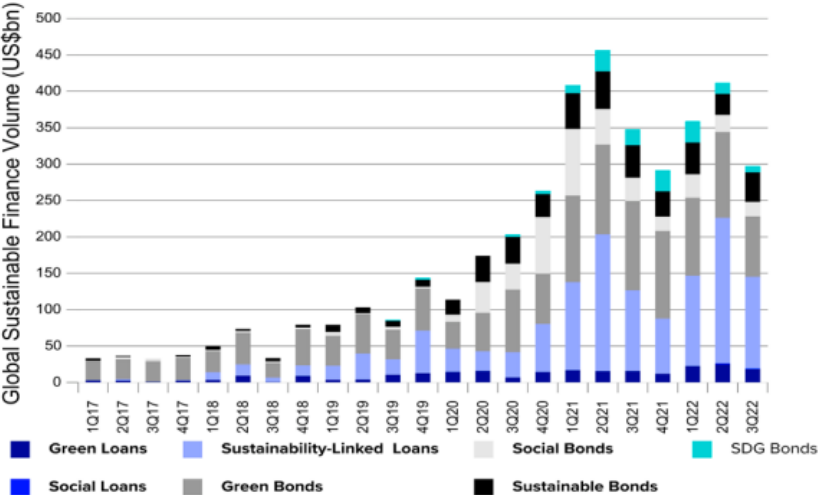
# Disclosure Considerations

- Proposed Climate Related Disclosure Rulemaking
  - SEC included questions for public consideration on whether additional disclosures should be required if a registrant leverages climate-related financing instruments, such as green bonds or other forms of sustainability-linked financing.
  - Specifically asked whether the SEC should require disclosure of key performance metrics tied to sustainability-linked financing instruments.

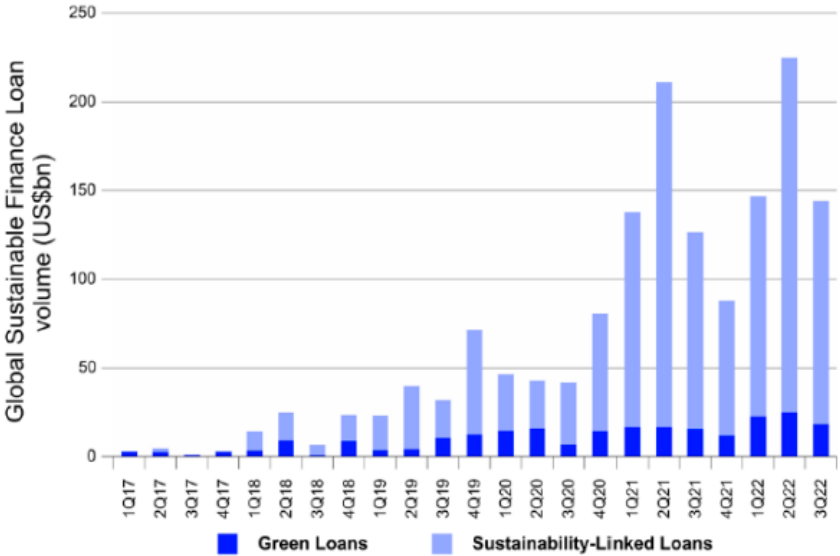
# Sustainability Linked Loans

- ***History:*** From sophisticated publicly listed investment grade borrowers to broad adoption across public and private markets
- ***Sustainable Finance Context:***
  - Project Based Sustainable Finance (Green Bonds, Green Loans, etc.) use for green projects
  - Performance Based Sustainable Finance (Sustainability Linked Loans) general corporate purposes
- ***Features:*** KPIs, pricing ratchet up or down, sustainability structuring agent, market terms

# Sustainability Linked Loans



\*Includes Schuldschein  
 \*A small selection of bonds may receive both SDG and Green, Social or Sustainable bond credit.



Source: Refinitiv LPC, Green Lending Review (October 2022)

# Sustainability Linked Loans

## *Key Considerations*

- ESG Strategy and Plan
- Establishing KPIs and Third-Party Ratings
- Reporting Requirements
- “Rendezvous Clause”
- “Greenwashing” and Disclosure Risks

# Further Reading

Reuters Legal News

## ESG in the credit agreement: a closer look at sustainability-linked loan mechanics

By Andrew T. Budreika, Esq., Benjamin Stango, Esq., and Elizabeth Goldberg, Esq., Morgan, Lewis & Bockius LLP

JUNE 10, 2022

Environmental, social, and governance (ESG) issues continue to dominate business and investing news. In this article, after providing some recent context, we examine some key credit agreement provisions governing one of the hottest banking products in ESG – sustainability-linked loans (SLLs).

