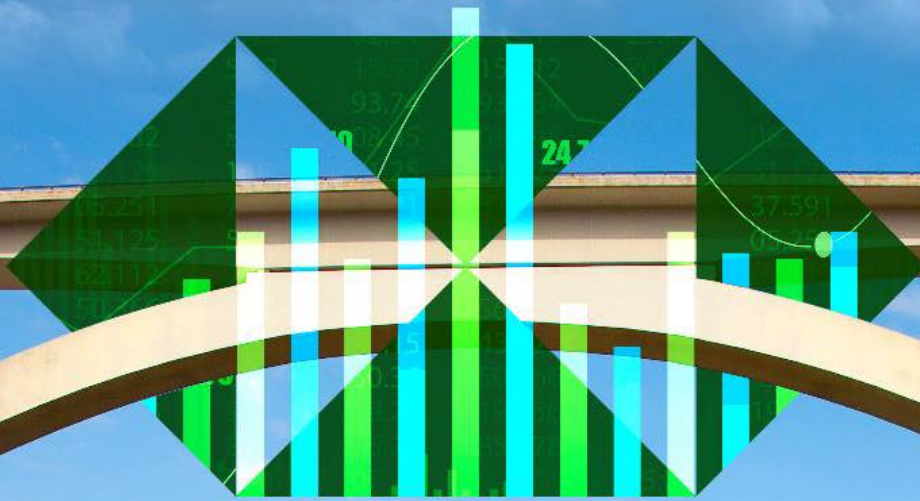


ESG – the ascent continues





Key Points

- ◆ Appetite for ESG (environment, social, governance) assets and products is showing no sign of dissipating with issuances of sustainable finance bonds rising dramatically on a global basis.
- ◆ Driving this increased issuance activity is a combination of investor demand, regulation, risk management considerations and COVID-19.
- ◆ If the ESG market is to fully mature, regulations and standards will need to be better aligned.
- ◆ Leading providers of Issuer Services such as HSBC have an excellent track record of supporting a diverse range of sustainable or green deals.

The global ESG movement is thriving and the market's growth is expected to accelerate exponentially. The adoption of ESG among issuers – which until recently was seen by many in financial services as a tangential issue – is being fuelled by investor appetite, new regulations, risk management and the COVID-19 crisis. HSBC Issuer Services looks at how ESG and sustainability are changing market dynamics.

ESG momentum keeps building

Having undergone a meteoric rise in 2020 – ESG linked issuances are continuing to gather momentum. Reports indicate that sustainable finance bond issuances reached \$777.6 billion in the first nine months of 2021, a record high. ¹Of that total, green bond issues accounted for \$362.06 billion and social bonds \$170.9 billion. ²Jamie Pratt, Regional Head of Issuer Services, Americas at HSBC, notes that in addition to sustainable bonds, there was a notable increase in sustainability linked loans (SLLs), - namely loans whereby the interest paid by the borrower is gradually reduced depending on whether they meet a set of pre-agreed sustainability KPIs (key performance indicators). Conversely, the rates on SLLs paid by borrowers will increase if they do not meet their KPIs. One of the reasons as to why SLLs are so popular is that they are more flexible than traditional green or social bonds as the use of proceeds do not need to be allocated by issuers to exclusively green or social projects. ³According to the Climate Bonds Initiative, SLL

issuances reached \$202 billion in the first six months of 2021, surpassing green loans by some distance. Karen Lomax, Managing Director, Head of Issuer Services for Europe at HSBC, believes that SLLs will continue to enjoy robust growth moving forward.

Aside from clearly-defined green or social bonds, transition bonds are also generating interest. Transition bonds – as the name suggests – enables high carbon pollutant companies or sectors to obtain financing so that they can make their business operations and strategies more sustainable. Perhaps one of the most high profile transition bond issuances involved Snam, an energy infrastructure company in Italy, which issued a €750 million dual tranche bond with proceeds being used to fund emission reductions through renewable energy, energy efficiency, green construction projects and the retro-fitting of gas transmission networks to ensure they can operate using alternative energy sources such as hydrogen.⁴

In terms of geographical location, the Climate Bonds Initiative notes the majority of green bond issues in 2020 took place in Europe, followed by North America whereas China, Japan and France were among the largest social bond issuers. ⁵However, Asia-Pacific – led by China – is also seen as being an increasingly active green bond market. Nonetheless, the volume of issuances do tend to be skewed in favour of developed markets. Climate Bonds Initiative analysis found that developed markets accounted for 4/5s of all green bond volumes in 2020, while emerging markets comprised 16% - a decline from 22% in 2019. ⁶Despite this, Pratt points out that HSBC Issuer Services is working with a number of major issuers in emerging markets supporting their various sustainability bond issuances.

