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 sustainability-related 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 integrating ESG considerations into decision-making, capital allocation, pricing, and value assessments. In addition, supervisors have integrated ESG factors across capital markets regulation, including through corporate reporting, due diligence requirements, prospectus disclosures and benchmark regulation.

The key building blocks of EU sustainable finance legislation are in place, including the EU Taxonomy for Sustainable Activities (the EU Taxonomy), the Sustainable Finance Disclosure Regulation (SFDR), the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD).[1] The EU is currently working to simplify its sustainable finance regulatory framework to mobilise additional capital for the transition while reducing administrative burdens for reporters. In the UK, the government has continued work to establish the key pillars of its sustainable finance framework, including the Sustainability Disclosure Requirements (SDR) regime and anti-greenwashing rule, the anticipated adoption of IFRS sustainability disclosure requirements for companies and the embedding of transition planning-related disclosures into corporate reporting.

We are also seeing responses in Europe to US developments. These regulatory changes shape investor expectations regarding the content of ESG disclosure in offering documents and due diligence procedures when underwriting an offering.

AFME has a dedicated cross-divisional Sustainable Finance team which supports members across the European sustainable finance framework including the EU Taxonomy, CSRD, CSDDD and equivalent UK regulation. AFME's divisions also review ESG matters on a product-specific basis, e.g. green securitisation or ESG-related disclosures in capital markets products.

We acknowledge the work that has been, and is being, undertaken with respect to ESG matters by numerous other trade and international organisations and standard-setters. These guidelines aim to contribute to this work from the perspective of leveraged finance practitioners.

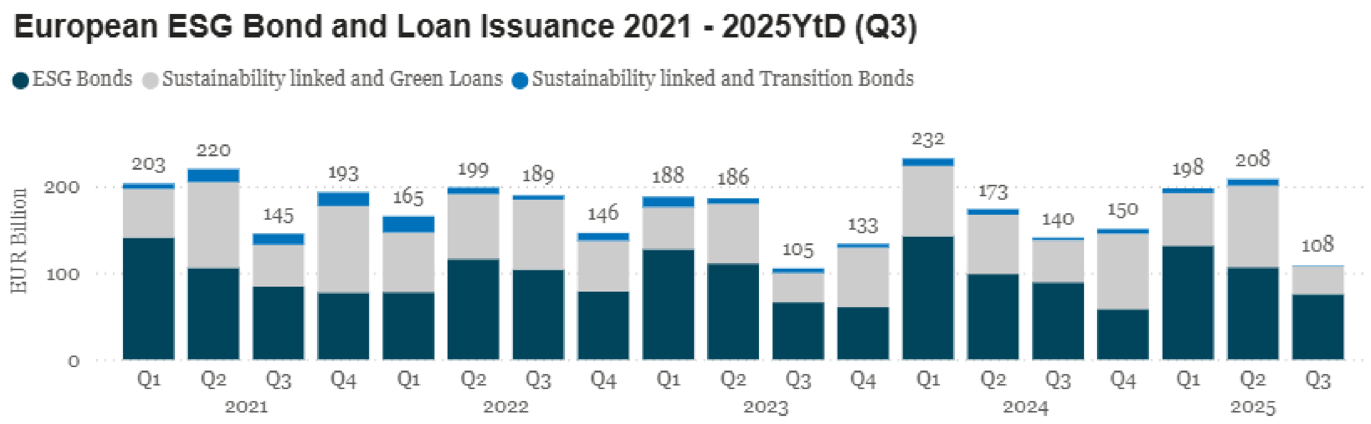
We believe that AFME, through the European High Yield Committee, can play a key role in helping to establish a set of market practices and considerations that take into account the broader sub-investment grade and leveraged finance markets and that work for all market stakeholders, including issuers,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

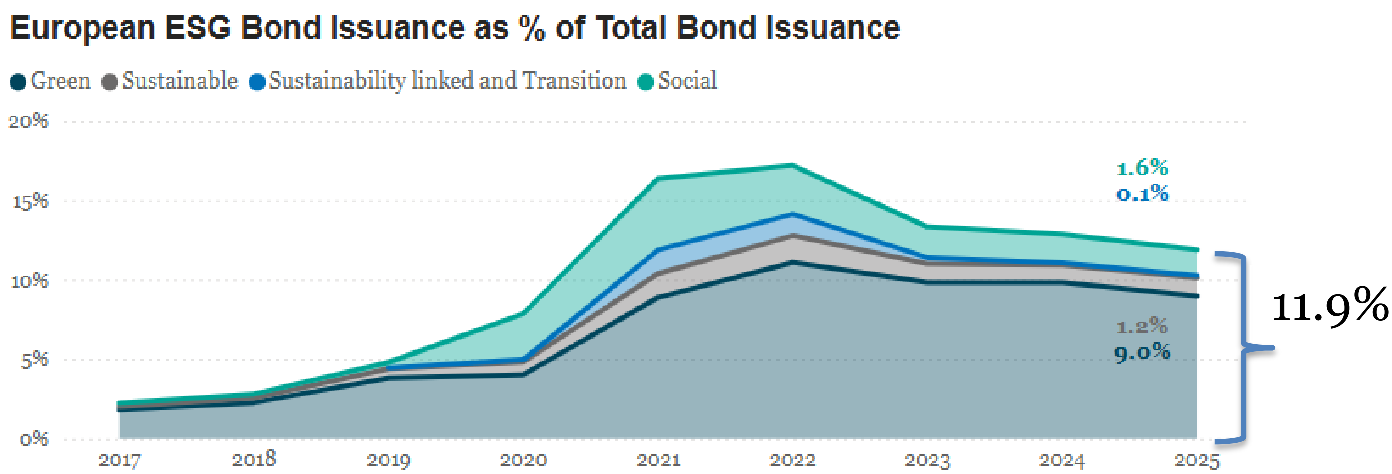
At present, there are a number of approaches for ESG-related bond financings, including:

- a project "use of proceeds" based approach (e.g. Green/Social/Sustainability (GSS) Bonds),
- a company target-linked based approach (e.g. Sustainability Linked Bonds), and
- transition financing (e.g. Transition Bonds which have had a low volume to date).

However, even 'conventional' bonds which are not structured as GSS+ bonds (as defined below) are nonetheless expected or even required, as the case may be, to contain ever more robust ESG disclosures and due diligence procedures, though the extent of such disclosures depends on the particular circumstances. We intend to address the broader universe of European high yield in these recommendations, as well as specifically in the context of GSS+ Bonds. The market is rapidly evolving as reflected by the below statistics:

[1] It shall be noted that European directives have to be transposed into national law and EU member states have a certain degree of flexibility under the relevant directive to implement stricter rules than required under a directive, which is oftentimes referred to as "gold-plating".





Source: AFME with Dealogic data

These recommendations are focused on current market practice and regulation. The intention is to update these recommendations as the market further develops.

