ALERT MEMORANDUM

ESMA Publishes Requirements on Sustainability Disclosure In Prospectuses

August 1, 2023

On July 11, 2023, the European Securities and Markets Authority (ESMA) issued a public statement detailing expected sustainability disclosure in prospectuses for both equity and non-equity securities, in light of requirements under the Prospectus Regulation[1] (the **Public Statement**)[2].

While the Public Statement is primarily addressed to national competent authorities in accordance with ESMA's role of general coordination and promotion of a coordinated Union response[3], it is also intended to be taken into account by issuers and their advisors.

In the absence of a legal framework, the guidance provided in the Public Statement and summarized in this alert memorandum provides useful insight on the expected sustainability disclosure in prospectuses for both equity and non-equity securities, pending adoption of legislative proposals, and notably the Listing Act[4] and the Regulation on European Green Bonds[5].

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors.

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[1] Regulation (EU) No. 2017/1129 of the European Parliament and of the Council of June 14, 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.
[2] https://www.esma.europa.eu/sites/default/files/2023-07/ESMA32-1399193447-441_Statement_on_sustainability_disclosure_in_prospectuses.pdf
[3] Article 31 of Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of November 24, 2010 establishing a European Supervisory Authority (European Securities and Markets Authority).
[4] Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) 2017/1129, (EU) No 596/2014 and (EU) No 600/2014 to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises, which envisage disclosures with respect to sustainability matters.
[5] Proposal for a Regulation of the European Parliament and of the Council on European green bonds dated July 2021 which is expected to include requirements for prospectuses, although it is not expected to give details of the sustainability-related disclosures that should be included in prospectuses drawn up under the Prospectus Regulation.

Scope of the Public Statement

The Public Statement intends to address sustainability disclosure in prospectuses for both equity and non-equity securities. This alert memorandum more specifically focuses on non-equity securities advertised as taking into account a specific ESG component or pursuing ESG objectives (**ESG Bonds**). More particularly, it relates to both (i) non-equity securities whose proceeds are applied to finance or refinance green and/or social project activities, such as green bonds, social bonds or sustainability bonds (**Use of Proceeds Bonds**) and (ii) non-equity securities for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability and/or ESG objectives (**Sustainability-Linked Bonds**).

General guidance

A guidance based on the Prospectus Regulation requirements

ESMA reminds issuers and their advisors that sustainability-related disclosure in prospectuses should comply with general disclosure requirements under the Prospectus Regulation.

In particular:

> "*a prospectus shall contain the <u>necessary</u> information which is <u>material</u> to an investor for making an informed assessment of: (a) the assets and liabilities, profits and losses, financial position, and prospects of the issuer and any guarantor; (b) the rights attaching to the securities; and (c) the reasons for the issuance and its impact on the issuer*"[6].

Hence, the type of sustainability information to satisfy this requirement will depend on the materiality of the information to an investor. This "materiality analysis" should be conducted by considering the circumstances of the issuance, the characteristics of the issuer and the type of securities issued.

As a consequence, even though the disclosure requirements under Commission Delegated Regulation 2019/980[7] do not explicitly refer to sustainability-related matters, such matters should be considered and assessed when drawing up prospectuses.

ESMA also points out that the Prospectus Regulation refers to sustainability-related disclosures as follows:

> "*environmental, social and governance circumstances can also constitute specific and material risks for the issuer and its securities and, in that case, should be disclosed*[8]".

General principles

ESMA indicates that disclosure on sustainability-related matters in prospectuses should take into account the three following points:

- **Basis for statements**: in order to comply with the requirement to provide objective information[9], including, notably, a presentation of a balanced view of both positive and negative aspects, issuers should provide the basis for any statements relating to their sustainability profile, or that of the relevant securities. This implies, notably, providing details on the specific market standard or label to which the issuer of the securities adheres and referring to the underlying data or assumptions and/or to any third party research or analysis;
- **Use of disclaimers**: sustainability-related disclaimers should not be used to excuse non-performance of factors over which the issuer exercises control, such as, for example, a disclaimer stating that the proceeds of the offering

[6] Article 6(1) of the Prospectus Regulation.

[7] Commission Delegated Regulation (EU) 2019/980 of March 14, 2019 supplementing Regulation (EU) No. 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No. 809/2004.

[8] Recital 54 of the Prospectus Regulation.

[9] Recital 27 of the Prospectus Regulation.

may be invested contrary to the criteria for project selection set out in a prospectus. ESMA notes, however, that disclaimers, including risk factors, may indicate that the sustainability expectations of the issuer may differ from those of an investor, or that the notion of sustainability may change according to scientific progress, relevant legislation or investor preferences;

— **Comprehensibility**: the sustainability disclosure should comply with the requirement for comprehensibility[10]. In particular, the components of mathematical formulas should be clearly defined and, where applicable, the product structure should be clearly described and any technical terminology relating to sustainability should be adequately defined.

