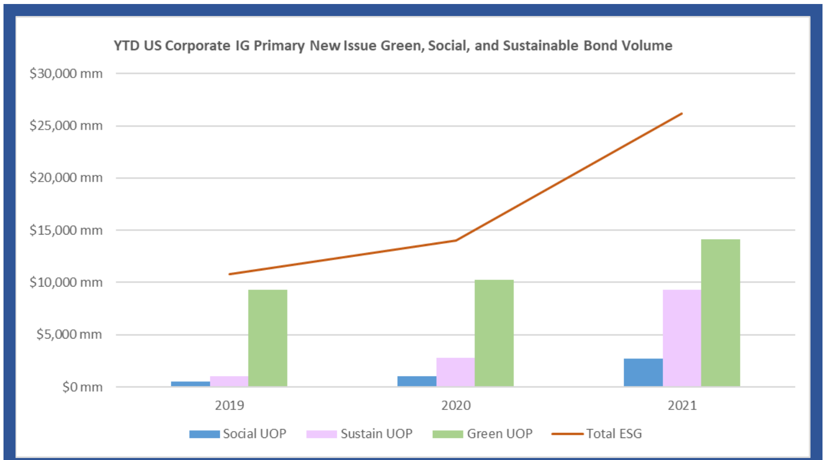
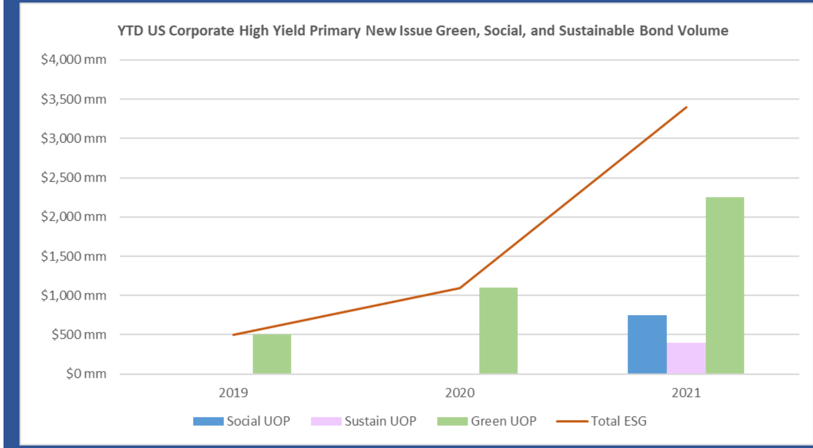
June 2021

There is now a concerted effort by financial regulators around the globe to begin considering rules and guidance as it relates to ESG investment products and marketing. All in all, over 80% of global assets under management could be subject to some sort of climate and social disclosure in the coming years. In Europe, this has already been the case since March with the start/launch of the EUSFDR Level 1 requirements.

This month's ESG report acts as a quick guide to the developing regulatory disclosure efforts that are occurring globally in response to interest by investors in sustainability and ESG themed investment opportunities (and their impact). Here we highlight some of the key developments as it relates to guidance on ESG disclosure and taxonomies for ESG investments as well as the ascendance of the social component and geopolitical considerations.



***Investment Grade**: June was a strong month for green and sustainable related themed bond issuance. AEE came to market twice this month with two green bonds (Academy served on Union Electrics' long 10YR), along with Nextera, ConEd, and Sothern California Edison, which printed a 2 part-sustainability bond (Academy also served as co-manager). Hewlett Packard also printed an $1bn inaugural sustainability bond (Academy co-managed). Note: Academy served as co-manager on Salesforce's $1bn Sustainability Bond offering June 29th.*



***High Yield**: 2021 continues to be a big year for high yield ESG themed issuance. OneMain Financial printed the first social bond for high yield issuers. OMF printed a $750mm social bond in line with its Social Bond Framework (Academy co-managed).*

United States:

Should the SEC begin to require ESG disclosure, it would have noticeable impacts. Financial market participants (FMPs) would have to bolster their resources with increased data analytics and reporting capacity, as well as the human capital to contend with the growth in ESG information, analysis, and disclosure documents for investors.