2. Overview

Disclosure of ESG factors depends, amongst other factors, on the individual circumstances of the issuer, its industry, regulatory environment, stakeholders (e.g., financial sponsors, shareholders or actual/potential investors), and the terms and conditions of the high yield bond being issued, i.e. whether a conventional high yield bond or GSS+ Bond (as defined below). This paper provides a framework for assessing relevance and materiality of certain ESG factors, 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/ sustainability-linked/ transition (hereinafter referred to as "GSS+ Bonds").

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 (i.e. quantifiable on a consistent methodological basis), collectible, evidence-based and reliable. For example, in the context of sustainability-linked bonds (SLBs), it is considered best practice for key performance indicators (KPIs) and sustainability performance targets (SPTs) to reference externally identifiable reference points and thus be able to be benchmarked.[3] 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 include, where the context allows, 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] See, for example, the ICMA Sustainability-Linked Bond Principles (June 2024): "*The KPIs should be: (i) relevant, core and material to the corporate issuer's overall business, (or economic, social and governance policies for sovereign issuers) and of high strategic significance to the issuer's current and/or future operations (or sustainable development policies for sovereign issuers); (ii) consistent with the overall issuer's sustainability strategy or policies but also reflecting the most material strategic dimensions for the issuer; for example, the KPI may be included in or supported by a strategy/policy disclosure, or notably for hard-to-abate sectors, by a transition plan; (iii) measurable or quantifiable on a consistent methodological basis; (iv) externally verifiable; and (v) able to be benchmarked, i.e. as much as possible using an external reference or definitions to facilitate the assessment of the SPT's level of ambition.*

3. ESG Factors

A. 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, reducing deforestation, 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[4] and "Brown" Taxonomies, with the current EU Taxonomy (see "Disclosure and Reporting"), there is only a EU taxonomy relating to environmental issues in place to date with delegated acts related to climate and environmental matters.[5] 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 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 and 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 'double materiality' approach will likely become more important as regulators, investors and governments continue to focus on climate change and environmental protection (see "Disclosure and Reporting").

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 any transition plans;
- 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;
- Levels of monitoring / reporting carbon and/or greenhouse gas emissions; and
- Key performance indicators / company-specific environmental targets and the company's performance against them.

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

B. Social

Social factors include human rights, diversity, equity 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;

[4] For the European Union's initiative towards a 'Social Taxonomy', see "Disclosure and Reporting" and for 'Brown Taxonomy' see "Transition bonds" below.

[5] In recent years, many countries implemented, or are in the process of implementing, national Green Taxonomies, for example, United Kingdom, Singapore, China, Colombia and Indonesia.

- Employee welfare, education and participation;
- 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;
- Tax structuring, tax equity and transparency in reporting;
- Adherence to local minimum wage standards; and
- Key performance indicators / self-imposed environmental targets and the company's performance against them.

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. This is evident in the proposals for a "Social Taxonomy" by the EU Platform on Sustainable Finance in February 2022 (see "Disclosure and Reporting"), as well in an increased focus on social factors by investors. The desire for regulation of the social component of ESG has already been translated into several legislative frameworks in the European Union (e.g. the EU Corporate Sustainability Reporting Directive, the EU Corporate Sustainability Due Diligence Directive, the UK's Modern Slavery Act, the French Duty of Vigilance Act or the German human rights due diligence law) and in the US (e.g. the Uyghur Forced Labor Prevention Act) or best practice corporate governance codes (e.g. gender quota).

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, laws and regulations and performance and implementing good practices in those areas will likely play an increasing role in complying with investor and regulatory requirements, particularly for corporations operating globally which are most likely subject to varying standards.

C. 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 their own employees, other stakeholders (such as investors, suppliers 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 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);
- Sustainability-related 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 in investor decisions and regulatory oversight. While this area is, relative to social aspects, already subject to a number of different frameworks with respect to certain 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.

However, companies looking to address ESG matters should ensure that they do not seek to consider each of the "E", "S", and "G" in silos. This is important as many topics, while perhaps most frequently associated with one of the categories, will actually have considerable overlap with other categories (e.g., a company's approach to climate change may primarily be considered an "E" issue, but will likely have considerable crossover with governance practices as well as certain social matters), as well as the fact that much emerging regulation specifically deals with each of the "E", "S" and "G" (e.g. the EU's Corporate Sustainability Due Diligence Directive).

4. Diligence

This summary, together with Annex A (*High Yield ESG Due Diligence Questionnaire*), is not meant to be mandatory or comprehensive, nor to cover all ESG considerations. It is intended to provide a suggested framework for market participants' ESG due diligence with respect to high yield and leveraged finance transactions and to complement, rather than replace, existing due diligence processes and to suggest relevant considerations that should be considered in this context.

In addition, we note that there is currently no one generally accepted standard or guidance (legal, regulatory, or otherwise) relating to how ESG due diligence should be undertaken, and the field is rapidly evolving. However, guidance is forthcoming under the Corporate Sustainability Due Diligence Directive (CSDDD), which aims to establish clearer expectations for companies in this area. As such, market participants should closely follow regulatory developments, including CSDDD and other initiatives such as the UN Guiding Principles on Business and Human Rights, OECD Due Diligence Guidance for Responsible Business Conduct, Sustainability Accounting Standards Board (SASB) Materiality Map, Global Reporting Initiative (GRI) Standards, and Task Force on Climate-related Financial Disclosures (TCFD) Recommendations, to ensure that all operations comply with relevant legislation and adjust their due diligence processes accordingly. There are a variety of tools and processes, such as early-stage risk screening, which can help identify potentially materially relevant ESG factors and assist with the scoping of diligence and the refinement of diligence questions.

We further note that, certain topics already form part of due diligence practices conducted or questionnaires prepared by underwriters and other participants for use in existing due diligence processes. The diligence exercise should be driven by materiality considerations and should be designed to verify disclosure. AFME also acknowledges 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 topics and items below (or in Annex A) are material for the particular company or industry, as some may not be relevant for certain transactions. 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.[6]

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 a sustainable finance transaction.

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 limited direct 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 the corresponding regulatory environment and that they relate to additional factors such as the issuer's credit, the issuer's ESG strategy, including any set targets (whether or not related to the issuance of a sustainable finance instrument), the use of proceeds or the KPIs / SPTs set in case of a sustainability-linked instrument.

Parties are encouraged to consider the following:

- Where relevant or appropriate, address ESG factors in financial statements and management commentary (i.e. Management's Discussion & Analysis (MD&A)), critical accounting judgments, key factors affecting the company's results of operation 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 should be 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. See Annex A (*High Yield ESG Due Diligence Questionnaire*).

