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TREASURY ESSENTIALS

Need to know for treasurers and their teams

DECEMBER 2023 / INTRODUCTION

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Welcome to the second edition of Treasury Essentials, our bi-annual publication which seeks to provide insight into topical legal issues of relevance to finance and treasury teams.

In this edition, we consider recent developments in the sustainable finance market – the recently adopted EU Green Bond Standard, ESMA's statement on sustainability disclosures in prospectuses and the publication of the ACT Borrower's Guide to Sustainability-Linked Loan Terms, which was launched over the summer.

Next we turn yet again to the long process of benchmark reform looking at developments beyond LIBOR this time. Our final item highlights some practical considerations for companies that make use of the audit exemption for qualifying subsidiaries under the Companies Act 2006.

I hope you enjoy this edition of Treasury Essentials. If you would like to explore any of the topics covered in more detail, or if you have any thoughts/feedback on this or previous editions of Treasury Essentials, please get in touch with your usual Slaughter and May contact or a member of the Treasury Essentials team. If any of your colleagues or contacts would like to receive this publication, please click here.

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THE EU GREEN BOND STANDARD – A WELCOME LEAP FORWARD FOR SUSTAINABLE FINANCE?

The long-awaited EU Green Bond Standard (**EU GBS**) has been published in the EU's Official Journal, entering into force on 20 December 2023 and applying 12 months thereafter.

First put forward as part of the European green deal investment plan, the standard forms part of the EU sustainable finance agenda which aims to leverage financial markets to support sustainable economic growth in Europe.

The EU GBS is a voluntary "gold standard" available to all green bond issuers (in and outside the EU) to help the financing of sustainable investments. It is the first attempt to regulate the green bond market which has so far operated on the basis of voluntary adoption of market-based standards such as the ICMA Green Bond Principles.

Compliance with the various requirements discussed in this article will allow issuers to use the label "European Green Bond" or "EU GB" in their green bond prospectus, provided that the prospectus is published pursuant to the EU Prospectus Regulation.

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EU GBS requirements

- **Taxonomy alignment.** The proceeds of the bond should be allocated to projects aligned with the EU Taxonomy (subject to a 15 per cent. flexibility pocket for when there is no technical screening criteria available at the time of issue and certain other activities).

- **Factsheet and reporting.** The EU GBS requires an issuer to publish a green bond "factsheet" prior to issue as well as comply with various pre- and post-issuance reporting requirements. External reviewers must provide a pre-issuance review of the factsheet as well as post-issuance review of the allocation reports.

- **External review.** All EU GBS bonds must be checked by an external reviewer to ensure compliance with the EU GBS and that funded projects are aligned with the EU Taxonomy.

- **Supervision of external reviewers.** The EU GBS sets out detailed rules for external reviewers including registration with, and supervision by, the European Securities and Markets Authority.

- **Voluntary disclosure requirements for the wider market.** The EU GBS also separately includes voluntary sustainability disclosure requirements for bonds "marketed as environmentally sustainable" (i.e. use of proceeds green bonds and sustainability-linked bonds with environmental key performance indicators and targets). These voluntary disclosure templates can be used by issuers even if they do not intend to use the EU GBS label and are intended to facilitate comparison of green bonds and sustainability-linked bonds for investors in the wider market as well as addressing greenwashing concerns. The full detail is expected to be set out by the Commission in due course.

Sanctions

Competent authorities have wide-ranging powers to ensure compliance including the ability to require publication of factsheets or reports in line with the EU GBS, impose fines, suspend trading and also make public the fact that the issuer is not in compliance with its obligations and require the issuer to publish that information on its website.

Future of the label

There is no doubt that the EU GBS is an ambitious standard and goes well beyond existing guidelines and labels in the green bond market. The co-legislators have made it clear that their intention is for the standard to be for high quality green bonds, integrating European green bonds within the wider remit of the EU sustainable finance regulatory framework and tackling greenwashing concerns.

This raises the question of which issuers are in a position to use the standard. At the outset at least, the EU GBS is likely to be used by EU institutions as well as "pure play" issuers. The key concern around take up of the label more broadly is linked to usability of the EU Taxonomy. Take up will further depend on investor demand, pricing advantages and if issuers can be otherwise incentivised to move away from an existing well-functioning market based on voluntary best practice.

