AFME Recommended ESG Disclosure and Diligence Practices for the European High Yield Market

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1 Introduction

AFME and its members acknowledge that ESG factors are an increasingly urgent focus of investors in the context of capital markets offerings, including with respect to high yield bond and other leveraged finance transactions. Investors are increasingly using ESG considerations as a driver for decision-making, capital allocation, pricing, and value assessments in addition, policymakers have given strong indications that ESG considerations will be increasingly important in regulatory analysis and decision making. In the past, the approach to ESG factors was largely driven by the requirements of individual investors, often at the stage when the deal is being marketed, which meant that issuers are either dealing with conflicting requests for ESG-related information or have been unable to answer some of the investors' questions in a timely manner or at all.

In this context, the EU has been more actively focused on promulgating ESG focused regulation, including particularly its Taxonomy for Sustainable Activities (the "EU Taxonomy") and its work related to sustainability disclosure and reporting under the Sustainable Finance Disclosure Regulation (SFDR) and the EU non-financial reporting directive (NFRD) and Corporate Sustainability Reporting Directive (CSRD). [1]

We acknowledge the work that has been, and is being, undertaken with respect to ESG matters by numerous other trade and international organisations, ranging from the Loan Market Association (LMA), the (U.S.) Loan Syndications and Trading Association (LSTA), the International Capital Market Association (ICMA), and the International Swaps and Derivatives Association (ISDA) to the working groups at the UN-supported Principles for Responsible Investing and the European Leveraged Finance Association (ELFA). AFME currently reviews ESG matters at a number of committees and working groups across products and policy response initiatives.

In addition, the European Investment Bank (EIB) has partnered with Amundi to encourage development of a European green debt market outside of investment grade green bonds. The "Green Credit Continuum" programme, which aims to contribute to the development of new financing required to meet the commitments made under the Paris Agreement on climate change, involved the creation of a fund that invests in in high-yield corporate green bonds, green private debt and green securitised credit. The group will form a scientific committee composed of climate finance experts, which will define and promote guidelines for the three markets and will establish a network to source deals and projects.

We believe that AFME, through the European High Yield Committee, can play a key role in helping to establish a set of market practices and considerations that take into account the broader sub-investment grade and leveraged finance markets that work for all market stakeholders including issuers, buy-side investors, financial sponsors and shareholders.

At present, there are a few approaches for ESG-related financings:

- a project "use of proceeds" based approach (e.g., Green/Social/Sustainability Bonds),
- a company operating model-based approach (e.g., Sustainability-Linked Bonds), and
- other bonds that are not directly based on the two approaches above, but that incorporate any relevant ESG-related issues into disclosure and other processes.

We intend to address the broader universe of European high yield in these recommendations, as well as specifically in the context of use of proceeds bonds and sustainability-linked bonds, as appropriate. The market is fast evolving, and these recommendations are focussed on the current market practice and regulation. The intention is to update these recommendations as the market further develops.

[1] On 21 April 2021, the European Commission published a package of legislation and other documents on ESG and sustainable finance, including a Proposal for a Corporate Sustainability Reporting Directive (CSRD), which will revise and extend rules introduced by the Non-Financial Reporting Directive (NFRD. See the "Reporting" section below for more information).

2 Overview

Disclosure of ESG factors depends on the circumstances of the issuer and other stakeholders (e.g., financial sponsors/shareholders) and on the nature of the high yield bond being issued. This paper provides a framework for assessing relevance and materiality, including:

- impact of ESG factors upon an issuer's strategy and business model;
- exposure of an issuer to ESG risks, to be considered at an issuer [2] level and a wider stakeholder level including sponsors/shareholders; and
- whether the high yield bond is being "labelled", e.g., as green / social / blue / sustainability/ transition.

Key to the discussion is the ability to provide clear, transparent disclosure that would be material to an investment decision. A pre-requisite for a company to disclose ESG data is that it needs to be defined, measurable, collectible, evidence-based and reliable. This, in turn, requires the information to be subject to appropriate governance and internal procedures and controls, and in some instances third-party verification (see "Assurance" below).

As the market evolves and develops, there will be an ongoing balancing of the interests of investors in seeking detailed information and issuers' practical ability to disclose such information. Market participants should be sensitive to the fact that a pragmatic, balanced and proportional approach is required.

[2] References to "Issuer" herein are, where the context allows, include the "restricted group" supporting the credit of the group, and disclosure of ESG factors will generally be done at a consolidated level reflecting such group.

3 ESG Factors

3.1 Environmental

Environmental factors include the contribution a company or government makes to reducing climate change through minimising greenhouse gas emissions, along with issues related to waste management and energy efficiency. Given renewed efforts to combat global warming, cutting emissions, water usage, and decarbonizing is becoming more important. Environmental aspects of sustainable finance have generally received the most attention from regulators and market participants. For example, although there have been proposals for Social and "Brown" Taxonomies, the current EU Taxonomy only relates to environmental issues. Similarly, much of the focus in sustainable finance by regulators and stakeholders have generally been with respect to the climate and environment.

Good environmental practices and performance can have a more direct positive (or negative) effect on both the company's performance and operations, as well as on the environment at large, and these areas are already subject to some level of framework for assessing the environmental impact of certain practices and industries. The current market and regulatory environment, however, will require a more focused analysis, including a greater emphasis on a company's ESG-related targets, commitments, practices and performance, as well as on how they might affect the climate or other aspects of the environment on a general, rather than just on a local or regional, basis. This will likely become more important as regulators, investors and governments continue to focus on climate change and environmental protection.

Specific factors considered in this area may include:

- analysis of the overall environmental policy;
- environmental risk and opportunity assessment, including details of the key risks/opportunities, control measures and improvements;
- analysis of risks related to climate change;
- compliance with relevant environmental laws, regulations, licenses/permits;
- any fines, sanctions or other legal or regulatory action related to environmental issues;
- sources of energy (and methods of obtaining such energy);
- presence and/or removal of waste or hazardous materials; and
- levels of monitoring/reporting carbon and/or greenhouse gas emissions.