[6] It is anticipated that these considerations, together with the questionnaire attached as Annex A, 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 has increased significantly over the last couple of years, not only from an investor's, but also from a regulator's, perspective[7], AFME recommends the development of broader, more structured stakeholder due diligence practices. Stakeholders include customers and suppliers (i.e. the entire value chain), workers, communities and regulatory bodies. See Annex A (*High Yield ESG Due Diligence Questionnaire*).

[7] See for example, UK Modern Slavery Act, the proposed EU Corporate Sustainability Due Diligence Directive, the German Supply Chain Due Diligence Act or the US Uyghur Forced Labor Prevention Act.

5. Disclosure and Reporting

A. General

Disclosure and reporting of Sustainable Finance activities, investments and objectives has become increasingly prominent in recent years. Consistency and comparability of disclosures and reporting has the potential to provide investors and other stakeholders with data enabling them to assess the performance and benefits of the growing ESG market and allocate funds more efficiently.

Issuers, in particular issuers of GSS+ Bonds, should provide clear, transparent disclosure of relevant information that would be material to an investment decision for the particular GSS+ Bond. Parties should, where possible, ensure that ESG data is disclosed in a manner that is defined, measurable, collectible, evidence-based (i.e. quantifiable on a consistent methodological basis) and reliable. In the context of SLBs, for example, it is considered best practice for key performance indicators KPIs to be based on externally verifiable sources and thus be able to be benchmarked. 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. Disclosure should be even; a focus solely on the issuer's ESG ambition, strategy and initiatives without discussing the risks stemming from ESG scrutiny or changing regulatory landscape should be avoided. 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 conventional 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. In case of GSS+ Bonds, however, enhanced disclosure may be appropriate, depending on the context. For a discussion of disclosure considerations related to GSS+, see Chapter 10 (Green / Social / Sustainability Bonds), Chapter 11 (Sustainability-Linked Bonds) and Chapter 12 (Transition Bonds) 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 investment decision, and that such disclosure is tailored to the particular issuer, GSS+ Bond and/or industry and is related to the credit position of the issuer (or the use of proceeds or the KPIs/SPTs). 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), its ability to deploy the funds for green/sustainable purposes and/or attain its SPTs as well as its ability to repay the debt generally.

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, a sustainable financing framework or other periodic disclosure. Similarly, ESG-related information disclosed in periodic sustainability disclosures 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 or the KPIs). Issuers should only include or incorporate ESG-related information into the offering memorandum when they have confidence that such information is consistent with Rule 10b-5 disclosure standards.

The Sustainability Accounting Standards Board ("SASB") has developed a chart that maps the materiality of different ESG-related factors for specific industry sectors[8]. Similarly, in June 2022, the International Capital Markets Association ("ICMA") published, as part of its "Illustrative KPI Registry", a materiality matrix for suitable KPI categories for specific industry sectors.[9]

[8] https://www.sasb.org/standards/materiality-finder/.

[9] International Capital Markets Association, Illustrative KPI Registry, https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/

Disclosure in the Offering Document

The Issuer should also consider the following factors related to ESG disclosure[10]:

- 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 1.5°C or lower scenario.
- Issuers should 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. See also Chapter 4 (*Diligence*).
- Issuers should reflect any material ESG-related risks in the risk factors, including, without limitation, considering whether the below represent material risks:

    - Whether changes in regulation which could impose additional capital or compliance costs on the issuer or otherwise put pressure on the issuer's business model;
    - Whether failure to meet ESG expectations, standards or targets could have a material adverse effect on the issuer's business and/or the trading price of the issuer's securities, in particular in the case of self-imposed sustainability targets or sustainability playing an important role in the issuer's credit story (e.g. 'strengths & strategy' section);
    - When the decision has been made to include ESG ratings in the offering documentation, issuers could consider including a risk factor on the lack of regulation of ESG rating providers and the varying assessment methodologies and criteria among those providers; and
    - Issuers could consider including a general risk factor about the lack of market consensus on sustainability.

- For GSS+ Bonds in particular, issuers should consider, amongst others, the following risk factors:

    - The relevant GSS+ Bond may not be suitable for all investors seeking exposure to sustainable assets and may also not meet all ESG-related objectives of such investors;
    - failure to use the proceeds for 'eligible green projects' (or any failure around a green project) or non-compliance with (interim) SPTs will not constitute an event of default under the bond terms;
    - the above-mentioned issues, and any subsequent withdrawal of a second-party opinion (to the extent obtained), might have a material adverse effect on the value of the securities, reputational risks for the issuer and, in the case of a sustainability-linked instrument, will change the bond characteristics (e.g. coupon step-up);
    - reporting and second-party opinions are generally not legally actionable; and
    - there is currently no regulatory regime for SPO providers.

- Use of Proceeds – This is most important for Green / Social / Sustainability Bonds, because they 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. To the extent third party verification is sought, issuers should consider involving the external verifier in the discussions around the use of proceeds and seek their view as to compliance with the green bond framework and/or the guidelines pursuant to which the bond is being issued.
- If applicable, issuers should provide any relevant definitions (e.g. for "Eligible Green Projects") and look-back periods (if any).
- 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. The levers that the issuer intends to use to affect the KPIs and therefore reach its SPTs should also be disclosed, as well as any accompanying risks and any recalculation policy that may require or entitle the issuer to amend its KPIs/SPTs in certain circumstances.
- Business – To the extent relevant and 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 or any implications on the key factors affecting the results of operations.
- References to the ESG aspects of the bond should be clear and understandable.

[10] It should be noted that these disclosure considerations do not only apply to issuers of sustainable finance instruments, but also issuers of 'conventional' bonds.

B. ESG Reporting and Disclosure Regulation

In addition to contractual disclosure and reporting obligations in the case of GSS+ Bond issuances, European high yield issuers are and will become subject to several regulatory disclosure and reporting regimes, some of which may have very similar, but nevertheless distinct, obligations and requirements. Issuers need to determine whether information provided under one reporting regime is appropriate for inclusion under other applicable regimes. This is particularly important when considering "materiality" and the obligation to provide all relevant information to investors, as certain regulatory frameworks implemented new legal concepts, such as "double materiality".

The reporting and disclosure regulatory landscape is constantly evolving and rapidly changing. For an update of the regulatory landscape, please see AFME's report "Sustainable Finance in Europe: Regulatory State of Play - Key impacts for banks and capital markets 2024".[11] AFME continues to support members as they navigate the continually evolving regulatory framework, led through its 'Sustainable Finance Steering Committee' and dedicated working groups. AFME also highlights the experiences of its members through its policy engagement and consultation submissions.

[11] https://www.afme.eu/publications/reports/details/sustainable-finance-in-europe-regulatory-state-of-play---key-impacts-for-banks-and-capital-markets-2024

6. Business Model

The following are some of the risks and considerations that should be included in connection with an ESG business model as holistic ESG considerations with respect to a particular company:

- 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); and
- Opportunities highlighted by the TCFD disclosures include resource efficiency, resilience, and novel energy sources, products, services, and markets.