Notes:

1. Reuters – October 12, 2021 – Global Sustainable Bonds see record issuance in Jan-Sep 2021
2. Reuters – October 12, 2021 – Global Sustainable Bonds see record issuance in Jan-Sep 2021
3. White & Case – May 28, 2020 – Sustainability-linked loan or green loan: Which? When? Why?
4. Climate Bonds Initiative – August 31, 2021 – 2021 Green forecast updated to half a trillion
5. Climate Bonds Initiative – April 23, 2021 – Record \$700 billion of green, social & sustainability issuance in 2020: Global state of the market report
6. Climate Bonds Initiative – April 23, 2021 – Record \$700 billion of green, social & sustainability issuance in 2020: Global state of the market report

Leading the way in driving flows into green projects: Case study
“Established by HSBC, the IFC (International Finance Corporation) the OECD (Organisation for Economic Co-operation and Development), GIF (Global Infrastructure Facility) and CPI (Climate Policy Initiative), FAST (Finance to Accelerate the Sustainable Transition)-Infra is an industry-led, public-private partnership designed to raise the flow of private finance to developing world sustainable infrastructure,” according to Giovanni Fenocchi, Global Head of Issuer Services at HSBC.⁴



Giovanni Fenocchi

Drivers for change

Chris Knowles, Global Head of Strategy and Product, Issuer Services at HSBC, says sustainability bond issuances are being driven by a combination of issuers reshaping their businesses towards net-zero, and the ESG investment demands coming from end investors. A survey by Russell Investments of 369 asset managers running \$79.6 trillion found 82% incorporate qualitative or quantitative ESG factor assessments into their investment processes in contrast to 78% in 2020. ¹Investment firms are also throwing more resources at ESG with the survey indicating that fund managers are hiring growing numbers of ESG experts. For instance, it found that 55% of managers now employ dedicated ESG professionals compared to 43% in 2020. ²So why are fund managers doing this? Firstly, many institutional investors' (plus their own underlying stakeholders) want their returns to be sustainable. In addition, some investors argue ESG assets outperform non-ESG assets. This is a highly contentious and contested claim though – as different empirical studies have reached diametrically opposing conclusions about the performance of ESG assets relative to non-ESG assets. ³While some companies raising funds via sustainable debt issuances can benefit from lower borrowing costs – otherwise known as the greenium – others argue investors are losing bps (basis points) of yield when purchasing green bonds versus non-green bonds.

Regulation and public policy is incentivising organisations to issue more ESG-linked bonds. Knowles says that the recent COP26 Climate Change Conference in Glasgow – together with some of the government targets on meeting net zero – are compelling more companies to seek out funding to help them green their businesses. The imposition of ESG regulation on investors is forcing change as well. The EU – through its Sustainable Finance Disclosure Regulation (SFDR) – along with markets such as the UK, Hong Kong and Singapore – are introducing ESG reporting rules for investors, which is encouraging them to build up their exposures to ESG assets.

The current US administration is also taking climate change seriously - with the Securities and Exchange Commission (SEC) poised to introduce mandatory ESG reporting rules for companies. ⁵Regulation will be a big driver behind issuance activity.

Risk management considerations are another factor pushing corporates into issuing sustainable bonds, says Fenocchi. Firstly, COVID-19 has served as a wake-up call for corporates, reminding them of the importance of sustainable growth together with the risks which natural disasters can pose to their businesses. In fact, the pandemic has triggered a wave of sustainable bond issuances over the last two years. Longer-term climate risks are also prompting companies to issue sustainable bonds. Fossil fuel producers or those heavily reliant on fossil fuels as a means of production face existential challenges - especially if adoption of renewables becomes increasingly widespread. In order to future-proof their businesses, these high carbon companies will need to adapt, something which can be enabled through issuing sustainable bonds or leveraging SLLs. Doing nothing is simply not a feasible option, especially as more global investors are beginning to divest from companies which they believe are not making enough progress on mitigating climate change. Major institutions including Norway's oil fund and pension fund ABP have outlined their divestment plans while Aviva recently warned a number of companies that it would start selling down its investments in them if firm action is not taken to significantly reduce their carbon emissions.⁶

Notes:

