

ESG disclosure for new bond issues

Disclosure of environmental, social and governance (ESG) related information by investee companies is an increasingly important topic for market participants and policy makers alike. ICMA's Legal & Documentation Committee and its ESG Working Group have been discussing issues relating to ESG disclosure for new international, unsecured bonds issued in EMEA and distributed outside of the US under Regulation S. These discussions have included considerations related to disclosure for sustainable products such as green and social bonds and sustainability-linked bonds, as well as for "vanilla" bonds with no sustainability element.

Market practice for disclosing how an issuer will use the proceeds of a green, social or sustainability bond has developed over several years in line with the [Green Bond Principles](#), [Social Bond Principles](#) and [Sustainability Bond Guidelines](#). The precise way and extent to which such disclosure is included in an issuer's base prospectus is evolving as an increasing number of issuers are choosing to include an option to issue green or social bonds under their debt issuance programmes. Similarly, the market for sustainability-linked bonds is developing and market participants are focusing closely on how the terms of such bonds are drafted.

More generally, ICMA's underwriter community has noted the importance of ensuring that any ESG-related information that could affect the credit of the issuer (ie its ability to pay back the principal amount and pay interest in the meantime) is disclosed in the issuer's bond prospectus – regardless of whether it relates to a sustainable product or not. An issuer's credit will be affected by the financial and competitive position and outlook of the issuer and its industry over the lifetime of the bond (or, in the case of a programme, the bonds to be issued under the programme). Issuers may need to consider, among other things, any of its other financings that are related to ESG KPIs and metrics such as sustainability-linked loans, because increased financing costs on this type of instrument could impact its overall financial position and be relevant to a credit assessment of the issuer. In addition, where ESG information is an integral part of the issuer's principal activities, this is required to be disclosed under the EEA and UK Prospectus Regulations.

Outside of a bond prospectus context, many companies are already subject to periodic non-financial or sustainability reporting requirements; or choose to make such periodic disclosures voluntarily. They also often have one or more ESG ratings. Regulatory requirements for periodic reporting of climate and other ESG-related information are set to increase in the EU, the UK and the US following:

- the European Commission's [proposal](#) for a Corporate Sustainability Reporting Directive published in April;
- the UK Government [consultation](#) on requiring mandatory climate-related financial disclosures (to which the ICMA Corporate Issuer Forum [responded](#) in May – see the article below);
- the UK FCA's open [consultation](#) on enhancing climate-related disclosures by standard listed companies (see further the box below); and

- the US SEC's recent [consultation](#) on climate-related disclosures (to which ICMA [responded](#) on 15 June).

In addition, IOSCO recently published a [Report on Sustainability-related Issuer Disclosures](#) elaborating IOSCO's [vision](#) for an International Sustainability Standards Board (ISSB) under the International Financial Reporting Standards Foundation and describing the role the ISSB could play in setting a common global baseline of sustainability-related corporate reporting standards.

The current view of the ICMA Legal & Documentation Committee and its ESG Working Group is that ESG information disclosed in periodic sustainability reports and ESG ratings does not need to be replicated in an issuer's bond prospectus unless the information is relevant to the bonds to be issued (ie it impacts the credit of the issuer or is relevant to the use of proceeds, the terms of the bond or integral to the issuer's principal activities).

Among other things, this will help to ensure that prospectuses do not become cluttered with information that is not necessary for an investment decision in the bonds; and avoid a needless increase in bond issuers' costs. It also reflects the higher liability that attaches to prospectus disclosure compared with other forms of disclosure in many jurisdictions and the cautionary note sounded by several policy makers such as [IOSCO](#), the [European Commission](#) and the [SEC](#) in relation to the current reliability of ESG disclosures. Specifically in relation to ESG ratings, ESMA stated in the [ESMA Report on Trends, Risks and Vulnerabilities No. 2 of 2020](#) that "differences in the definition, scope and methodology used by ESG rating providers cause confusion among investors" and "Investment misallocation is likely to take place, either unintentionally through the composition of ESG-rating based indices, or intentionally from greenwashing and product mis-selling". The FCA's Director of Strategy highlighted in a [speech](#) in November 2020 that: (a) ESG rating providers rely on public information and so their outputs are subject to data gaps; (b) ESG rating providers have very different methodologies leading to wide variation in ESG ratings for any given company; and (c) there may be a concern if firms use ratings mechanically without a detailed understanding of the methodologies the providers apply and careful consideration of whether they are fit for purpose. In addition, a recent FCA [consultation paper](#) discusses challenges and potential harms arising from the roles played by ESG rating providers and sets out possible policy actions in this area.

In terms of marketing materials for new bond issues, it is possible for ESG (and indeed other) information to be included in marketing materials but not in the prospectus where such information is not required under the general prospectus disclosure test in the EEA or UK Prospectus Regulation. This means that the issuer and underwriters might conclude that it is appropriate to include in marketing materials certain additional information that is not necessary for an investment decision (and so is not included in the prospectus) but provides more background, context or detail on the information contained in the prospectus. However, as is the case with any review of marketing materials against prospectus disclosure, a judgment call will need to be made in relation to the overall "consistency" of the marketing materials with the prospectus. Related to this, a key concern for market participants is the need to minimise the risk of greenwashing that could arise if the

information conveyed in marketing materials is more extensive than the disclosure that is included in the prospectus and is not checked to the standard required for prospectus disclosure. In order to minimise this risk, it is considered advisable to avoid including in marketing materials considerable additional ESG-related disclosure that is not included in the prospectus because it is not necessary for an investment decision, in particular where the information is difficult to substantiate.

ICMA members will continue to discuss the issues outlined in this article and related matters against a rapidly evolving backdrop of regulatory and other ESG-related developments.

UK FCA consultation CP21/18

On 22 June, the UK FCA launched a [consultation](#) on: (a) enhancing climate-related disclosures by standard listed companies and (b) ESG topics in capital markets.

This is an important consultation for ICMA's primary market community because it seeks views on a number of issues that could directly impact new international bond issues listed in London (or offered publicly in the UK) as well as UK market participants generally. This includes questions on (a) whether and how to implement TCFD-aligned disclosure rules for issuers of standard listed debt and debt-like securities; and (b) whether specific requirements for use-of-proceeds bond frameworks and their sustainability characteristics should be introduced to the UK prospectus regime.

ICMA's primary market community will be considering this consultation carefully in cooperation with other ICMA groups in advance of the deadline on 10 September 2021.



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