Consider which, if any, ESG KPIs are to be included, as these will depend on the specific company, industry, and operating model. For example, KPIs for green financings, often focus on carbon emissions reduction, renewable energy usage, and water conservation, while social financing KPIs may emphasize metrics such as gender diversity in senior management, employee turnover rates, and community engagement initiatives. Regulatory frameworks, such as the Corporate Sustainability Reporting Directive (CSRD), require companies to disclose comprehensive information on environmental, social, and governance KPIs. For example, the disclosures required in European Sustainability Reporting Standard (ESRS) E1 (Climate Change) comprise KPIs such as targets related to climate change mitigation and adaption, (gross) scopes 1, 2, 3 and total greenhouse gas (GHG) emissions and internal carbon pricing.

The evolution of the EU Taxonomy, the EU Low-Carbon Benchmark Regulation, and the CSRD has already refined the focus areas for KPIs and expanded measurement possibilities, providing a clearer framework for assessing sustainability performance. In the UK, the TCFD framework has been integrated into mandatory reporting requirements, further guiding companies on climate-related KPIs.

It should be noted that if KPIs are disclosed upon issuance, investors will likely expect ongoing disclosure. Therefore, issuers and sponsors should carefully consider which KPIs to disclose, balancing transparency with cost and management time, while investors and other market participants should remain sensitive to these considerations. In the case of Sustainability-Linked Bonds (SLBs), the International Capital Market Association (ICMA) published a 'KPI registry'[12], providing high-level recommendations and illustrative examples of KPIs for SLB issuers across various industries, such as energy efficiency improvements, waste reduction targets, and social impact metrics.

[12] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp

7. Assurance, ESG Ratings and Second Party Opinions

Assurance

Under several regulatory frameworks, including the Corporate Sustainability Reporting Directive (CSRD), companies are required to adhere to disclosure frameworks that mandate external assurance and verification of their sustainability reports. These frameworks aim to enhance the credibility and reliability of disclosed information by ensuring that it is independently verified. By subjecting disclosures to external assurance, companies are encouraged to maintain high standards of transparency and accountability in their sustainability practices. This process helps mitigate the risk of greenwashing and supports informed decision-making by stakeholders who rely on consistent and trustworthy ESG information.

Issuers are recommended to obtain a third party- assurance report for the benefit of investors. Several nongovernmental organizations have developed certification standards for green bonds, and the opinions they provide can vary depending on the issue and the organization involved. Many of the standards in the industry (e.g. Climate Bond Initiative (CBI), ICMA and LMA Green Bond/Loan Principles, Social Bond/Loan Principles, Sustainability Bond Principles and the Sustainability-Linked Bond/Loan Principles) recommend or require the use of a third-party certification or assurance. For example, in case of a Sustainability Linked Bond, it is recommended that it engages with a relevant third party to either (a) develop 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. In case- of a SLB, the ICMA Sustainability-Linked Bond Principles require external verification of the performance of the KPI(s) against the (relevant) SPT by a 'qualified external reviewer with relevant expertise' at least once per year.[13] See also further below under "Second Party Opinions (SPOs)".

ESG as part of a credit 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.

ESG Ratings

The use of ESG ratings has increased rapidly given growing investor demand, the increased offering of sustainable investment products, the developing acknowledgement of sustainability risks and opportunities and sustainability-related regulatory pressure. Uses of ESG ratings include supporting the assessment of the ESG performance of companies, the related creation of different sustainable investment products or sustainability-linked bonds, loans, derivatives, guarantee facilities, hedging agreements, accounts receivables, supply chain finance and to identify sustainability risks and opportunities in this context. For these reasons, transparency of ESG ratings methodologies and the quality of ESG data input have been a focus for the finance sector and regulators.[14]

On 19 November 2024, the European Union officially adopted its ESG Ratings Regulation, aiming to enhance the quality and reliability of ESG ratings. The regulation provides a clear definition of what constitutes an "ESG Rating," which is the primary criterion for falling within its scope. Under the ESG Ratings Regulation, any person that wishes to operate as an ESG ratings provider in the EU will require an authorization by ESMA (with different registration requirements for third country established entities and, for a limited period, so called "small ESG ratings provider"). All ESG ratings providers operating within the EU will be required to adhere to organizational requirements that ensure the integrity and reliability of ESG rating activities. This entails maintaining a permanent, independent, and effective oversight function to oversee all aspects of their ESG ratings provision. The regulation continues to enforce restrictions on ESG ratings providers from engaging in activities that could conflict with the delivery of ESG ratings, such as audit, assurance, consultancy services, and the provision of credit ratings.

A key policy goal of the UK government is to encompass ESG ratings that are "likely to influence" decisions to make specified investments under the FSMA 2000 (Regulated Activities) Order 2001 (RAO). On 14 November 2024, HM

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[13] See also ICMA "Guidelines for External Reviewers", https://www.icmagroup.org/sustainable-finance/external-reviews/ .

[14] OECD (2025), *Behind ESG ratings: Unpacking sustainability metrics*, OECD Publishing, Paris, https://doi.org/10.1787/3f055f0c-en.

Treasury outlined the future UK regulatory framework for ESG ratings providers, following a consultation on proposals for the regime in spring 2023. Secondary legislation has been introduced to expand the regulatory perimeter in the FSMA 2000 (Regulated Activities) Order 2001 (RAO) to include the activity of providing ESG ratings. Affected ESG ratings providers will need to obtain authorization from the UK Financial Conduct Authority (FCA) and adhere to the regulatory regime as prescribed by the FCA.

More companies obtain ESG ratings and ESG ratings are more commonly seen in offering documents of HY bond offerings, not only in the case of GSS+ bonds, but also in conventional HY bond transactions. Issuers should be aware that disclosure of an ESG rating will be part of the offering document will be subject to the same liability as the bond disclosure. Instead of specifically stating the rating given, issuers may want to consider highlighting only the fact that they have obtained an ESG rating and/or that they have met a certain threshold. Irrespective of the extent of the disclosure of ESG ratings in offering documents, it should always be accompanied with an appropriate disclaimer and a risk factor.

Second Party Opinions (SPOs)

Second party opinions (SPOs) are independent assessments provided by external entities to evaluate the alignment of financial instruments, such as green bonds or sustainability-linked bonds, with established sustainability criteria and frameworks. SPOs play a crucial role in enhancing transparency and credibility of the sustainable finance market by verifying that the issuer's sustainability claims and objectives are consistent with recognized standards, such as the Green Bond Principles or Sustainability-Linked Bond Principles promulgated by ICMA, the Climate Bond Standard of the Climate Bond Initiative, the EU Taxonomy or the EU Green Bond Standard.