Other factors, such as biodiversity and ecological impacts, may be material for certain business sectors/industries.

3.2 Social

Social factors include human rights, diversity and inclusion, labour standards in the supply chain, any exposure to illegal child labour, and more routine issues such as adherence to workplace health and safety. A social score also rises if a company is well integrated with its local community and therefore has a 'social license' to operate with consent. Good social practices such as adherence to human rights and labour standards, good health and safety policies, and positive community engagement will likely have a beneficial effect on employee satisfaction and performance, community relations and a company's reputation.

Specific social factors may include:

- formal policies related to Health and Safety, Anti-Discrimination, Diversity, and Human Rights;
- data privacy and security polices and related issues;
- supply chain standards;
- polices related to workplace incidents (including record keeping /statistics);
- social related complaints/claims/enforcement actions associated with employees or key stakeholders;
- material complaints and/or any litigation regarding how the company conducts its business;
- assessment of any community relations projects, education and/or social awareness relating to the company's services/products;
- financial inclusivity, i.e., helping customers that are underserved by traditional channels.
- policies and procedures related to customer welfare, product safety and exposure to social impacts; and
- adherence to local minimum wage standards.

Although there has historically been a greater emphasis on "environmental" considerations (and related regulatory and market developments), social aspects of the framework are gaining growing importance[3]. This is evident in the proposals for a Social Taxonomy, as well in an increased focus on social factors by investors. However, this may not be an easy area for market participants to assess because while environmental and governance aspects of sustainable finance are already subject to relatively well-developed frameworks and practices, the focus on social factors is relatively new and under-developed. Determining how these factors might affect a company's performance or reputation is a complicated process, along with implementing appropriate procedures to ensure good social performance. Understanding the issues related to social practices and performance and implementing good practices in those areas will likely play an increasing role in complying with investor and regulatory requirements.

[3] The IRSG and KPMG have issued a report that provides good background on the accelerating role social aspects play both globally and in the UK

3.3 Governance

Governance refers to a set of rules or principles defining rights, responsibilities and expectations between different stakeholders in the governance of corporations. It generally covers the structure and conduct of a company's Board of Directors and management, particularly their conduct towards other stakeholders (such as investors and employees), as well as compliance with applicable laws and regulations. It also relates to the responsibility of the Board and management to design and maintain adequate procedures to ensure that the company does not engage in illegal or unethical conduct, and to ensure that such behaviour is identified and remedied. A well-defined corporate governance system can be used to balance or align interests between stakeholders and can work as a tool to support a company's long-term strategy. Good corporate governance can have a positive effect on a company's financial status and reputation, as well as increasing employee and public confidence in the company's Board and management.

ESG aspects of the governance framework and existing procedures, processes and controls should be integrated into, and not considered apart from, the existing governance framework procedures, processes and controls.

ESG reporting and disclosure of information, including ESG Key Performance Indicators (KPIs), (with appropriate adjustments) should apply equivalent procedures, processes and controls, with respect to the identification, management, reporting and disclosure of financial information, as those generally applied by the issuer, particularly for metrics and targets.

ESG risks should be considered within the issuer's existing enterprise risk management frameworks, alongside other risks. Material ESG risks should be documented in an issuer's risk register.

Specific governance considerations may include:

- oversight of the Company's purpose and culture;
- composition and rotation of the Board of Directors (i.e., number of women, independent and minority directors);
- ESG budget, training programs, evaluation and oversight procedures;
- standards related to minority shareholder informational and voting rights;
- level of direct Board responsibilities for ESG matters;
- adequate policies to safeguard against illegal practices (including, but not limited to, corruption and fraud) and any history related to such incidents;
- corporate governance and/or ethical related enforcement/litigation or employee claims or breaches related to issues such as anti-bribery, corruption, unfair labour practices, human rights abuses, and other malpractices; and
- relevant information on the company's auditor, including any material disputes between the company
- and its auditor, and/or any material restatement of the company's financial statements.

Similar to social considerations, governance aspects of sustainable finance are gaining more attention and will likely play an increasing role investor decisions and regulatory oversight. While this area is, relative to social aspects, already subject to a somewhat well-developed framework with respect to good governance practices (and the effect of "bad" practices on a company's performance and reputation), it is likely that emphasis on governance will increase as the ESG market further develops. For example, the European Commission intends to put forward a proposal on sustainable corporate governance that is expected to place an increased focus on human rights, amongst other ESG factors, and will require greater due diligence on business relationships throughout the value chain.

4 Diligence

This summary is not meant to be comprehensive, nor to cover all ESG considerations. It is intended to complement, rather than replace, existing due diligence processes and to suggest relevant considerations that should be considered in this context. We acknowledge that ESG factors and practices will vary depending on the company's business sector, geography and other factors, and that parties will require flexibility in approach to these or any other such considerations.

The diligence exercise should be driven by materiality considerations and should be designed to verify disclosure. Diligence of ESG factors should, generally, be subject to the same types of procedures and considerations as other factors relevant to the transaction. It is also very important for parties to carefully consider which of the diligence considerations below are material for the particular company and its industry. ESG-related diligence questions are increasingly growing from a few questions in the general diligence questionnaire to an increasing number of questions under separate headings or in a separate set of ESG-related questions and considerations. In addition, some parties are reportedly asking ESG-related diligence questions even when the issuance is not related to ESG.

General or generic questions that are not necessarily related to the particular industry or issuer, or that are not related to the issuer's credit or use of proceeds, for example, may result in increased time, costs and complexity, for little benefit. They may also distort the investor's view of the ESG-related issues that are likely to affect the issuer and its ability to service and repay the debt. We therefore recommend that ESG-related diligence questions are carefully tailored to the particular company and/or industry and that they relate to the issuer's credit (or the use of proceeds).