For further details on the EU GBS, please see our full briefing here.

For more sustainability-related updates, please subscribe to our Sustainable Matters blog here. The blog covers a wide range of issues from climate change and the energy transition to social impact considerations and human rights, exploring what it means for corporates and the market.

SUSTAINABILITY DISCLOSURES IN PROSPECTUSES: THE EUROPEAN PERSPECTIVE

Reforms that would incorporate sustainability-related disclosures in prospectuses are being considered by the relevant authorities in the UK and Europe. The European Securities and Markets Authority (**ESMA**) published a public statement earlier this year on this issue. The statement sets out ESMA's expectations on how sustainability-related matters should be disclosed in prospectuses under the EU Prospectus Regulation. This article sets out some key takeaways for issuers of debt securities listed on an EU Regulated market.

Key takeaways

- For ESG labelled bonds, the disclosures ESMA expects to see include:
  - In relation to "use of proceeds" bonds, disclosures about the use and the management of the proceeds and information enabling investors to assess the sustainability ambition underpinning the process for project evaluation and selection. For example, prospectuses could include a summary of the material information from bond frameworks or reference the legislation used to determine the sustainability profile of the projects (if any).
  - For sustainability-linked bonds, ESMA expects information about the selected KPIs, the targets and information enabling investors to assess the consistency of the KPIs and the associated targets with the relevant sector-specific science-based targets (if any) and the issuer's sustainability strategy.
  - In both cases, ESMA recommends that issuers disclose in their prospectuses whether they intend to provide post-issuance information. This disclosure should include an indication of what information will be reported and where it can be obtained.
- In terms of sustainability disclosure more generally, ESMA reminds issuers that sustainability-related matters that are considered material should be disclosed in the prospectus in line with the general disclosure test (the "necessary information" test) under Article 6(1) of the EU Prospectus Regulation.
- In addition, ESMA states that:
  - Issuers should provide the basis for any statements concerning their sustainability profile or that of the securities they issue. For example, (i) by stating that the issuer or securities adhere to a specific market standard or label and including the material information about that standard or label in the prospectus, (ii) by referring to the underlying data and assumptions and/or (iii) by referring to any research or analysis by third parties.
  - Care should be taken over the inclusion of ESG risk factors that act as disclaimers "used to excuse non-performance of factors over which the issuer exercises control". For example, a risk factor stating that the proceeds may be invested contrary to the criteria for project selection should not be included as the issuer has control over project selection.
  - Sustainability disclosures should comply with the requirements set out in Article 37(1) of CRD 2019/980 (around comprehensibility of information in the prospectus). For example, there should be sufficient disclosure around technical terminology such as GHG emissions and GHG intensity.
- Finally, ESMA warns that issuers should not include sustainability-related disclosure in an advertisement (such as marketing materials) that is also not included in the prospectus.

Comment

Overall, ESMA's statement is reflective of the general direction of travel in terms of sustainability disclosure expectations. Many issuers are likely to be mindful of some, if not all, of these considerations when preparing their prospectus disclosure. The statement is aimed at National Competent Authorities (**NCAs**), however, ESMA has highlighted that it should be taken into account by issuers and their advisors when drawing up prospectuses. In practice, this will likely mean that NCAs will pay closer attention to sustainability disclosure as part of prospectus vetting.

What is clear is that regulators are increasingly paying closer attention to prospectus sustainability disclosures. The statement represents the first step in this area with sustainability disclosure requirements to be introduced as part of upcoming EU Listing Act reforms as well as voluntary sustainability disclosure requirements for bonds marketed as environmentally sustainable introduced as part of the EU Green Bond Standard. Similarly, in the UK the FCA has indicated that it will consider introducing requirements as part of upcoming reforms to the UK prospectus regime (discussed in further detail in our briefing here).

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ACT BORROWER'S GUIDE TO SUSTAINABILITY-LINKED LOAN TERMS

In August, we produced a new Borrower's Guide to Sustainability-Linked Loan Terms for the Association of Corporate Treasurers (**ACT**). The Guide aims to equip treasurers with an understanding of the parameters of a sustainability-linked loan (**SLL**) and how those characteristics are protected in facility documentation.