Issuers of GSS+ Bonds may therefore consider preparing a ‘Sustainable Financing Framework’ (the “Framework”), a standalone document in which the issuer can describe how their sustainability strategy and financing strategy are connected and demonstrate alignment with the relevant standard in relation to the issuance. Issuers that set up such a Sustainable Financing Framework would typically engage a third-party to confirm pre-issuance alignment of the framework with the requirements of such standard.[15]

SPOs typically involve a review of the issuer's sustainability strategy, the environmental or social impact of the eligible projects in the case of use of proceeds instruments, or the robustness of the KPIs and SPTs in the case of sustainability-linked instruments. SPO providers, often specialized firms or rating agencies, offer expert analysis and validation, with the SPO assessment published alongside new or updated Framework. This document can help give investors comfort that the financial products contribute to sustainability goals. By providing an independent evaluation, SPOs help mitigate the risk of greenwashing and foster trust in the sustainable finance market.

In practice, care should be taken to not inadvertently integrate the Framework and SPO as an offering document. Practices are still evolving, but in Rule 144A and SEC-registered deals, mentioning the Framework in the offering document is generally light-touch (i.e. a summary of the green bond framework) and while the existence of the SPO is mentioned in the document, the conclusions are not typically summarized therein. It is important to avoid the integration of the Framework as an offering document and therefore subject it to the same 10b-5 liability as the offering memorandum.

SPO providers are currently not subject to mandatory regulatory regimes in their capacity as such providers (unless they are separately regulated in their capacity as a rating agency) except for the European Green Bond Standard (EU GBS), which establishes a standalone regulatory regime for external reviewers who must register with ESMA and who will be supervised by the same with a particular focus on avoiding actual and potential conflicts of interest.

[15] See ICMA Principles. Note, that the ICMA Sustainability-Linked Bond Principles, for example, do not require issuers to set up a ‘Green Bond Framework’ or to obtain a second party opinion. However, it is considered best practice for European High Yield Bonds.

8. Green / Social / Sustainability 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 Green / Social and Sustainability bonds are issued under the Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines each formulated by the International Capital Markets Association ("ICMA") [16]. Issuers may also seek certification from the Climate Bond Initiative ("CBI"), in which case the bonds must adhere to the CBI Principles[17].

A separate "Green Bond Framework"[18] 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 net proceeds (or an equivalent amount) 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; and
- **Verification:** details on any SPO obtained to verify whether it aligns with the ICMA principles. Post-issuance verification would then verify that the proceeds were managed and allocated in line with the Framework. Any details on parties providing verification for any post issuance reporting should also be included where applicable.

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); and
- 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.

EU Green Bond Standard

On 21 December 2024, the European Green Bond Standard[19] ("EU GBS") entered into force. The EU GBS is a voluntary standard for issuer both inside and outside the European Union and intended as the "gold standard" for green bonds, underlying the European Union's leadership ambition in the area of sustainable finance. In essence, the EU GBS requires that all bond net proceeds are allocated in alignment with the EU Taxonomy. EU Green Bonds ("EU GBs") issued under the EU GBS, will become subject to supervision by the relevant competent authorities under the EU prospectus regulation. The EU GBS further establishes a registration and supervisory regime for external reviewers which will be supervised by the European Securities Markets Authority (ESMA). The following are the key characteristics of the EU GBS:

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[16] While ICMA covers investment grade bonds, the Green Bond Principles (https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/), the Social Bond Principles (https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/social-bond-principles-sbp/) and the Sustainability Bond Guidelines (https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-bond-guidelines-sbg/) are used for most bond issuances, including issuances of high yield bonds.

[17] 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.

[18] Please note that a "Green Bond Framework" (and similarly a "Social" or "Sustainability" bond framework) are not required under the ICMA Principles and are rather a 'key recommendation'. However, a framework is considered to be 'best practice'.

[19] EU GBS https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202302631

- **Use of Proceeds:** 100% of the net proceeds must be Taxonomy-aligned. However, EU GBS provides for a "flexibility pocket" allowing up to 15% of net proceeds to be earmarked towards economic activities that comply with Taxonomy, but for the Technical Screening Criteria (TSC) in case no TSC are in place, subject to certain additional requirements;

- **"CapEx Plan":** Issuers are required to publish a "Capex Plan" if proceeds are to be allocated towards CapEx and OpEx that do not meet, but will meet, the requirements under the EU Taxonomy. The Capex Plan further needs to set out a timeline by which such CaPex and OpEx shall be aligned with the EU Taxonomy which shall, in any event, be before the maturity date of the EuGB. In addition, there is a third-party verification requirement for the Capex Plan;

- "**Green Bond Factsheet**"**:** Before issuing an EU GB, issuers must publish an EU Green Bond Factsheet which is also subject to a third-party verification requirement. The Green Bond Factsheet is the quasi-Green Bond Framework under the EU GBS;[20]

- **Allocation & Impact Reports:** Until full allocation of the EuGB proceeds, issuers are required to publish annual allocation reports. After full allocation, such allocation report is subject to third-party verification. After full allocation and at least once during the lifetime of the EuGB, issuers are required to publish an impact report;

- **Supervisory Regime for Issuers:** As EuGB fall within the scope of the EU Prospectus Regulation, they are subject to supervision by an EU member state's respective competent authorities which are granted various powers and sanctions and enforcement powers;

- **Standalone supervisory regime for External Reviewers:** The EU GBS also establishes a standalone regulatory regime for external reviewers, including a registration requirements. Such external reviewers are subject to supervision by ESMA. One of the rationales for establishing such supervisory regime is to prevent actual and potential conflicts of interest;

- **Optional Disclosure for SLBs and "other" green bonds:** The EU GBS also provides for voluntary disclosure templates for pre- and post-issuance disclosure for all bonds "marketed as environmentally sustainable" and SLBs with environmental sustainability objectives.

Sustainability-Linked Loans Financing Bonds

In June 2024, ICMA and LMA launched the so-called "Sustainability-Linked Loans financing Bond Guidelines" (SLLBG). According to ICMA, Sustainability-Linked Loans financing Bonds (SLLBs) are a separate category, but are largely based on the guidelines for GSS bonds as SLLBs consist of the financing of a portfolio of sustainability-linked loans adopting the Use of Proceeds project finance structuring.

The key characteristics of SLLBs are:

- The proceeds (or an equivalent amount) will be applied to (re-)finance, in part of in full, a portfolio of new and/or existing eligible sustainability-linked loans aligned with the LMA Sustainability-Linked Loan Principles;
- They are aligned with the four components of the SLLBGs, being:
    - Process for Project / SLL Evaluation & Selection;
    - Management of Proceeds;
    - Use of Proceed portfolio; and
    - Reporting.

[20] A template factsheet can be found as Annex A to the EU GBS.