Parties are encouraged to consider the following:

- where relevant or appropriate, address ESG factors in financial statements, management commentary (i.e. MD&A), critical accounting judgments, and working capital. For example, relevant ESG considerations should be taken into account with respect to asset impairment, changes in useful life (depreciation / amortisation) or fair valuation of assets, and provisions (contingent liabilities, transitional costs).
- general ESG factors are already considered in management and documentary diligence practices.
- the scope and depth of these questions will be subject to materiality considerations relevant to the specific company or industry segment and will be an evolving landscape as more precise measurement and greater expectation of disclosure evolves
- a model form of ESG due diligence questions to facilitate consistency and guide market participants in their due diligence efforts for high yield and leveraged finance transactions is attached hereto. See Annex A. It is anticipated that these questions will be updated on an ongoing basis to reflect market developments / revised expectations.

Stakeholder due diligence: Stakeholder due diligence has historically been *ad hoc* (e.g., customer due diligence). As the focus on, and market for, ESG products increase, AFME recommends the development of broader, more structured stakeholder due diligence practices. Stakeholders include customers and suppliers, workers, communities, and regulatory bodies.

In October 2018, the Organisation for Economic Co-operation and Development (OECD) published a report on "Due Diligence for Responsible Corporate Lending and Securities Underwriting[4]", which is intended to provide a common global framework for financial institutions to identify, respond to and publicly communicate on environmental and social risks associated with their clients. Parties may wish to consult the diligence guidelines in the report for reference.

[4] https://mneguidelines.oecd.org/rbc-financial-sector.html

5 Disclosure

General

Issuers of ESG-related securities should provide clear, transparent disclosure of relevant information that would be material to an investment decision. Parties should, where possible, ensure that ESG data is disclosed in a manner that is defined, measurable, collectible, evidence-based and reliable. This, in turn, requires the information to be subject to appropriate governance and internal procedures and controls, and in some instances third-party verification (see "Assurance" below).

Absent a single standard, issuers and underwriters must focus on transparency and clear disclosure. As the market evolves and develops, there will be an ongoing balancing of the interests of investors in seeking detailed information and issuers' practical ability to disclose such information. A pragmatic balanced and proportional approach is required. Unduly burdening issuers risks undermining ESG goals. Market participants should be sensitive to this.

A decision on what ESG information is material for issuer disclosure in a high yield transaction is subject to the same discussions and considerations as those related to what ESG information is generally material for disclosure to investors in annual and other periodic reports to the extent relevant to the creditworthiness of the obligors. Therefore, ESG disclosure in offering documents should be consistent with disclosure in annual and other periodic disclosures. For a discussion of disclosure considerations related to bonds issued under the Green Bond Framework, see the "Green Bond" section below.

It is very important that ESG disclosure is designed to give investors all relevant and material information necessary for them to make an informed decision, and that such disclosure is tailored to the particular issuer and/or industry and is related to the credit position of the issuer (or the use of proceeds). Parties should carefully consider what ESG-related information is relevant for the issuer, while also assessing whether such information is material to the issuer (including any effect on the sustainability factors) or its ability to repay the debt.

Parties should also consider whether the bond offering document is the best place to provide ESG-related disclosure, or whether such information would be better provided in the issuer's annual report or other periodic disclosure. Similarly, ESG-related information disclosed in periodic sustainability disclosure or reports should not necessarily be replicated in the issuer's bond prospectus unless it is relevant to issuer's credit (or the use of proceeds).

The Sustainability Accounting Standards Board ("SASB") has developed a chart that maps the

materiality of different ESG-related factors for specific industry sectors.

The Issuer should also consider the following factors related to ESG reporting and disclosure:

- relevant listing rules and anti-fraud regulation (e.g. Rule 10b-5) already require the disclosure of material ESG information. For example, it may be appropriate to describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.
- issuers should reflect any material ESG-related risks in the risk factors, and also consider the impact of ESG-related issues on the use of proceeds, business and MD&A sections in particular and should expand disclosure in those sections as appropriate.
- risk factors
    - for ESG-related bonds, issuers should include a risk factor that its bonds may not be suitable for all investors seeking exposure to sustainable assets and may also not meet all ESG-related objectives ofsuch investors.
    - issuers may also elect to include a general risk factor about the lack of market consensus on sustainability.
    - issuers could consider impact of any failure around a green project, impact of failure to meet KPIs including margin impact, etc.

- use of Proceeds – This is most important for Green/Social/Sustainability bonds, which are issued to fund projects that meet the issuer's criteria for sustainability. These may adhere to a particular "Green Bond Framework" or constitute "Eligible Green Projects," as defined and identified by the issuer.
- if applicable, issuers should provide any relevant definitions (e.g., for "Eligible Green Projects").
- sustainability-Linked Bonds do not include restrictions regarding use of proceeds and the ESG considerations of the bond are generally considered either by way of KPIs or, if not, by a "green" or other certification from a third party.
- business - To the extent relevant taking into the account the specific company or industry, issuers should consider the impact of ESG factors on the strategy of the group and/or specific disclosure around the impact of ESG factors upon an issuer's strategy and business model;
- MD&A – MD&A discussions should continue for eligible green projects as appropriate and should include any particular criteria that will affect KPIs, e.g., what line items may be affected through strategy to reduce emissions.
- references to the ESG aspects of the bond should be clear and understandable.

ESG Disclosure Rules

Sustainable Finance Disclosure Regulation

In addition to the issuer considerations mentioned above, the Sustainable Finance Disclosure Regulation (SFDR) introduced various disclosure related requirements for financial market participants and financial advisors at entity, service and product level. It aims to provide more transparency on sustainability within the financial markets in a standardised way, thus preventing greenwashing and ensuring comparability. It requires, among other things, that asset managers and institutional investors disclose adverse impacts of their investment decisions on sustainability factors.

The SFDR will, under relevant circumstances, require (1) pre-contractual disclosures, (2) website disclosure and (3) periodic disclosures of sustainability-related information and, for investment products with sustainability objectives, product-level disclosures on their alignment with the EU Taxonomy Regulation.

For financial advisers, such information includes (a) information about policies on the integration of sustainability risks into the investment advice, and (b) consideration of principal adverse impacts on sustainability factors in the investment advice, in each case, on a “comply or explain” basis.