As it relates to funds, the SEC already commented on ESG in April with its Risk Alert to investors and earlier this year when it began its request for public input on climate change disclosure, which appears to be its first foray into the issuer side. Recent reporting, however, indicates challenges ahead as there is some internal debate at the SEC as to how to best apply these disclosures (i.e. on a material basis or not). The US House Subcommittee on Consumer Protection and Financial Institutions (Committee on Financial Services) are also holding hearings on proposed bills related to climate and financial risk.

In addition to these recent developments, the US SEC was named as co-lead in a Technical Expert Group with the Central Bank of Singapore by IOSCO to review a prototype climate related disclosure framework which will help decide whether IOSCO endorses the IFRS SSB as the global standard setter for sustainability related corporate reporting. The US is also a lead in the G20's Sustainable Finance Study Group. Participation in these groups is critical as it helps show the world that the US is involved, and more importantly, provides the United States with the opportunity to help set the table in how sustainability is financed in the years to come.

European Union:

The EU currently has some of the most developed ESG-related disclosure regulations and taxonomy in place. In March of this year, the EU's SFDR came into effect. At its core, it aims to prevent "greenwashing" and is a part of the broader EU Action Plan to help reorient capital flows towards sustainable investments as well as to direct mainstream sustainability into risk management (in addition to fostering transparency). The SFDR is a phased process and requires financial market participants to disclose sustainability impacts as it relates to their organizations and to their products. Transparency is a common theme as the SFDR aims to make sustainability related risks more readily available by requiring FMPs to furnish the Principle Adverse Impacts (PAIs) of their products and/or strategies.

Along with the SFDR is the EU's Green Instrument Taxonomy and Green Bond Standards, which like the ICMA's principles, provide guidance on the process surrounding the use of proceeds, project selection and evaluation, and fund management/reporting of ESG bonds. The EU has also been active in providing guidance on ESG investments. It recently just stated that ESG linked bonds should be excluded from capital buffers. Lastly, in addition to climate related disclosure, there is now discussion to include social metrics as well!

China:

While a lot remains to be determined, China is no doubt looking to engage and make itself a leader in the green arena. To do this, it needs to position itself as a "green" leader, which it is doing. Earlier this year, the People's Bank of China announced it is looking to partner with the EU to develop/help harmonize green investment standards and is also a co-chair on the G-20 Sustainable Finance Study Group.

Additionally, the PBOC Governor announced plans this month to set up a mandatory climate disclosure system and incorporate climate factors into financial stress tests. It's likely that China's strategy will be to under promise and over deliver on climate. This means that they will initially commit to lower standards, and when they exceed them, they will claim a phenomenal decarbonization effort. The social component will be a challenge, highlighted more recently by the labor and human rights issues in the Xinjiang region.

Japan:

Japan's FSA and Tokyo Stock Exchange are looking to create a framework to certify green and transition bonds. In many ways this is seen as a bid to attract investment into new technologies by providing guidelines for the key "green" industries that exist in Japan.

United Kingdom:

Separately from the EU, the UK has recently formed a technical expert group to develop a green taxonomy. There have been calls by UK pension funds for more social risk impact monitoring as well as natural capital standards (biodiversity) and ESG fund guidelines.

What does all this mean?

- *Financial market participants including asset managers, issuers, ratings entities, and the like will need to* ***focus investment and hiring accordingly*** *as it relates to ESG. With the inclusion of climate/environmental information into the reporting ecosystem (and quite possibly social metrics), more support will be needed to perform analysis and review.*
- ***Patchwork regulation*** *may create uneven playing fields or areas of enhanced opportunity depending on how a particular nation/region defines "green" or "social".*
- ***Geo-ESG and optics of global leadership:***
    - *Given that climate-change is a global concern, those who appear to be less engaged could be seen as laggards and reduce their global credibility. Engagement in sustainable finance discussions is also critical to defining the narrative for what a sustainable future looks like. Will the future be emerald green or pale green with some brown?*

- *Will this **pop the ESG bubble**? Like the recent crackdown on crypto in China, could regulatory actions result in a sell-off of ESG assets should investors find that their previously "green labeled" investment does not meet new requirements? This is a very real possibility.*

Further Resources

China & EU Green Investment Standards: https://www.ft.com/content/cddd464f-9a37-41a0-8f35-62d98fa0cca0

Quick Taxonomy Guide: https://www.climatebonds.net/files/reports/policy_taxonomy_briefing_conference.pdf