*Global annual sustainable debt issuance continues its exponential growth, more than doubling from \$769.1 billion for 2020 to \$1.689 trillion in 2021, with the largest volume increases in sustainability-linked loans.*

ESG appears omnipresent in recent months. The Securities and Exchange Commission (SEC) continues to scrutinize ESG claims: on May 25, it proposed disclosure rules (<https://bit.ly/3aK5ayg>) “to promote consistent, comparable, and reliable information for investors concerning funds’ and advisers’ incorporation of environmental, +social, and governance (ESG) factors.” Earlier, on March 21, it proposed rules to enhance and standardize climate-related disclosures for investors. We previously covered the March 21 proposal in “SEC proposes a change in disclosure climate,” Reuters Legal News, April 7, 2022.

In addition to regulators, business leaders, rating agencies, and other stakeholders continue to debate the meaning of ESG and what characteristics should qualify products to be covered under its positive mantle. Looking specifically at loan and debt markets, global annual sustainable debt issuance (including sustainability-linked bonds and loans and green and social bonds and loans) continues its exponential growth, more than doubling from \$769.1 billion for 2020 to \$1.689 trillion in 2021, with the largest

Readers interested in ESG in the finance space will benefit from an understanding of sustainability-linked loan products, both in their principles and in the linguistic details of a credit agreement. According to the Sustainability-Linked Loan Principles (SLL Principles), jointly published by the LMA, LSTA, and Asia Pacific Loan Market Association (APLMA), “[t]he sustainability-linked loan product enables lenders to incentivize the sustainability performance of the borrower.”

Lenders are heavily marketing sustainability banking solutions to institutional investors and borrowers. Institutional investors who wish to support companies focused on ESG are seeking products to combine with evolving ESG-related due diligence and investing strategies. As a result, banks are looking to facilitate those investments through bond and loan markets. Banks also want to find ways to help borrowers showcase their commitment to ESG initiatives, and loan market participants are using the tool of SLLs with increasing frequency to fulfill that objective.

*Ford Motor Company’s publicly available SLL from fall 2021 serves as a useful example of how these principles are installed deep in the verbose plumbing of a corporate credit agreement.*

While the SLL Principles cover this framework in more detail, in essence, a borrower and its lenders select meaningful key-performance indicators (KPIs) of an E, S or G variety, and then they set sustainability performance targets (SPTs) tied to those indicators. If the borrower achieves or exceeds its SPTs, it is typically rewarded with lower interest and fees. If the borrower falls short of the SPTs or some minimum threshold, it can be penalized with higher interest and fees.

# Biography



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With a focus on utilities and underwriters, Kimberly counsels clients on corporate and securities law. She represents clients on debt and equity transactions in both publicly registered and private Rule 144A and Regulation S offerings, including related exchange offers. She also advises utilities with ongoing disclosure needs under the Securities Exchange Act of 1934 and in negotiating credit facilities. Public utility systems also hire Kimberly for guidance on financing, reorganization, and disaggregation.

At her previous firm, Kimberly represented underwriters and utility companies with issuing mortgage securities, unsecured debt, hybrid preferred securities, and common and preferred stock. She also advised on issuing tax-exempt bonds relating to pollution control facilities and other conduit issuer arrangements.

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Thomas advises clients on securities law matters, with a particular focus on representing utility and energy clients in capital markets transactions. Tom's practice includes representing clients in registered offerings of debt and equity securities, Rule 144A and Regulation S transactions, and private placements. Tom also advises public companies on Securities Exchange Act of 1934 disclosure obligations and assists clients with compliance with the Sarbanes-Oxley Act of 2002 and other corporate governance requirements.

# Biography



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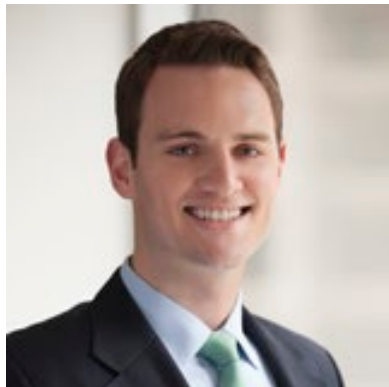
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Erin counsels public companies and their boards with respect to securities regulation, capital market transactions, and corporate governance matters, drawing on her long tenure at the US Securities and Exchange Commission (SEC) in the Division of Corporation Finance. Erin regularly advises on complex SEC disclosure and compliance issues, including environmental, social, and governance (ESG) considerations and crypto asset matters.