In an ESG context, it is important that ESG disclosure and reporting is related to the purpose of the ESG framework. In a capital raising context, parties will need to take into consideration any related time and cost implications, as well as consider the materiality of any information that is provided. This information should be related to the credit position of the issuing company, and there is some question as to whether the bond offering document is the best place to provide such information, including any such information provided in relation to SFRD requirements. Under this view, such information would be better provided in the company’s annual report or other periodic disclosure.

Task Force on Climate- Related Financial Disclosures

The Financial Stability Board (FSB) established the Task Force on Climate- Related Financial Disclosures (TCFD) to develop recommendations for more effective climate-related disclosures.

In 2017, the TCFD released climate-related financial disclosure recommendations[5], which proposed disclosure requirements designed to assess risk against different climate scenarios, and also to report a range of metrics. The TCFD recommends that preparers of climate-related financial disclosures provide such disclosures in their mainstream (i.e., public) annual financial filings, and stated that “any disclosure recommendations by the Task Force would be voluntary, would need to incorporate the principle of materiality and would need to weigh the balance of costs and benefits”.

The proposal includes recommendations in four areas:

- governance - the organization’s governance around climate-related risks and opportunities,
- strategy - the actual and potential impacts of climate-related risks and opportunities on the organization’s businesses, strategy, and financial planning
- risk management - the processes used by the organization to identify, assess, and manage climate-related risks, and
- metrics and targets - the metrics and targets used to assess and manage relevant climate-related risks and opportunities.

The recommendations are supported by recommended disclosures that build out the framework with information intended to help investors and others understand how reporting organizations assess climate-related risks and opportunities.

The UK government has indicated that it intends to make climate-related financial disclosures mandatory for publicly listed companies, large private companies and limited liability partnerships (LLPs). These disclosures would be in line with the requirements of the (TCFD) and are related to the UK government’s 2019 Green Finance Strategy and are designed to support the country’s transition to net zero.

There is also a question of whether TCFD-aligned disclosure rules should also apply to issuers of standard listed debt securities.

[5] https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf

U.S. Considerations

In contrast to the European approach, the U.S does not intend to require a "line-item" based approach to disclosure but will rather rely on its "principle based" disclosure regime to provide investors and other stakeholders with relevant and material ESG information. There is some concern that principles-based disclosure requirements, without more specific product relevant information, may not produce the disclosures and information that investors may need. Parties will need to analyse the effects of the U.S. approach on disclosure (as well as consider the specific requirements of U.S. Regulation S-K) to determine, on relevant transactions, how to navigate the different approaches and resulting disclosures that are required for a securities transaction, and how these differences might affect the structure and conduct of the offering. This is particularly important considering that there is some opposition in the U.S, including in the U.S. Congress, to any mandatory ESG-related disclosures requirements, particularly those that are not directly related to the issuer's performance or its ability to repay the debt.

However, U.S. Securities and Exchange Commission Chairman Gary Gensler has suggested that the SEC will take a closer look at whether companies are living up to any commitments they have already made on climate-related issues and noted that he had asked his staff to consider potential requirements for companies that have made forward-looking climate commitments, or that have significant operations in jurisdictions with national requirements to achieve specific, climate-related targets. Chairman Gensler also announced that he had asked his staff to consider the ways that funds are marketing themselves to investors as sustainable, green, or 'ESG' and to determine what factors undergird those claims, and that he wants more information on human capital disclosure, or how corporations interact with their employees.

IOSCO Disclosure Initiative

The International Organisation of Securities Commissions ("IOSCO") has stated an intention to form a common international baseline through the creation of an International Sustainability Standards Board ("ISSB") under the IFRS foundation. The ISSB would, among other things, create a set of international standards for sustainability-related disclosures across jurisdiction.

General

Reporting of Sustainable Finance activities, investments and objectives has become increasingly important in recent years. Consistency and comparability of such reporting is very important in providing investors and other stakeholders with required information to assess the performance and benefits of the growing ESG market.

Issuers of ESG products will need to comply with the reporting requirements under the EU Taxonomy and the NFRD/CSRD, while also complying with general legal and contractual reporting requirements related to such issuances. This will apply both to any reporting made in connection with the offering and to any related periodic and ongoing reporting. While it is important that there are no inconsistencies between these disclosure regimes, it is unclear what effect this will have going forward. Parties may need to determine whether information provided under one reporting regime is appropriate for inclusion under the other regime. This is particularly important when considering materiality, selective disclosure and the obligation to provide all relevant information to investors.

Sustainable Finance Taxonomies

A. EU Taxonomy on Sustainable Finance

As part of the EU Action Plan on Sustainable Finance, the EU has issued a Taxonomy on Sustainable Finance (the "Taxonomy"), which is a classification system that enables categorization of economic activities/sectors that play key roles in climate change mitigation and adaptation.

The Taxonomy established six environmental goals:

- climate change mitigation;
- adaptation to climate change;
- the protection of water and marine resources;
- the transition to a circular economy;
- pollution prevention and control; and
- the protection and restoration of biodiversity and ecosystems.

To be included in the proposed EU Taxonomy, an economic activity must contribute substantially to at least one environmental objective and do "no significant harm" to the other five environmental objectives. The classifications will work through technical screening criteria, methodology and regulatory guidance.

The first part of the Commission's work defined the economic activities that substantially contribute to the first two goals, mitigation of and adaptation to climate change. Therefore, in April 2021, the Commission unveiled a set of implementing rules under the Taxonomy, which detail the technical criteria that companies must comply with in order to receive a green investment label in Europe. It covers 13 sectors, including renewable energy, transport, forestry, manufacturing, buildings, insurance and even the arts, which together account for nearly 80% of EU greenhouse gas emissions. Specifically, companies to which the Taxonomy applies will have to explain how and to what extent their financial products align to the taxonomy[6].