9. Sustainability-Linked Bonds

Sustainability-linked bonds are target-based instruments with characteristics aligned to an issuer's sustainability goals, typically through tracking a set of key performance indicators (KPIs) and testing the performance of those KPIs against sustainability performance targets (SPTs). Typically, the non-satisfaction of a SPT will require the issuer to pay either a higher coupon or a premium at maturity (a margin step-up), whereas the satisfaction of the SPT will lead to no incremental change in the finance costs of the instrument. If an issuer has a climate transition plan or similar strategy, the issuer's transition plan can be used to help identify appropriate KPIs or SPTs for a sustainability-linked instrument.

Most European bonds are issued under the Sustainability-Linked Bond Principles formulated by ICMA.[21]

Similar to Green / Social / Sustainability bonds, a sustainability-linked financing framework is typically prepared, and a second-party opinion is obtained from an external consultant confirming alignment with the ICMA SLBP which are both publicly available on a Company's website, which includes reference to:

- **Selection of Key Performance Indicators:** KPIs should be 'core' and 'material' to the issuer's business;[22]
- **Calibration of Sustainability Performance Targets:** SPTs should be ambitious, i.e. more than 'business as usual';[23]
- **Bond Characteristics:** non-compliance with the SPT leads to a structural change in the bond (e.g. coupon step-up, redemption premium);
- **Reporting:** any details regarding the issuer's ongoing KPI performance as well as any verification/monitoring of the SPT; and
- **Verification:** post-issuance annual assessment of KPI performance against the SPT.

Parties should consider the following and there is enhanced market scrutiny on:

- Selection and calibration of material KPIs (including scopes, estimates and assumptions that are built into each) and suitably ambitious SPTs (particularly those that are compatible with a 1.5º warming scenario and/or Net Zero by 2050);
- Greenwashing/reputational concerns if SPTs or KPIs are of low ambition or poorly designed – for example, the FCA published a letter in June 2023 discussing weaknesses in the sustainability-linked loan market which could inhibit market growth.[24] ICMA published a controversy analysis of the sustainability-linked bond market in October 2023; the most common controversies associated with sustainability-linked bonds were unambitious targets, inadequate penalties or lack of transparency;[25]
- Disclosure of an SLB issuer's transition strategy in case of environmental related KPIs, e.g. by way of setting interim targets or compliance with Climate Transition Finance Handbook ("CTFH") formulated by ICMA (see also Chapter 12 (Transition Bonds));

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[21] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/.

[22] KPIs should be (i) relevant, core and material to the issuer's overall business, and of high strategic significance to the issuer's current and/or future operations; (ii) measurable or quantifiable on a consistent methodological basis;(iii) externally verifiable; and (iv) able to be benchmarked, i.e. as much as possible using an external reference or definitions to facilitate the assessment of the SPT's level of ambition.

[23] The SPTs should be ambitious, i.e. (i) represent a material improvement in the respective KPIs and be beyond a "Business as Usual" trajectory; (ii) where possible be compared to a benchmark or an external reference; (iii) be consistent with the issuers' overall strategic sustainability / ESG strategy; and (iv) be determined on a predefined timeline, set before (or concurrently with) the issuance of the bond.

[24] https://www.fca.org.uk/publication/correspondence/sll-letter-june-2023.pdf

[25] https://www.icmagroup.org/assets/documents/Sustainable-finance/Market-integrity-and-greenwashing-risks-in-sustainable-finance-October-2023.pdf

- Meaningfulness of the change in the bond characteristics, i.e. the level of the financial penalty; and
- Appropriate disclosure of any “recalculation policy” in the offering documentation.

10. Transition Bonds [26]

Transition bonds are currently primarily seen in Japan, after it implemented its transition finance framework[27], and in the utilities sector (e.g. companies with exposure to oil and coal). Outside of these limited contexts, there are not currently a significant market for instruments labelled as "transition bond(s)".[28] However, there is renewed emphasis on building transition strategy disclosure into every green bond and SLB, particularly if an issuer has published a transition plan.

General

Transition bonds are intended for industries with high greenhouse gas (GHG) emissions, which may be referred to as "hard-to-abate" industries, in order to incentivize those industries to become more sustainable and to mobilize the necessary capital for an orderly, real economy transition to net zero. Transition finance has been defined by GFANZ as: Investment, financing, insurance, and related products and services that are necessary to support an orderly, real economy transition to net zero as described by the four key financing strategies that finance or enable 1) entities and activities that develop and scale climate solutions; 2) entities that are already aligned to a 1.5 degrees C pathway; 3) entities committed to transitioning in line with 1.5 degrees C-aligned pathways; or 4) the accelerated managed phaseout of high-emitting physical assets.[29]

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 predefined 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.

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[26] The transition bond issuance volume still remains at a low level. Therefore, it is presently not possible to make a meaningful comment on market practice and standards as the market is yet to fully develop.

[27] https://capitalmonitor.ai/sector/energy-and-utilities/why-japan-embraces-transition-bonds/.

[28] See the findings of the UK Transition Finance Market Review for a more in-depth discussion. https://www.cityoflondon.gov.uk/supporting-businesses/economic-research/research-publications/scaling-transition-finance See also ICMA's February 2024 report Transition Finance in the Debt Capital Market. https://www.icmagroup.org/assets/Transition-Finance-in-the-Debt-Capital-Market-paper-ICMA-14022024.pdf

[29] Recommendations-and-Guidance-on-Financial-Institution-Net-zero-Transition-Plans-November-2022.pdf

Annex A High Yield ESG Due Diligence Questionnaire

Introduction

This questionnaire[30] is intended to provide a suggested framework for market participants' ESG due diligence with respect to high yield and leveraged finance transactions. However, the scope of the questionnaire is not limited to such areas, and the underlying guidance should be helpful in any capital markets transaction.

The questionnaire is not meant to be mandatory or comprehensive, nor to cover all ESG considerations. In addition, we note that there is currently no one generally accepted standard or guidance (legal, regulatory or otherwise) related to ESG and the field is evolving. As such, market participants should closely follow and implement any regulatory developments to ensure that all operations comply with relevant legislation, and adjust the questions and relevant references in this questionnaire accordingly.

We further note that the below 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. As such, this questionnaire 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 also 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 may not be relevant for certain transactions.

How to use this questionnaire:

- *[General ESG questions]* Part 1 is intended to cover general ESG compliance-related diligence questions. This can be used as a standalone section or supplemented, as applicable, by questions from Parts 2-4 and/or Part 5.
- *[Detailed ESG questions by topic]* Parts 2-4 are intended to provide additional detailed questions per topic. If required by parties, these questions can be used as a supplement to Part 1 and/or Part 5.
- *[Offering-related ESG questions]* Part 5 is intended to provide themed samples of questions which can be used in connection with an offering of green "use-of-proceeds" bonds ("**UoP Bonds**") or offering of sustainability linked bonds ("**SLBs**"). Part 5 may also be used for any other bond offerings that are not UoP Bonds or SLBs, but that nevertheless incorporate relevant ESG-related issues into disclosure and other processes.