1. Pensions & Investment (November 10, 2021) ESG becoming even greater focus for money managers, survey finds
2. Pensions & Investment (November 10, 2021) ESG becoming even greater focus for money managers, survey finds
3. FT Adviser (October 26, 2021) Are ESG stocks really outperforming?
4. HSBC (January 19, 2021) Fast-Infra- A public-private initiative
5. Bloomberg (December 15, 2021) Untested ESG reporting draws scrutiny as SEC readies rules
6. Financial Times – (November 9, 2021) Stay or sell? The \$110 trillion investment industry gets tough on climate



A market ripe for improvement

As a fairly nascent market, ESG – as an asset class – is still developing. One of the biggest barriers faced by corporates and investors alike is that there is a lack of joined-up regulation, which is contributing to widespread uncertainty. Take the UK and EU, for example. Although the UK pledged to mirror a lot of the existing EU rules, it has notably diverged on ESG. Firstly, it did not onshore the SFDR, while it has only retained the high-level requirements contained in the Taxonomy Regulation – an EU classification system detailing which economic activities are sustainable.¹ The UK has also said it will introduce its own disclosure regime, investment labelling and taxonomy.² Even within the EU, different regulators are adopting their own tailored ESG rules causing further confusion.³ On a global level, the regulatory divergences are even more pronounced. The absence of any global regulatory consensus – especially on taxonomies – means investors and issuers will need to comply with different ESG rules on a cross-border basis. In addition to creating complexity for all parties involved, the lack of standardised rules also increases the risk of greenwashing – a situation whereby issuers and investors make misrepresentations—willing or otherwise—about their green policies and achievements.

Aside from inconsistencies around global regulations, Knowles highlights there is also a lack of agreed upon ESG standards. The problem lies with there being too many standards and ESG scoring systems being adopted by supranational bodies, ratings agencies and industry groups. One of the most commonly used ESG metrics is the FSB's (Financial Stability Board's) TCFD (Task Force on Climate-related Financial Disclosures), a template designed to improve and increase climate related financial reporting by corporates and investors. Other popular standards include the UN's SDGs (Sustainable Development Goals), the GHG (Greenhouse Gas) Protocol and the SASB (Sustainable Accounting Standards Board). In the green bond market, metrics such as ICMA's (International Capital Market Association) Green Bond Principles and the EU Green Bond Standard are also widely leveraged. The abundance of all of these

different standards makes it hard for issuers and investors alike to know which benchmark(s) to follow. In the case of ratings agencies, many providers adopt tailored methodologies when scoring issuers on ESG – which leads to major divergences. In some cases, different ratings agencies will assign contradictory ESG scores to the same company or issues. According to MIT, ESG scores by ratings agencies are aligned with each other only 60% of the time.⁴ This makes it more challenging for investors to obtain good quality or accurate ESG data from issuers.

Supporting a growing sector

HSBC Issuer Services is at the forefront of supporting a number of major ESG linked transactions, according to Lomax. The bank has participated in a number of high-profile green deals in the last year.

Case studies

- ◆ “Issuer Services was appointed as **Facility Agent, Sole coordinator and initial mandated lead arranger** on a GBP1bn facility for British Airways Plc encompassing a UKEF covered GBP800,000,000 5-year term loan facility and a GBP200,000,000 commercial facility. The transaction is a part of the UKEF-supported Sustainability-Linked Export Development Guarantee (“EDG”) scheme. The facility has been structured as an SLL, with the margin under the facility linked to one KPI; BA's total grams of CO₂ per passenger km, measuring the company's aircraft fuel efficiency,” says Fenocchi.

Notes:

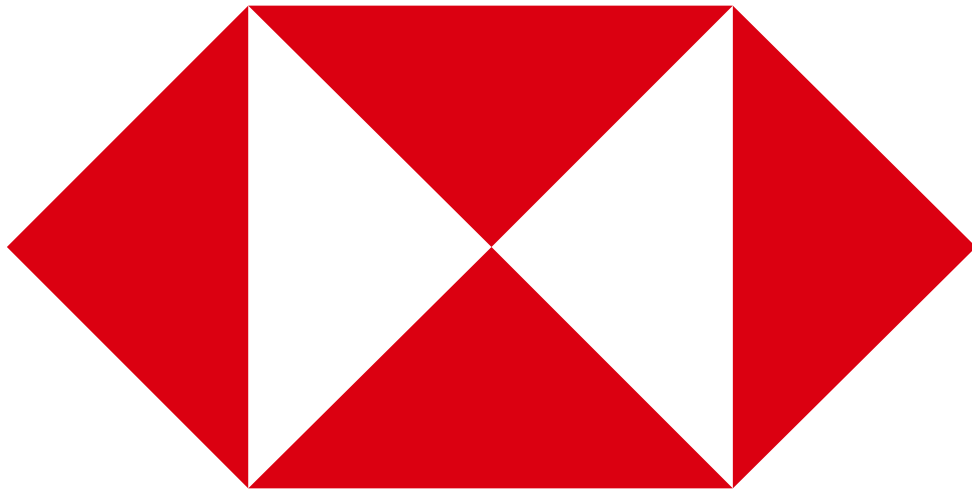
1. Hogan Lovells (December 15, 2021) UK and EU regulatory divergence
2. Hogan Lovells (December 15, 2021) UK and EU regulatory divergence
3. ETF Stream (November 2, 2021) European regulators must align on ESG or risk greenwashing deluge
4. Forbes (March 7, 2021) Ratings agencies punish companies that try to do good