In July 2021, the European Commission adopted the delegated act supplementing Article 8 of the Taxonomy for scrutiny by co-legislators. This delegated act specifies the content, methodology and presentation of information to be disclosed by financial and non-financial undertakings concerning the proportion of environmentally sustainable economic activities in their business, investments, or lending activities.

[6] A decision on gas and nuclear was delayed and will be dealt with separately. The Taxonomy describes which economic activities are in line with the Paris Agreement, with the objective of limiting global warming to 1.5°C.

B. Social Taxonomy

The Platform on Sustainable Finance (PSF), under its mandate to advice the European Commission, has begun work on its review of the Taxonomy Regulation and on covering other sustainability objectives, including social objectives and activities that significantly harm the environment.

As part of this work, the Platform noted that social factors are not a focus of the existing regime and proposed the creation of a social taxonomy, which is expected to be based on the green taxonomy model, and which would first define social objectives and then substantial contributions, do no significant harm (DNSH) criteria and minimum environmenta*l* safeguards. The platform would consider contextual differences more closely and suggests that a social taxonomy should make also use entity-level, qualitative criteria.

The PSF recommends a stakeholder-centered approach to defining the relevant objectives of a social taxonomy, focused on workers, consumers, and communities. Respect for human rights should be viewed as the crucial standard, not just a minimum safeguard. The Platform will also provide more detailed guidance on assessment of compliance with minimum safeguards.

Non-Financial Reporting Directive

The Non-Financial Reporting Directive (NFRD) requires large listed companies, banks and insurance companies with more than 500 employees to publish reports on the policies that they implement in relation to the following sustainability issues:

- environmental protection;
- social responsibility and treatment of employees;
- respect for human rights,
- anti-corruption and bribery, and
- diversity on company boards (in terms of age, gender, educational and professional background.

With respect to these issues, the NFRD requires companies to disclose information about their business model, policies (including implemented due diligence processes), outcomes, risks and risk management, and KPIs relevant to the business. However, it does not introduce or require mandatory use of a non-financial reporting standard or framework, nor does it impose detailed disclosure requirements such as lists of indicators per sector. The NFRD requires companies to disclose information "to the extent necessary for an understanding of the development, performance, position and impact of [the company's] activities." This means companies should disclose not only how sustainability issues may affect the company, but also how the company affects society and the environment (the so called "double materiality" perspective).

Corporate Sustainability Reporting Directive

In April 2021, the Commission presented its proposal for a Corporate Sustainability Reporting Directive (CSRD), which aims to revise and strengthen the existing rules introduced by the NFRD, and to, over time, bring sustainability reporting up to the level of financial reporting.

The CSRD proposes to:

- extend the scope to all large companies and all companies listed on regulated markets (except listed micro-enterprises);
- require the audit (assurance) of reported information;
- introduce more detailed reporting requirements, and a requirement to report according to mandatory EU sustainability reporting standards; and
- require companies to digitally 'tag' the reported information, so it is machine readable and feeds into the European single access point envisaged in the capital markets union action plan.

The CSRD proposal envisions the adoption of EU sustainability reporting standards. The European Financial Reporting Advisory Group (ERFRAG), acting upon a request by the European Commission, will be responsible for developing two sets of draft standards for large companies and SME's, respectively. The standards will be tailored to EU policies, while build on and contributing to international standardization initiatives.

7 Business model

The following are some of the risks and considerations that should be included in connection with an ESG business model:

- material ESG opportunities and risks should be reflected in business plans, models, and in enterprise risk management.
- risks can be categorized as transitional (including policy, legal, technological, market and population) risks or physical risks.
- particular risks may include the risk of "stranded assets" – assets that have suffered from unanticipated or premature write-downs, devaluations or conversion to liabilities and whose value may decline due to regulatory or social pressure against using the assets due to the negative environmental impact, e.g., oil or coal reserves
- other risks could include issues related to internal controls or accountability standards, boycotts or public backlash against a company's products or treatment of its employees, and political or other stances taken by the company (or its employees).
- opportunities highlighted by the TCFD disclosures include resource efficiency, resilience, and novel energy sources, products, services and markets.
- consider which, if any, KPIs are to be included. These will be dependent on the specific company, industry and operating model. For example, KPIs for green financings have been focused on carbon emissions, water usage, energy usage, while for social financing they have been focused on diversity statistics for senior management.

The NFRD, as currently in force, requires companies in scope to disclose information about four non-financial matters: environment, social and employee issues, human rights, and bribery and corruption. The evolution of the EU Taxonomy, the EU Low-Carbon Benchmark Regulation and the NFRD may further evolve areas of focus for KPIs and measurement possibilities for KPIs. It should be noted that to the extent KPIs are disclosed upon issuance, investor expectations will likely be that these be disclosed on an ongoing basis. Therefore, issuers and sponsors should be mindful of which KPIs they wish to disclose from a cost and management time perspective, and other market participants such as investors should be sensitive to this.

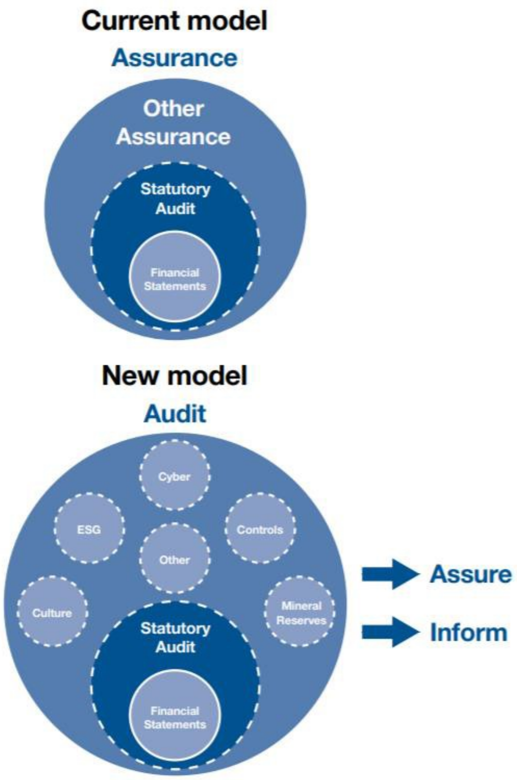
Although policymakers have indicated that they may be mandated in the future, at present, ESG-related verification and assurance procedures have been market driven and are not yet mandatory under any disclosure regime. However, many of the standards in the industry (Climate Bond Initiative (CBI), Green Bond Principles, Green Loan Principles, Social Bond Principles and Sustainability Bond Principles) recommend the use of a third-party certification or assurance.