SLLs are the most popular sustainable loan product by some measure. The volume of SLLs now far surpasses the volume of "use of proceeds" loans.

The popularity of SLLs lies in their breadth of application – they have much wider reach than use of proceeds loans. Green and social loans are only available to borrowers requiring funding for specific green and/or social projects. SLLs, on the other hand, carry no restriction on the use of the proceeds and are therefore available to all borrowers seeking to amplify their sustainability strategy by embedding it in their financing terms.

The rise in SLL volumes has brought with it increased focus on the structure and terms of SLLs, in particular, whether they are sufficiently robust to withstand accusations of greenwashing. SLL terms have tightened and become more sophisticated over time (particularly contractual protections for lenders), but there is still quite wide variation both in form and content. Although SLLs remain unregulated, concerns about whether best practices are being upheld in all cases has also recently attracted regulatory attention, with the FCA raising various concerns following its review of the SLL market earlier this year.

The Loan Market Association's (**LMA**) February 2023 updates to its Sustainability-Linked Loan Principles (**SLLP**), voluntary recommended guidelines published jointly by the LMA and its sister trade associations which specify the key features of an SLL, were heavily focused on protecting the integrity of the SLL product (discussed in further detail in our briefing here).

The SLLP, being high level principles, do not however address how their key features should be fleshed out and reflected in loan documentation.

The LMA's draft provisions for sustainability-linked loans (the **Draft Provisions**), published in May 2023 and designed to align with the updated SLLP, provide a framework for a more consistent approach to the documentation of SLLs (discussed in further detail in our briefing here).

While the Draft Provisions are now regularly used as a reference point on transactions (including refinancings), they are, and indeed are intended to be, just that – a reference point requiring a fair amount of case-specific customisation and negotiation.

Against this backdrop, our Borrower's Guide to Sustainability-Linked Loan Terms aims to equip borrowers with an in-depth understanding of key SLL documentation terms, how they are evolving and some of the discussion points to anticipate. The Guide includes an overview of the key features of the SLLP followed by a clause-by-clause commentary on key SLL documentation terms, by reference to the Draft Provisions. It builds on the introductory commentary on SLLs in our ACT Borrower's Guide to the LMA's Investment Grade Agreements published in November 2022.

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IBOR TRANSITION (CONTINUED) – NOTES FOR BORROWERS IN EURO AND CAN$

With the mammoth task of transitioning away from LIBOR coming to an end, the focus has turned to interest rate benchmark reform in non-LIBOR currency jurisdictions.

Borrowers in Canadian Dollars (**CAN$**) should be aware that in July 2023, the Canadian Alternative Reference Rate Working Group (CARR) announced a "no new CDOR or BA loan" milestone date of 1 November 2023, to facilitate a tapered transition for the CAN$ loan market ahead of CDOR's cessation after 28 June 2024. All new CAN$ loan agreements entered into since the beginning of November and from now on, should reference either a CORRA rate or CAN$ prime.

This development has prompted the Loan Market Association (**LMA**) to publish an updated schedule of reference rate terms for loans referencing the Canadian Overnight Repo Rate Average (**CORRA**) (the risk-free rate for CAN$). These updated terms provide the option of using either CORRA compounded in arrears or Term CORRA (which is a valid option for CAN$ loans).

The new LMA CORRA provisions are relevant to all CAN$ loans. Existing CAN$ facilities that reference CDOR and run beyond the end of June 2024 will need to be amended to reference alternative rates; new CAN$ loans should reference alternative rates from now on.

There is also news for borrowers in euro. There are no current plans to discontinue the publication of EURIBOR and the bulk of euro lending continues to reference EURIBOR (rather than the euro risk-free rate, €STR). However, the Working Group on Euro Risk-Free Rates (the **Euro Working Group**) is keen to ensure that contracts referencing EURIBOR contain robust fallbacks in the event that EURIBOR is discontinued or becomes non-representative at some time in the future.