1. General ESG compliance-related diligence questions

1. What environmental, social and governance ("**ESG**") concerns and opportunities has the company[31] identified in relation to its operations and supply chain?
2. Please describe any ESG policies which the company has in place currently and any ESG-related business contracts and/or third party reports, including details of how the company's ESG-related plans and strategy are covered in the company's business plans.
3. Please provide details about the company's ESG organizational structure (e.g., the size of the team, responsibilities, reporting lines and board level involvement with environmental and social issues).
4. Is ESG a factor in management's, including CEO and CFO, compensation and performance evaluation (including linkage, if any, to ESG-related key performance indicators ("**KPIs**"))?
5. Please give a brief overview of the regulatory framework, including environmental, sustainable or social legislation, in which the company operates. Please provide information on the major ESG regulatory risks

30 Nothing in this questionnaire constitutes legal advice, nor should this questionnaire be considered a summary of all issues to consider when undertaking ESG due diligence. Market participants conducting such due diligence should consult with their legal counsel as appropriate.

31 In this questionnaire, "company" refers to a holding company, its restricted subsidiaries and/or guarantors as the case may be. Questions may also be extended to unrestricted subsidiaries, where appropriate.

arising from existing and potential new legislation and regulations affecting the current and future business model of the company.

6. Has the company had any material complaints, claims, litigation or enforcement actions related to ESG issues over the time period covered by the due diligence exercise? Please also detail any current, threatened or pending claims, litigation or enforcement actions related to ESG. This could be from employees or other key stakeholders such as customers, suppliers or local communities.

7. Has the company obtained, or is it in the process of obtaining, an ESG rating or, if not, had any other discussions or correspondence with any ESG rating agency? If so, please provide details. Please discuss the main points or concerns raised by such agencies.

8. Is there anything related to ESG initiatives, commitments and auditing practices that we did not ask about that we should know or that might be considered to be material to a prospective investor in the company?

2. Environment

1. Does the company have an environmental policy which sets out commitments and targets to improve the company's environmental footprint? If so, please provide details of the policy, with particular focus on commitments and targets in relation to waste, water, energy, carbon and/or greenhouse gas emissions. Please also comment on the company's progress in achieving such targets.

2. Has the company performed an environmental or climate change risk and adverse impact and opportunity assessment? If yes, please comment on the relevant key risks/opportunities, control measures, improvements and corrective action plans put in place in response to any adverse impacts identified that cannot immediately be brought to an end and whether third parties are engaged for verification.

3. Does the company currently have a net zero or low-carbon transition plan in place, or have any intention to put such a plan in place? If so, is it science aligned[32] or does it include the Science Based Targets initiative[33] and have they been verified or assured? Is such a plan required in the company's jurisdiction of incorporation or operations or has such jurisdiction published any recommended or required transition pathways for the company's industry? If the company does have such a plan, how much capital expenditure/budget has been allocated to its implementation?

4. Is the company fully compliant with all relevant environmental legislation and regulations? In the time period covered by the due diligence exercise, has the company been reviewed, sanctioned, or fined by any regulatory body and/or subject to investigation, litigation or legal proceedings (whether outstanding or closed), claims, complaints or allegations regarding the company's environmental impact? If yes, please provide details.

5. Does the company assess and monitor its carbon and/or other greenhouse gas emissions? If yes, please elaborate on how the data is collected. Does the company report its carbon and/or other greenhouse gas emissions? Describe, if applicable, the use of independent verification, benchmarking procedures, (interim) climate transition goals and/or mitigation hierarchies, including versus peers and/or industry standards. If applicable, please also provide the result of the company's latest analyses and its progress in achieving any (interim) goals.

6. Please provide the company's scope 1, 2 and 3 greenhouse gas emissions for the last 3 years if known, and explain how they are calculated, assured and reported. To the extent that the company has decided not to calculate its scope 1, 2 or 3 greenhouse gas emissions or has determined that its scope 1, 2 or 3 greenhouse gas emissions are not material for disclosure purposes, describe on what basis such decision or determination has been made.

7. Does the company include any environmental obligations in its supply chain or contracts such as emissions-measuring protocols? If so, please provide details. Is any support provided or are business incentives offered by the company to entities in its supply chain to meet such obligations?

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[32] A plan is considered 'science-aligned' if it is in line with the latest climate science to meet the goals of the Paris Agreement (limiting global warming to below 2 degrees Celsius above pre-industrial levels and pursuing efforts to limit global warming to 1.5 degrees Celsius).

[33] The "Science Based Targets initiative" means the partnership between CDP, the United Nations Global Compact, World Resources Institute and the World Wide Fund for Nature; available at https://sciencebasedtargets.org/

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

9. Please provide details of key waste streams generated and how these are managed and disposed of.

10. 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?

11. Does the company provide environmental training or other instruction for its employees, including its subsidiaries' and its supply chains' employees? If so, please provide details.

12. Describe any financial statement line items which include climate-change related accounting metrics. Describe any internal controls over financial reporting created to support climate change accounting.

3. Social

1. Does the company and the entities in its supply chain have formal Health and Safety, Anti-Discrimination, Diversity, Data Privacy, and Human Rights[34] policies in place? Please provide details of such policies, including how often any workplace risk assessments are reviewed/updated within the company's supply chain. Does the company provide training to all employees on these policies?

2. Who in the company is responsible for overseeing data privacy and security? Please provide an overview of the company's data privacy and data security policies, including how often they are reviewed and whether they are reviewed by an external body. Does the company provide training to all employees on this topic? Has the company had any recent breaches of customer data?

3. Does the company have formal supply chain and supply chain standard requirements in place? If so, please provide details. Is any support provided or are business incentives offered by the company to entities in its supply chain, with a view to bringing them up to standard?

4. 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.

5. Is the company fully compliant with all relevant social legislation and regulations? In the time period covered by the due diligence exercise, has the company been reviewed, sanctioned, or fined by any regulatory body and/or subject to investigation, litigation or legal proceedings (whether outstanding or closed), claims, complaints or allegations regarding the company's social impact? If yes, please provide details.

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

7. If relevant, please outline any policy and procedures covering product safety (or any other social, health or other impact that the company's product or service may have on its customers or the general public).

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

9. 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?

10. Are employees represented on the company's Board of Directors, governance and other committees? If so, please provide details. If not, are employees otherwise able to interact with the Board and committees of the company?

11. Are workers permitted to join a union or otherwise engage in collective bargaining? If so, how many employees are currently represented by a union or subject to a collective bargaining agreement? Is the company's

[34] Consider whether it is appropriate to extend the enquiries to expressly cover slavery, human trafficking, servitude, forced labor and child labor issues. What is appropriate will vary depending on an assessment of whether there are substantive risk issues in this area based on the relevant facts.

relationship with labour unions, and its workforce more generally, positive? Please provide details of any material labour disputes during the time period covered by the due diligence exercise.