To the extent that an issuer is looking to issue a Sustainability-Linked Bond, it is recommended that it engages with a relevant third party to either

(a) develops individual KPIs that are then certified by such third party or

(b) satisfy a third-party ranking system that allows it to secure a "green" or other certification from such third party.

- issuers are recommended to obtain a third-party assurance reports for the benefit of investors. Several non-governmental organisations have developed certification standards for green bonds, and the opinions they provide can vary depending on the issue and the organisation involved.
- issuers should consider limited assurance standards, such as the ISAE 3000 assurance framework with respect to quantitative data. ISAE 3000, promulgated by the IAASB, deals with assurance engagements other than audits or reviews of historical financial information and is generally the assurance standard for compliance, sustainability and outsourcing audits.
- the 2019 Brydon report (which set out a set of recommendations on the quality and effectiveness of audit to the UK Secretary of State) recommends changes to the audit process to be a more effective process. The following figure (extracted from the 2019 Brydon report) illustrates the new audit model proposed and how it compares with the current model.



See the full report here:

- assurance reports may cover compliance with accepted Green/Social/Sustainability bonds processes, the issuer's ESG compliance generally or be based on the organisation's in-house criteria for what qualifies as a Green/Social/Sustainability bond.
- a qualitative review of internal policies, processes and/or commitments would currently be viewed as disproportionate and beyond current market practice.

- issuers should also consider to what extent their future annual sustainability reports are to be subject to assurance, as investors may expect a similar level of assurance to what is used in the offering document.

Regulators and other policymakers are increasingly considering oversight and/or regulation of providers of ESG ratings and data products. For example, the CSRD will require the audit (assurance) of reported information, and the European Green Bond Standard proposes a vetting process for third party assurance providers.

In addition, in its July 2021 consultation on ESG ratings and data products, IOSCO stated an intention to form a common international baseline through the creation of an International Sustainability Standards Board under the IFRS foundation. This board would, among other things, develop a basis for the implementation of audit and assurance frameworks.

9 ESG Rating

Rating agency (Fitch, S&P and/or Moody's) analysis on ESG factors relevant to credit ratings (such as, for example, Fitch's ESG Relevance Scores) are generally based on sector-specific templates for the assessment of each entity and are observational analyses of how much an ESG element affects a rating, while clearly identifying and displaying which ESG risk elements played a part in the rating decision. Although the criteria and basis for the ESG analysis undertaken by rating agencies may not be identical to that of ESG reporting and disclosure in the sub-investment grade context, such reports and analysis may provide guidance on ESG reporting and disclosure.

It is important that there is adequate and meaningful engagement between issuers and providers of ESG ratings and data products (including both "traditional" rating agencies and other providers of such information). Because of the wide breadth and potential complexity of issues related to ESG/sustainability, it is essential that the provider of ESG-related ratings information and data products have a clear view of the issuer's business, financial situation, and present and future objectives and plans, among other things. The provider must also make an assessment of how these factors might affect questions of materiality and proportionately. It would be difficult to obtain a complete picture without meaningful engagement with the issuer.

As part of any engagement, it is also important that providers of ESG ratings and data products provide transparency about the methodologies and factors that are being used to make their assessments. Companies subject to such ratings and data products should have a clear understanding of these methodologies and factors, as well as how such factors are used (by the provider and by investors) to assess the company and arrive at an ESG rating or score.

Consistency and comparability of ratings and data products are also extremely important for investors and other market participants, as inconsistencies or an inability to easily gauge the impact of ESG ratings, scores or data products could have a significant negative effect on the ESG market. While practice in this area is still developing according to market demands and expectations, there are indications that regulators and policymakers intend to increase their focus on these matters.

For example, in December 2020, the French AMF and Dutch AFM issued a position paper proposing a European regulatory framework for ESG data, ratings and related services, with a particular focus was on transparency and conflicts of interest, and in January 2021, ESMA similarly wrote to the European Commission, setting out its concerns that these prominent services are currently unregulated and unsupervised, and calling for legislation to introduce a robust regulatory framework.

In June 2021, the FCA issued a consultation on "Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets[7]". In Chapter 4 of the consultation, the FCA noted that it is asking for views on select Environmental, Social and Governance (ESG) topics in capital markets and is looking to generate discussion and engage stakeholders on, among other things, ESG data and ratings providers.

In July 2021, IOSCO also issued a consultation, on "Environmental, Social and Governance (ESG) Ratings and Data Products Providers[8]", which noted the following concerns about the current ESG ratings framework:

- there is little clarity and alignment on definitions, including on what ratings or data products intend to measure;
- there is a lack of transparency about the methodologies underpinning these ratings or data products;
- while there is wide divergence within the ESG ratings and data products industry, there is an uneven coverage of products offered, with certain industries or geographical areas benefitting from more coverage than others, thereby leading to gaps for investors seeking to follow certain investment strategies;
- there may be concerns about the management of conflicts of interest where the ESG ratings and data products provider or an entity closely associated with the provider performs consulting services for companies that are the subject of these ESG ratings or data products; and
- better communication with companies that are the subject of ESG ratings or data products was identified as an area meriting further attention given the importance of ensuring the ESG ratings or other data products are based on sound information.

[7] https://www.fca.org.uk/publication/consultation/cp21-18.pdf
[8] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD681.pdf

The IOSCO consultation is intended to form the basis for a series of proposed recommendations for securities markets regulators as well as ESG ratings and data products providers, users of ESG ratings and data products, and the companies that are the subject of these ratings or data products.