Sustainability disclosure: ESMA expectations

Disclosure depending on the type of securities

— **Use of Proceeds Bonds**: ESMA expects disclosure 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. This could take the form of a summary of the material information from the 'green bond framework' of the issuer or a reference to the legislation (that will be) used by the issuer to determine the sustainability profile of the projects;

— **Sustainability-Linked Bonds**: ESMA expects information about the selected key performance indicator(s) (**KPIs**), the sustainability performance target(s) (**SPTs**) and information enabling investors to assess the consistency of the KPIs and its associated SPTs with the relevant sector-specific science-based targets (if any) and the issuer's sustainability strategy.

Risk factors

The risk factors should disclose risks that are material and specific to the securities.

— **For Use of Proceeds Bonds**, this includes (i) risks regarding the allocation and management of proceeds and (ii) risks concerning the viability and achievement of the sustainable project.

— **For Sustainability-Linked Bonds**, this includes (i) risks regarding KPIs and associated SPTs, including risks concerning potential conflicts of interest when such KPIs are selected and monitored and (ii) the impact of the issuer's overall firm-level sustainability performance on the securities.

Reasons for the offer and use of proceeds

— **Use of Proceeds Bonds**: the goal and characteristics of the relevant sustainable project and how the sustainable goal is expected to be achieved should be described, as well as any permissible terms and conditions for deviations to the minimum use of proceeds and the sustainable project. If the sustainable project is not identified at the time of the prospectus approval, issuers should disclose the criteria which will be used to determine how the proceeds are allocated for sustainable purposes.

— **Sustainability-Linked Bonds**: if the Sustainability-Linked Bonds are issued for general corporate purposes, the rationale for the issuance as well as its impact on the issuer should be disclosed in the prospectus.

Information regarding the securities

If advanced amortization may occur, issuers should disclose any impact which this may have on the sustainability performance of an investment.

In addition, **in respect of Sustainability-Linked Bonds only**, the impact on interest payments of the fulfilment or failure to fulfil SPTs should be clearly

[10] Article 37(1) of the Commission Delegated Regulation 2019/980.

disclosed in the prospectus, as well as the means by which interest payments are calculated. Reference should be made to the relevant KPIs and associated SPTs.

Additional information

If issuers indicate that any advice or assurances have been provided by advisors or third parties about the sustainability characteristics of (i) the securities in respect of Use of Proceeds Bonds or (ii) the selected KPIs in respect of Sustainability-Linked Bonds, the prospectus should contain disclosure concerning the scope of those assurances and by whom they were provided.

Post-issuance information

ESMA recommends that, whether the securities are Use of Proceeds Bonds or Sustainability-Linked Bonds, the issuers disclose 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 (by including, for example, the URL to the website where investors will be able to access the post-issuance information).

Consistency with advertisements

ESMA notes that the importance of sustainability-related disclosure in the advertisement for investors is an indicator of its materiality. As such, issuers should ensure that any sustainability-related disclosure which is included by an issuer in the advertisements is first included in their prospectuses (e.g., through a supplement in case of base prospectuses) if such disclosure is material. This also ensures the consistency of the information in the advertisement with the information in the prospectus[11].

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Although the Public Statement mainly refers to the Prospectus Regulation and does not add any additional disclosure requirements for issuers, this publication will serve issuers and their advisors as it provides useful insight on ESMA expectations on the inclusion of sustainability-related disclosure in prospectuses for equity and non-equity securities.

These guidelines should make it possible to unify the market practice as regards sustainability-related disclosure in prospectuses for equity and non-equity securities, but remains subject to evolution, notably, as noted by ESMA, due to the introduction of new products to the markets or expected changes in the legislation.

For banks contemplating to issue ESG Bonds, these guidelines should be read together with the European Banking Association (**EBA**) guidelines. An increasing number of banks are looking at green capital to finance their green portfolios, including capital instruments qualifying as own funds for prudential purposes. The EBA published, on July 21, 2023, a report including some guidance on prudential instruments issued with ESG features which, in particular, discuss how clauses used for ESG issuances and the eligibility criteria for prudential instruments interact, with the ultimate aim of identifying best practices or practices/clauses that should be avoided[12]. The EBA analysis is not meant to address potential compliance issues with ESG requirements themselves, but it is aimed at clarifying the extent to which some provisions included in ESG Bonds may raise regulatory concerns in the context of the eligibility criteria for prudential instruments.

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[11] Article 22(3) and (4) of the Prospectus Regulation.

[12] EBA report on the monitoring of Additional Tier 1 (AT1), Tier 2 and TLAC/MREL Eligible Liabilities Instruments of European Union (EU) Institutions – Update (EBA/REP/2023/23).