

CADWALDER

ESG: Regulatory Reform on the Horizon?

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With ESG (Environmental, Social and Governance) funds on a dramatic incline, an incline expected to continue going forward, it seems inevitable that regulatory reform is on the horizon. Europe has been leading the charge in the incorporation of ESG considerations into its regulatory framework. As we look to gauge what type of regulatory reform might be around the corner for us here in the U.S., specifically in the realm of fund finance, it is useful to look at the regulatory developments in the EU.

Regulatory Reform in the EU

The most relevant EU regulation in this space is the Sustainable Finance Disclosure Regulation (SFDR), which came into effect in March of this year. The SFDR imposes mandatory ESG disclosure obligations on asset managers and other financial markets participants, and is a major milestone in the EU's efforts to ensure a systematic and transparent approach to sustainability within financial markets, thereby preventing greenwashing and ensuring comparability.

By way of background, the SFDR was introduced by the European Commission alongside the Low Carbon Benchmarks Regulation and the Taxonomy Regulation as part of a package of legislative measures stemming from the European Commission's Action Plan on Sustainable Finance.

According to its official wording, the SFDR "lays down harmonised rules for financial market participants and financial advisers on transparency with regard to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products."

The SFDR has imposed transparency and disclosure requirements on financial market participants and financial advisers such as banks, insurance companies, pension funds, and investment firms, at both entity and product level, aimed at protecting end investors by enabling them to make informed decisions about their investments. These market participants and advisers are now required to be transparent about:

- (i) their policies on the integration of sustainability risks in their investment decision-making and advisory processes;
- (ii) how they consider the adverse sustainability impacts of their investments (e.g., how the proceeds applied by borrowers have effects on ESG matters);
- (iii) the sustainability of their financial products;
- (iv) how environmental or social characteristics being promoted are met (e.g., if an index has been designated as a benchmark, information on how that index is consistent with those characteristics); and
- (v) where a financial product has sustainable investment as its objective and an index has been designated as a reference benchmark, information as to how the index is aligned with that objective and, if no index has been designated as a reference benchmark for such objective, an explanation as to how that objective is to be attained.

The disclosure requirements include:

- What firms must disclose and maintain on their websites;
- The information that must be provided to investors; and
- Periodic reporting to investors.

To comply with these obligations, relevant firms in the EU have had to make changes to their internal procedures and policies to comply with the new requirements, including in many cases investing in training staff in relation to the new obligations.

We understand that there has been some regulatory uncertainty regarding certain aspects of the SFDR – for example, with respect to the application of some obligations to entities established outside of the European Economic Area or

whether a financial product that includes ESG factors in its decision-making process falls within the scope of SFDR Article 8, which sets criteria for ESG funds. However, guidance is expected to be published in the future to elaborate on certain obligations under the SFDR.

Current Reform in the U.S.

While we await concrete regulatory reform here in the U.S. with respect to transparency and uniformity on ESG matters in the financial markets, there has been some reform by way of published guidance in the U.S. that is relevant to fund finance.

In 2019, the Loan Syndications and Trading Association (LSTA), the Loan Market Association (LMA) and the Asia Pacific Loan Market Association (APLMA) published the Sustainability Linked Loan Principles (SLLP), which were most recently updated in July of this year, and also published the Green Loan Principles, which were most recently updated in February of this year. The goal of this published guidance is to promote the development and preserve the integrity of the sustainability linked loan and green loan product by providing guidelines that capture the fundamental characteristics of these loans, thereby promoting sustainable development more generally. It is interesting to note that in the May 2019 version of the SLLP, engaging an independent third party to verify the borrower's performance against each sustainability target was a recommendation; it is now a "necessary element" pursuant to the latest SLLP.

In addition, in May of this year, the LSTA published an ESG Diligence Questionnaire, which is designed to be completed by the borrower and included with other diligence materials and is aimed at providing greater transparency on the ESG initiatives of the borrower.

Perhaps the biggest driver of change in the market, however, stems from investors themselves. For example, in side letters, we have seen an increasing number of GPs acknowledging investors' commitment to various indexes such as the UN Principles for Responsible Investment (PRI), and we understand that investors have been asking GPs to put those considerations into practice while making investments. We also understand that many investors are insisting on bespoke ESG reporting requirements, which remains challenging since there is no widely adopted standard ESG reporting template.

Things do seem to be progressing at a higher level, too, albeit not as quickly as our European counterparts in this area. Firstly, it has been apparent from the beginning of the Biden administration that it would support various ESG initiatives. Interestingly, the SEC published a regulatory agenda in June 2021 that signaled the SEC Chair's focus on ESG matters, including disclosures regarding climate change, corporate board diversity, cybersecurity risk and human capital management. Finally, it is worth noting that the 26th UN Climate Change Conference is expected to take place in Scotland later this year (November 2021), with many participants gearing up to discuss the progress made since the 2015 Paris Agreement and what steps should be taken next. It is likely we will see some additional guidance stemming from the Conference. These all appear to be positive steps towards reform in this space.

Conclusion

While it remains to be seen in which direction the U.S. will go in terms of regulation, it is abundantly clear that reform is coming. In the absence of harmonized rules on sustainability-related disclosures to end investors, for example, diverging measures will continue to be adopted, different approaches in different financial services sectors will persist, and this will cause significant distortions of competition because of significant differences in disclosure standards.

While there appears to be natural teething issues with the SFDR, this piece of legislation will undoubtedly serve as precedent for other jurisdictions looking to achieve the common goal of ensuring a transparent approach to sustainability within financial markets.