Before joining Morgan Lewis, Erin served as legal branch chief in the SEC's Office of Real Estate and Construction, where she oversaw legal reviews of transactional filings and periodic reports filed by a wide range of public companies, including special purpose acquisition companies (SPACs), real estate investment trusts (REITs), real estate platforms, and real estate-related finance companies. Throughout her more than 13-year career at the SEC, Erin served in other leadership roles, which included oversight of disclosure filings made by financial institutions, including fintech, marketplace lenders, banks, and bank holding companies as well as offerings of crypto assets, including the first public offerings of tokens, and other crypto exchange-traded products.



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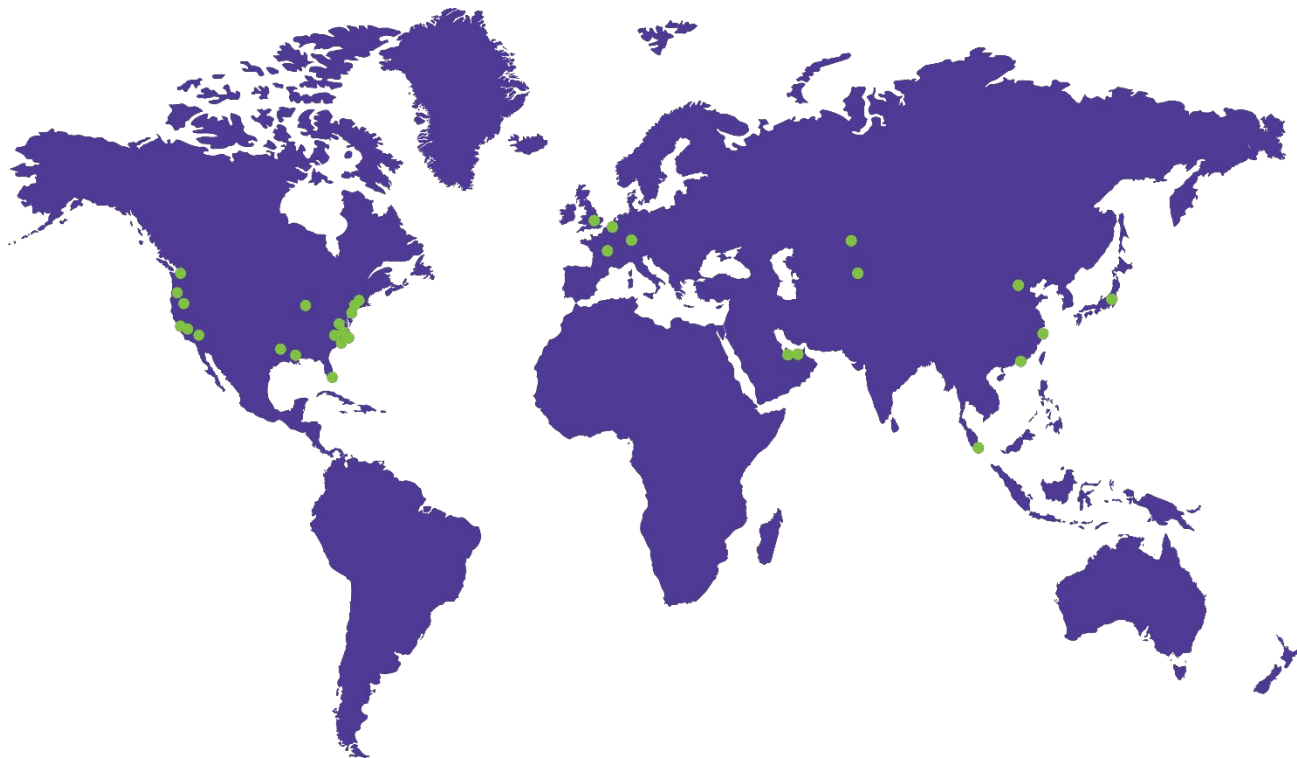
Andrew serves as legal counsel and trusted advisor across a broad spectrum of banking, credit, and capital markets transactions on all levels of a company's capital structure. Andrew advises public companies, private equity sponsors and venture capital firms, portfolio and other privately held companies, and joint ventures on debt financings, mergers and acquisitions, strategic investments, and other corporate and financing transactions. Andrew also regularly counsels clients on secured transactions, securities law, corporate governance, and other general corporate matters.

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