4. Governance

1. Please outline any specific ESG budget or ESG training programs in place at the company, or provided by the company to any entities within its supply chain.

2. Does the company currently engage in any ESG reporting, either as a part of or separate from its periodic reporting to investors? Is the company subject to mandatory disclosure requirements, such as the Task Force on Climate-Related Disclosures (the "**TCFD**")? Please provide a copy of any sustainability report, TCFD report, whether mandatory or voluntary, or similar public statements or commitments.

3. Does the company have formal supply chain governance standards in place? If so, please provide details. Is any support provided or are business incentives offered by the company to entities in its supply chain with respect to such standards?

4. Please provide the composition of the Board of Directors by total number of directors, number of independent directors, number of women and number of minorities. Are anti-discrimination and diversity considerations taken into account when determining the composition of the company's Board of Directors?

5. What percentage of the current Board of Directors have been on the Board of Directors for at least three years?

6. Does the company convene a shareholder meeting at least annually? Do the shareholders vote on the composition of the Board of Directors? What is the term of each Board member's service contract?

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

8. Is a member or committee of the Board of Directors assigned responsibility for ESG, sustainability and/or Corporate Social Responsibility matters within the company? If so, what is their qualification? Please provide details of the committee's responsibilities, including how often it meets. How are ESG-related matters brought to the Board's attention? Who oversees ESG monitoring/planning?

9. Please provide details of the company policies regarding anti-bribery and anti-corruption, including any employee training or education.

10. Is the company fully compliant with all relevant corporate governance and/or ethics-related legislation and regulations (including related to anti-bribery, fraud, corruption, unfair labour practices, human rights abuses, and other malpractices)? In the time period covered by the due diligence exercise, has the company been reviewed, sanctioned, or fined by any regulatory body and/or subject to litigation or legal proceedings (whether outstanding or closed), claims, complaints or allegations related to corporate governance? If yes, please provide details.

11. Does the company have an audit committee? If so, please provide details, including composition and policies.

12. 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 with its 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?

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

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

15. Does the company respond to any industry ESG questionnaires or supply chain questionnaires (such as, for example, Ecovadis or the Carbon Disclosure Project)? If so, please provide details, including responses and scores, where appropriate.

5. Offering-related questions

Framework

1. Is the company's framework (the "**Framework**") aligned with the [ICMA Green Bond Principles]/[ICMA Sustainability-Linked Bond Principles]/[EU Taxonomy]/[other] (the "**Guidance**")? If so, please provide details. If not, please explain the rationale for not following the Guidance and please confirm whether any comparative audits / assessments / gap analysis with the Guidance have been undertaken.

2. Is the company's Framework final? If not, please confirm the expected timetable for finalizing the Framework.

3. How often and in what manner will the Framework be updated?

*Key Performance Indicators/Sustainability Performance Targets [**mainly SLB offerings**]*

4. Please confirm that the KPIs and/or the Sustainability Performance Targets ("**SPTs**") described in the description of the notes section of the draft offering memorandum (the "**DoN**") reflect accurately and are consistent with the baseline, indicators and sustainability performance targets described in the Framework.

5. Please explain how the KPIs and/or SPTs are (re-)calculated and how they are of strategic significance to the company's current and future operations. To what extent will the SPTs require the company to go above and beyond its current ESG trajectory?

6. Please describe briefly how the company expects to achieve the KPIs and/or SPTs based on current corporate strategy and planning.

7. As at the date hereof, is the company aware of any amendment to, or change in, any applicable laws, regulations, rules or guidelines, or any change in the business or structure of the group, that may have a material impact on the KPIs and/or SPTs specified in the DoN?

8. Are the KPIs and/or SPTs reflected in any incentive arrangements or otherwise in assessment of divisional performance?

*Eligible Projects [**mainly UoP Bond offering**]*

9. Please discuss the eligibility criteria for the projects financed or refinanced to be deemed 'green' projects. Who determines the eligibility criteria and who will decide if the eligibility criteria is amended?

10. Is the eligibility criteria aligned with any Guidance? Please provide details.

11. How will the company monitor that the projects financed or refinanced are eligible green projects? What will happen if a project no longer meets the eligibility criteria of the Framework? Please discuss the process in case of any controversy in respect of a particular project.

12. Is the company aware of any countervailing risks that may result in the projects that have been designated as eligible green projects causing environmental harm or otherwise being deemed inconsistent with ESG principles?

*Monitoring and management of proceeds [**mainly UoP Bond offering**]*

13. What is the proposed use of proceeds from the offering? Please distinguish between the application of the actual cash proceeds as compared to any "allocation" of the proceeds for the purposes of compliance with the Framework.

14. Will the proceeds from the issuance be used for new or existing projects? What percentage of the use of proceeds does the company estimate will be used to finance new projects and what percentage to refinance existing projects? With respect to refinancing, what will be the permitted look-back period, and how was this determined?

15. By when does the company expect to allocate all the bond proceeds to eligible projects?

16. Please outline how the net proceeds of issuances will be held. Will the net proceeds be earmarked for allocation and/or legally segregated? Does the company anticipate any issues with the approach taken?

17. Please explain how unallocated proceeds will be dealt with. Are there any short-term instruments the company proposes to use until the bond proceeds are fully deployed?

18. Are there any exclusions to the use of proceeds?

Verification and Second Opinion Provider

19. Please provide details of the entity conducting the external review process of the Framework (the second opinion provider, or "**SOP**"), and their expertise and independence.

20. Please explain whether any issues were raised by the SOP as part of their external review of the Framework. Has the SOP expressed any specific comments or criticism on the Framework which have not been taken into account?

21. When will the SOP's opinion be issued? How often will it be updated going forward?

22. Will the Framework and the SOP's opinion be published on the company's website prior to launch of any bond offering?

23. *[**mainly for SLB offerings**]* Please confirm that an SOP has assessed the materiality of the KPIs and the ambition of the SPTs. Has the SOP expressed any specific comments or criticism on the KPIs and/or SPTs which have not been taken into account in the Framework? If so, please explain why.

Reporting

24. *[**mainly UoP Bond offering**]* Please explain how the company will report on the use of proceeds after the closing date of the offering.

25. *[**mainly UoP Bond offering**]* Please clarify how frequently, following the closing of the offering, the company will report and whether it will report until proceeds are fully allocated or for the lifetime of the bond. Please also provide details of where the post-issue reporting will be published.

26. Will the company provide its impact reporting methodology?

27. Please discuss whether the company will appoint an SOP to produce a verification report [on the allocation of proceeds](in the UoP Bond context)[on the performance of KPIs](*in the SLB context*). If yes, which entity(ies) are likely to be appointed and when? How frequently will they report and for how long?

28. Please describe how the SOP will be elected and any potential conflict of interest that may arise with the expected independent verifier or assurance provider.

29. Please clarify how the company intends to manage the administrative costs of issuing and reporting related to the bonds.

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