See Section 5 (“Disclosure”) and Section 8 (“ESG Assurance”) for the potential impact of IOSCO’s review on ESG disclosure and on provision of ESG ratings and data products.

10 Green Bonds

Green/Social/Sustainability bonds are issued to fund projects that meet the issuer's criteria for sustainability. For example, these may adhere to a particular "Green Bond Framework" or constitute "Eligible Green Projects," as defined and identified by the issuer and, when promulgated in final form, standards conforming to the EU Taxonomy Regulation.

Most European bonds are issued under the Green Bond Principles formulated by the International Capital Markets Association ("ICMA[9]"). Issuers may also seek certification from the Climate Bond Initiative ("CBI"), in which case the bonds must adhere to the CBI Principles[10].

Parties should consider the following:

- if applicable, issuers should provide any relevant definitions (e.g. for "Eligible Green Projects") in the Use of Proceeds section and elsewhere.
- bonds can include "green" in the title of the bonds (e.g. "Senior Secured Green Notes due 2025") or other relevant ESG criteria.
- an issuer may also include a statement on the front cover (e.g., "The Notes are being issued as green bonds in accordance with our green bond framework" or other relevant standards).
- rather than explicitly labelling bonds as green, some issuers have adopted an indirect approach, relying on the implied use of proceeds such as use for eligible green projects.

A separate "Green Bond Framework[11]" is usually publicly available on a Company's website, which includes reference to:

- use of Proceeds: including any applicable definitions (e.g. for "Eligible Green Projects").
- project Evaluation and Selection: how the issuer identifies and selects appropriate green projects.
- management of Proceeds: how proceeds are allocated and monitored by the issuer, and any details on substitution should a particular project become ineligible for funding under the framework.
- reporting: any details regarding the issuer's ongoing impact or environmental reporting.
- verification: details on any third-party opinion obtained to verify the issuance is green. Any details on parties providing verification for any post-issuance reporting should also be included where applicable.

On 7 July 2021, the European Commission proposed a European green bond standard (EUGBS), which will be a voluntary standard and which was one of the actions in the Commission's 2018 action plan on financing sustainable growth as part of the "European green deal". It is based on the recommendations of the Technical Expert Group on Sustainable Finance. Once it is adopted by co-legislators, this proposed Regulation will set a gold standard for how companies and public authorities can use green bonds to raise funds on capital markets to finance such ambitious large-scale investments, while meeting tough sustainability requirements and protecting investors.

This will be useful for both issuers and investors of green bonds. For example, issuers will have a robust tool to demonstrate that they are funding legitimate green projects aligned with the EU taxonomy. In addition, it is intended to ensure that investors buying the bonds will be able to more easily assess, compare and trust that their investments are sustainable, thereby reducing the risks posed by greenwashing. It also proposes a vetting process for third party assurance providers, and regulators will likely require minimum baseline professional and independence standards for such practitioners.

The new EUGBS will be open to any issuer of green bonds, including companies, public authorities, and also issuers located outside of the EU.

[9] 5 While ICMA covers investment grade bonds, the Green Bond Principles are used for most bond issuances, including issuances of high yield bonds.
[10] CBI verification entails (i) provision of a second party opinion that the bond framework follows the Green Bond Principles and (ii) post-issuance auditor assurance.
[11] https://ec.europa.eu/info/publications/sustainable-finance-teg-green-bond-standard_en

There are four key requirements under the proposed framework:

- taxonomy-alignment: The funds raised by the bond should be allocated fully to projects that are aligned with the EU taxonomy;
- transparency: Full transparency on how the bond proceeds are allocated through detailed reporting requirements;
- external review: All European green bonds must be checked by an external reviewer to ensure compliance with the Regulation and taxonomy alignment of the funded projects; and
- supervision by the European Securities Markets Authority (ESMA) of reviewers: External reviewers providing services to issuers of European green bonds must be registered with and supervised by the ESMA. This will ensure the quality of their services and the reliability of their reviews to protect investors and ensure market integrity.

11 Transition Bonds

General

Transition bonds are intended for industries with high greenhouse gas (GHG) emissions, which may be referred to as "brown" industries, in order to incentivise those industries to become more sustainable.

The idea is that these companies are working towards becoming "green" and that issuing the transition bonds, to some extent, embodies principles that will assist the company in reaching that goal.

These bonds are intended for companies which currently do not (and for the foreseeable future may not) have sufficient green assets available to finance, but that do have financing needs to reduce the greenhouse gas footprint of their business activities, as well as of their products and services. The proceeds from transition bonds are generally used to finance projects within pre-defined climate transition-related activities.

Relevant industry sectors include:

- mining – especially of minerals critical for the low-carbon economy, such as lithium and cobalt;
- heavy industry (e.g. cement, aluminium, iron, steel, chemicals);
- utilities (e.g. electricity, gas, water, cable, telecoms); and
- transport & mobility.

Transition bonds may also be issued by a company which lacks sufficiently green assets to issue a green bond.

Companies that issue transition bonds are expected to demonstrate either (a) the positive sustainable impact of the use of proceeds or (b) a strategic shift to a low carbon model (i.e., climate key performance indicator (KPI) linked bonds).

In this context, there is a heightened focus on the industries that would be expected to issue transition bonds, and therefore parties may apply a heightened scrutiny to such industries, particularly with respect to diligence and transparency.

Brown Taxonomy

The Platform on Sustainable Finance, under its mandate to advise the European Commission, is also considering an extension of the Taxonomy to cover significantly harmful (SH) and low impact activities as a means to address the so-called transition, or "Brown" offering framework.

12 ANNEX A: High Yield ESG Due Diligence Questionnaire

12.1 Introduction

This questionnaire is intended to provide a suggested framework for market participants' ESG due diligence with respect to high yield and leveraged finance transactions. It is not meant to be mandatory or comprehensive, nor to cover all ESG considerations. It is intended to complement, rather than replace, existing due diligence processes and to suggest relevant considerations, where appropriate, that should be taken into account in this context. We acknowledge that ESG factors and practices will vary depending on the company's sector, business practices, geographical location, output and other factors, and that parties will require some level of flexibility in following or applying these or any other such considerations. Parties should carefully consider which of the items below are material for the particular company or industry, as some of them may not be relevant for certain transactions.