As a result, the LMA has published updated €STR-based fallback provisions for loans referencing EURIBOR. Parties have the option of using either €STR compounded in arrears or Term €STR as the primary fallback.

The updated fallbacks for EURIBOR-referencing loans do not require parties to existing loans to re-open documentation to incorporate them; however, the updated fallbacks will be relevant to new EURIBOR facilities (or if the terms of existing facilities are being amended on a refinancing or for other reasons).

The new LMA drafting is useful and predominantly mechanical in nature, but is (of necessity) quite intricate and requires the parties to make a choice with regard to the use of the relevant compounded in arrears and/or term risk-free rates.

Click here for our recent briefing which summarises the background to these developments, the key features of the LMA's new provisions and some thoughts on the optional aspects from the borrower's perspective.

With the LIBOR transition process largely complete, attention has turned to non-LIBOR currencies and benchmarks. Different countries and currencies are progressing at different rates.

AUDIT EXEMPTION FOR QUALIFYING SUBSIDIARIES: SOME PRACTICAL CONSIDERATIONS

Section 479A of the Companies Act 2006 (**CA 2006**) permits a subsidiary to be exempted from the requirement to file audited individual accounts if its parent provides a wide-ranging statutory guarantee of all of the outstanding liabilities of the subsidiary (a **section 479 guarantee**).

There are long-lasting implications should a parent company issue a section 479 guarantee, some of which are discussed below. This is not intended to be an exhaustive list, but to highlight some issues that a parent company considering using the section 479 guarantee may wish to consider.

The exemption

Subject to certain exclusions, under section 479A CA 2006 a company is eligible for exemption from the audit of individual accounts, if that company's parent is established in the UK and:

- all members of the subsidiary agree to the exemption;
- the parent gives a guarantee of the subsidiary's outstanding liabilities; and
- the subsidiary is included in the consolidated accounts drawn up by the parent.

The parent company guarantee

This statutory guarantee (the section 479 guarantee) takes the form of a statement given by the parent (which is signed by the parent and the subsidiary) and filed with Companies House. No separate parent guarantee document is required nor any solvency declaration.

As noted above, the members of the subsidiary must agree to the exemption. There is no prescribed form for this (other than the agreement must show the subsidiary company's name and registered number in a prominent place on the document), but would likely take the form of a shareholder resolution.

The effect of the section 479 guarantee is wide-ranging. The parent company will guarantee all outstanding liabilities of the subsidiary that exist at the end of the financial year to which the guarantee relates. "Outstanding liabilities" for this purpose is construed broadly and is generally understood to include all contingent and prospective liabilities to which the subsidiary is subject.

The guarantee is enforceable against the parent by any person to whom the subsidiary company is liable in respect of those liabilities, so the parent potentially becomes liable to a wide range of third parties.

A key point to note is that once the statutory guarantee has been made, it cannot be revoked. The parent company's liability in respect of the subsidiary will only cease on satisfaction in full of the liabilities covered by the guarantee, irrespective of whether or not such liabilities extend beyond the end of the financial year in which the guarantee was granted. Even if the subsidiary returns to audited status in any subsequent year, this has no effect on the section 479 guarantee previously provided.

Practical considerations

Careful thought is therefore needed before entering into such a statutory guarantee which the directors of both corporate entities will need to work through. For example, subsidiary directors may wish to consider the implications for raising finance in the absence of audited accounts while the parent company directors will need to weigh up the risks and practical considerations associated with giving the section 479 guarantee and becoming liable for the subsidiary's ongoing liabilities.

Any financing arrangements applicable to both the parent and subsidiary should also be considered prior to the granting of the section 479 guarantee to ensure that, for example:

- the granting of the section 479 guarantee is not prohibited under the terms of the arrangements;
- the failure to provide financial statements of the subsidiary would not breach any ongoing financial information undertakings; and
- any other knock-on effects of the grant of such a guarantee are understood.

There may well be other commercial implications in granting a section 479 guarantee and whether the exemption will be suitable for a particular group will need to be carefully considered.

KEY CONTACTS

If you would like to discuss any of the above in more detail, please contact your relationship partner or email one of our Treasury Essentials team.

You can find previous editions of Treasury Essentials here.

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