- ◆ Issuer Services was appointed **Paying Agent, Trustee** and **Security Trustee** on Kem One's €450,000,000 5.625% Sustainability-Linked Senior Secured Notes due 2028. Kem One is Europe's second-largest producer of PVC and a leading producer of low-carbon hydrogen in France. They have a stated aim to be at the forefront of ESG financing, contributing towards the French Business Climate Pledge objectives and the achievement of carbon neutrality by 2050.
- ◆ Issuer Services played a key role in the inaugural transaction under The Nature Conservancy ('TNC') Blue Bonds for Conservation program which is the world's largest Blue Bond for conservation to date. Proceeds from the USD 364 million issuance will be used to allocate capital towards debt sustainability and marine conservation for the nation of Belize and the deal is supported by political risk insurance from International Development Finance Corporation ('DFC'). This transaction showcases ISV's ability to provide agency services to clients on a truly global basis with ISV London performing the roles of **Issuing & Paying Agent, Cash Manager** and **Custodian**, while ISV New York acted as **Trustee, U.S Paying Agent, U.S. Transfer Agent, Registrar** and **Administrative Agent**.
- ◆ HSBC Issuer Services acted as **Paying Agent, Joint Active Bookrunner** and **Common Depositary** on the Tesco Euro Medium Term Note programme. In 2021 Tesco successfully priced its debut GBP Sustainability Linked Bond (SLB) issue, a GBP400 million 7-year transaction.
- ◆ HSBC's Issuer Services **Agency** and **Account Bank** services were leveraged to support a project aimed at developing, constructing and operating a portfolio of solar photovoltaic (PV) plants in Jordan for Yellow Door Energy. Founded in 2015 in the UAE and Jordan, Yellow Door Energy provides sustainable energy solutions for commercial and industrial businesses. Today the company has over 110 megawatts of solar projects in the Middle East and South Asia.

- ◆ HSBC Issuer Services in Hong Kong acted as **Trustee, Issuing and Paying Agent, Registrar, Exchange and Transfer Agent, CMU Lodging** and **Paying Agent and Calculation Agent** for a recent sovereign green bond issued by Hong Kong.
- ◆ HSBC Issuer Services in Hong Kong served as **Trustee, Principal Paying Agent, Transfer Agent, Conversion Agent** and **Registrar** on a green convertible bond issued by a Korean steel producer as part of its efforts to become carbon neutral by 2050.
- ◆ HSBC Issuer Services in Australia was the Mandated Lead Arranger and Bookrunner, Sole Structuring Adviser and Sustainability Coordinator, and Facility Agent on ASX-listed private hospital group Ramsay's AUD1.5bn inaugural SLL. The SLL was the first by an Australian healthcare company and the largest corporate (ex. FIG) syndicated SLL in Asia Pacific.
- ◆ HSBC Issuer Services in Mauritius was appointed escrow agent for the acquisition and transfer of multiple renewable assets between India-based renewable energy company Greenko and a leading Japanese conglomerate. HSBC provided a one-stop solution for cash and document escrow facilities in Mauritius, supporting a complex deal with a total transaction value of approximately USD960m.
- ◆ HSBC Issuer Services in Hong Kong acted as financial adviser and mandated lead arranger on a \$2.7 billion financing transaction to support a CDPQ-led consortium with their acquisition of a 50% stake in Greater Changhua 1 offshore wind farm developed by Ørsted in Taiwan.

ESG is now firmly engrained in the industry and issuances – together with investor appetite globally – are projected to grow significantly. It is vital issuers engage with counterparties boasting extensive experience and global reach on ESG matters if they are to meet their various sustainability objectives.



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