We note that the below questions in each topic area may include certain questions (or cover certain topics) that already form part of questionnaires prepared by underwriters and other participants for use in existing due diligence processes; we have repeated them here only for ease, so that each topic can stand alone as a complete set.

12.2 Environment

1. Does the company have an environmental policy which sets out commitments and targets to improve the company's environmental footprint?

2. Has the company performed an environmental or climate change risk and opportunity assessment? If yes, please provide comment on the relevant key risks/opportunities, control measures and improvements and whether third parties are engaged for verification.

3. Is the company fully compliant with all relevant environmental permits/licenses/consents? In the time period covered by the due diligence exercise, has the company been under review by, been sanctioned by, or been fined by any regulatory body regarding the company's environmental impact? If yes, please provide details.

4. Does the company assess, monitor and report its carbon and/or other greenhouse gas emissions? Does the company benchmark versus peers and/or industry standards? If yes, can you provide the result of the company's latest analyses.

5. What are the company's primary energy and water sources?

6. Provide details of key waste streams generated and how these are managed and disposed of.

7. Describe any soil or groundwater contamination , or chemicals/hazardous substances used or present on site, including with respect to leaks, spills or any related legal or regulatory actions. How does the company manage the containment and disposal of the subject substances?

8. In the time period covered by the due diligence exercise, has the company been the subject of any litigation (closed or on-going) with respect to its environmental impact? If yes, please provide details.

9. Does the company provide environmental training or other instruction for its employees? If so, please provide details.

10. Does the Company currently use (or plan to use) alternative sources of energy or power (e.g., solar, wind, hydro) in its facilities? If so, please provide details.

12.3 Social

11. Does the company have formal Health and Safety, Anti-Discrimination, Diversity, and Data Privacy, and Human Rights policies in place? Please add details.

12. Who in your organisation is responsible for overseeing data privacy and security? Please provide insight into your data privacy and data security policies, how often they are reviewed and whether an external body has reviewed the policies? Do you provide training to all employees on this topics? Have you had any recent breaches of customer data?

13. Do you have formal supply chain standard requirements in place? If so, please discuss and/provide further details?

14. Does the company monitor incidents/accidents in the workplace? If so, please provide a breakdown of statistics for the time period covered by the due diligence exercise.

15. Have you had any social related legal, regulatory complaints, claims or enforcement actions over the time period covered by the due diligence exercise, associated with employees or key stakeholders?

16. Over the time period covered by the due diligence exercise, has the company been the subject of any employee related class-action lawsuits (whether a closed or on-going)?

17. Please outline any community relations projects, education and/or social awareness relating to the company's services/products.

18. If relevant, please outline your policy and procedures covering product safety (or any other social, health or other impact that your product or service may have on your customers or the general public?).

19. Please provide confirmation that the company adheres to local minimum wage standards.

20. Does the company's health and safety policy include workplace risk assessments? If so, please provide details, including how often are they reviewed and updated.

21. Does the company have a policy designed to deal with human rights and other labour standards? Please provide details.

22. Is there a formal procedure for employees' general questions/views/concerns/grievances? If so, please provide details. If not, how are such matters addressed at the company?

    Are employees represented on (or otherwise able to interact with) the company's Board, or with its governance and other committees?

23. Are workers permitted to join a union or otherwise engage in collective bargaining?

24. Does the company have a formal procedure for employee grievances? Please provide details.

12.4 Governance

25. Integration Infrastructure - Does the company have a specific ESG budget? Are there ESG training programs? Is there an evaluation system or oversight mechanism (KPI's) related to ESG concerns?

26. Please provide the composition of the Board of Directors: Total #, # of independent members, # ofwomen, # of minorities. Are anti-discrimination and diversity considered in determining the composition of the company's Board?

27. Board of Directors Turnover: What % of the current board of directors have been on the board for atleast three years?

28. Does the company convene a shareholder meeting at least annually? Do the shareholders vote on theBoard of Director composition? What is the term of each Board of Directors member?

29. What safeguards are in place to ensure that minority shareholder rights (with respect to access toinformation and voting rights) are fair and transparent?

30. Is a member of the board assigned responsibility for ESG/sustainability/CSR matters within thecompany? If so, what is their qualification? Who oversees ESG monitoring/planning?

31. Please provide details of the company policies regarding anti-bribery and anti-corruption, includingany employee training or education.

32. Please describe any corporate governance and/or ethical related employee claims/breaches/enforcement/litigation action relating to issues such as anti-bribery, fraud, corruption, unfair labour practices, human rights abuses, and other malpractices. Please providedetails of any third party (regulatory or otherwise) investigations, litigation, or prosecution.

33. Does the company have an audit committee? Please provide details, including composition andpolicies.

34. Who is the firm's auditor? How long has the auditor been in place? Within the time period covered by the due diligence exercise has the company had a material dispute over accounting practices withits auditor? Within the time period covered by the due diligence exercise has the company been required to restate, in any material manner, its financial statements?

35. How are ESG-related matters brought to the Board's attention? Is there any specific Board member(or committee) that is specifically tasked with ESG-related matters?

36. Does the company have a code of conduct? If so, how is it communicated to employees, and how is itmonitored/maintained?

37. Does the company have a whistle-blower policy? Please provide details, including any complaintprocedures, remediation processes and protections against retaliation.

Finance for Europe

London Office
39th Floor
25 Canada Square
London E14 5LQ
United Kingdom

Switchboard:
+44 (0)20 3828 2700

Brussels Office
Rue de la Loi, 82
1040 Brussels
Belgium

Switchboard:
+32 (0) 2 788 3971

Frankfurt Office Neue
Mainzer Straße 75
Bürohaus an der Alten
Oper 60311 Frankfurt
am Main Germany

Switchboard:
+49 69 153 258 963

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