The U.S. does have the advantage of being able to learn from other jurisdictions such as the EU before implementing regulation or additional guidance. One would hope, however, that regulation, if and when it does arrive in the U.S., acts as a way of clarifying and encouraging market participants in ESG matters, rather than as a deterrent.

See also our prior *Fund Finance Friday* articles that are relevant in this context:

[**ESG Loans – The Next Big Wave in Fund Finance**](#), where we review the what, why and how questions related to sustainability-linked loans; and

[Top 10 Items to Consider When Structuring Your ESG Facility](#), where we address the credit facility terms that are most relevant in the ESG facility context.

[The ABCs of ESG](#), where we review the fundamentals of ESG.

'Fund Finance Friday: Industry Conversations' — Alternative Credit with Andie Goh and Peter Keane

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FUND FINANCE FRIDAY
INDUSTRY CONVERSATIONS



Samantha
Hutchinson



Andie
Goh

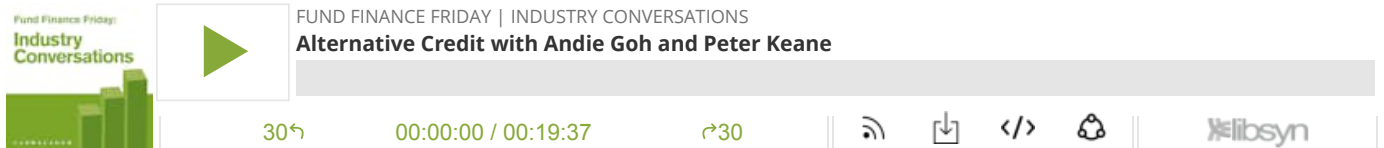


Peter
Keane



In this week's *FFF: Industry Conversations*, Cadwalader partner Samantha Hutchinson sits down with Ares Credit Group's Andie Goh and Peter Keane to discuss how fund finance fits into the alternative credit space, activity in the market, and more.

Subscribe on [Apple Podcasts](#), [Google Podcasts](#) or [Spotify](#) to never miss an episode.



LSTA Issues New Credit Agreement Guidance

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By **Leah Edelboim**
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Yesterday, the Loan Syndications and Trading Association (the “LSTA”) circulated a revised draft of its Form of Revolving Credit Facility to its members.

The LSTA first published its comprehensive Form of Revolving Credit Facility in 2017. Prior to that time, the LSTA had “Model Credit Agreement Provisions,” a library of standard provisions for a credit agreement, but it had not previously offered its members a full-form credit agreement.

The LSTA form credit agreement establishes a baseline for where the market is as it relates to the rights and obligations of the parties to a financing transaction. Parties can often agree that they will go with the “LSTA standard” for portions of their credit agreement.

As to the revised agreement, the changes cover several topics, but, significantly, there are updated provisions that pertain to the LIBOR transition and includes hardwired fallback language. This is important to many market players because, while some banks have developed their own language for the transition, many other banks and their counsel are relying heavily on the model language produced by the LSTA.

Other significant changes relate to the letter of credit-related provisions. Additional changes include updates to the ERISA and Bail-In provisions, as well as standard language pertaining to U.S. QFC Stay Rules.

Cadwalader finance partners Chris McDermott and Jeff Nagle served as external counsel to the LSTA on this project.

The final form is expected to be published in about a month.

Wes Misson on ESG Fund Finance in Private Equity Law Report Primer

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ESG-linked facilities sped from a concept with a handful of prototype deals in the wild 18 months ago to becoming an established and growing segment of the fund finance market today. Investor demand is the driving force, and sponsors are responding with ESG-oriented fund offerings. Value-aligned financing is a logical next step.

In the **first installment** of a two-part series, *Private Equity Law Report* traces the path of the ESG fund financing market from inception to the current framework for pricing and performance measurement, leaning on insights from Cadwalader's Wes Misson along with other market participants. The article is recommended reading for those who have been following the market from a distance and for anyone newly getting up to speed.

Fund Solutions Continued...Last Chance to Register

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Following the panel hosted by Samantha Hutchinson in July and due to popular demand, Women in Fund Finance is hosting a second panel discussion on alternative liquidity solutions. Next Tuesday, October 5, from 10-11 a.m. EDT, join Sam and industry experts as they discuss the latest trends and how private managers are using alternative liquidity to manage their portfolios. Registration is available [here](#).

Subscription Line Competition Among Lenders Leading to Greater Service Demands

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Private Funds CFO this week published an article titled “Sub lines: Where has the ‘white glove’ service gone?” focusing on panelists' remarks regarding the current level of service various market players are seeing from lenders and the need to “plan ahead,” according to the panel, when it comes to borrowers managing their subscription credit lines. The discussion took place on the second day of the *Private Equity International's* CFOs & COOs Fall Forum. To review the subscription-required article, [click here](#).

Next Wildgen Webinar: Security Agreement Structuring and Negotiation

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In the next installment of Wildgen's "Fund Finance" webinar series, to take place on October 14, Michael Mbayi will be joined by several industry leaders for an in-depth discussion concerning the structuring and the negotiation of security arrangements. To register, click [here](#).

New Fund Fanatics Episode

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Scott Aleali and Jeff Maier put out another episode of “Fund Fanatics” on LinkedIn this week, this time with special guest Drew Pearson, the NFL Hall of Famer and former Dallas Cowboy. To view this week’s episode, click [here](#).

Fund Finance Hiring

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Fund Finance Hiring

DBS's FIG team has experienced strong growth over the past two years and, as a result, is looking to hire a Credit Analyst/Deal Execution role in London. For more information on the role, please visit [here](#).