Post-issuance impact reporting for green and social bonds – 2020 and beyond

Post-issuance impact reporting is a complex and resource-intensive task for green and social bonds issuers that many investors expect issuers to undertake. This article highlights some of the key guidance points on impact reporting in the latest ICMA guidelines and the best practices recommended by other industry bodies.

Background

Post-issuance impact reporting for green and social bonds has been a topic of tremendous interest among issuers and investors in the past few years, spurred on not just by the increase in issuance volumes across industry sectors, geography and issuer type, but also by the heightened scrutiny that investors are placing on the actual environmental and social impact of their capital markets investments. In research conducted by the Climate Bond Initiative (the CBI), it was found that 79% of green bonds issued in or before November 2017 have some form of impact reporting in place and the number of bonds with associated reporting has grown steadily since 2010 (with an average annual growth rate of 139%), when the first still outstanding green bonds came to market[1].

With the current climate crisis and its deleterious impact on wildlife, natural habitats, infrastructure, livelihoods and communities globally – from widespread wildfires in Australia to long-term droughts in Thailand and extreme heatwaves in Europe, each occurrence more severe than before – it is imperative that financial sector market participants urgently mobilize capital to finance businesses that produce measurable positive environmental and/or social outcomes, and influence businesses that are not doing so to change their practices for a sustainable future. However, there remains a question as to how debt capital market participants can really gauge the type and extent of positive outcomes achieved unless they are identified, measured and reported in an accurate, objective and clear fashion. In 2019, several industry-driven voluntary guidelines and updates were released, aimed at demystifying pre-issuance and post-issuance impact reporting for issuers and providing investors with the benefit of report transparency, consistency and comparability by attempting to harmonize the substance and format of impact reports. This note highlights some of the key principles featured in the recently-published ICMA papers titled *'Handbook on Harmonized Framework for Impact Reporting'* and *'Working Towards a Harmonized Framework for Impact Reporting for Social Bonds'* (June 2019) (together, the **ICMA Papers**) and the *Nordic Public Sector Issuers Position Paper on Green Bonds Impact Reporting* (January 2019) (the **NPSI Paper)**.

Post-issuance impact reporting – best practices

Post-issuance reporting on *actual* impact outcomes is not mandatory under current editions of the ICMA Papers, the NPSI Paper and the Climate Bonds Standard which, instead, require issuers to report on *expected* outcomes in order to be considered compliant with the relevant standard or guideline. The ICMA Green Bond Principles and the Social Bond Principles expect issuers to report annually on, amongst other things, the *expected* impact of the projects selected and state that *"issuers with the ability to monitor achieved impacts are encouraged to include those in their regular reporting"*. The NPSI Paper, which complements the ICMA Green Bond Principles, recommends that issuers undertake impact reporting *"based on expected environmental impact (ex-ante) from the project [they] finance or co-finance. Issuers that have the ability to provide impact reporting based on actual (ex-post) impacts, are encouraged to do so"*, actual impact reporting being an ambition[2] rather than a requirement.

Below is a summary of, and commentary on, some common themes in the ICMA Papers and the NPSI Paper that issuers and investors alike should consider when preparing or reviewing impact reports. It should be read alongside the original publications to allow for a more comprehensive understanding of their intricacies.

1 *"Post Issuance Reporting In The Green Bond Market"*, Climate Bonds Initiative, March 2019 (the **CBI Report**)

2 "Reporting Principles – Expected impact, with actual impact as an ambition" – NPSI Paper, at page 14

The underlying project for the impact outcomes reported should be clearly identified. Where relevant and possible, the report should also include data on outcomes at a portfolio level.

- As the investors in one tranche of bonds may not necessarily have also invested in the issuer's other tranches of bonds, an impact report should, as far as possible, state the impact outcomes that are attributable – pro-rated, where applicable, to avoid overstating the outcomes – to the project funded[3] by the proceeds from the bond issuance. This would allow investors to track and evaluate the environmental and/or social impact of their investment in a particular tranche of bonds[4]. Although this could be challenging to achieve for repeat issuers with vast portfolios of projects (and potentially overwhelming for investors attempting to comprehend large volumes of methodologies and impact data), one-time and infrequent issuers should certainly strive to deliver impact reports with data that can be more precisely linked to a specific project.
- Where outcomes are aggregated at a portfolio or programme level (as an alternative to, rather than in addition to, project-level reporting), this should be clearly disclosed together with the reasons for doing so. For example, financial institutions with a green bond framework may find it difficult to provide meaningful impact reports at a project level because they do not own or manage the underlying projects. Additionally, the bond proceeds are often on-lent to a large and diverse base of borrowers across a range of industry sectors and locations that would render reporting at a project level considerably cost-inefficient and impractical. Indeed, the NPSI Paper recognizes this issue and recommends that "for green bond frameworks where no commitment is made to reporting on smaller projects, i.e. projects below a defined investment size, project-by-project reporting is not required". Some other reasons issuers commonly cite for impact reporting on an aggregated basis are: (i) there are confidentiality considerations that restrict the issuer's ability to provide detailed information on the project, (ii) the issuer's competitive advantage may be undermined if project data is disclosed, (iii) bond proceeds are allocated on a portfolio, not project, basis, and (iv) individual projects are small in scale and would yield more meaningful results if aggregated with those produced by associated projects[5].

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3 The ICMA Papers recommend basing impact reporting on amounts allocated to projects, whereas the NPSI suggests using disbursed amounts as a basis for calculations to be conservative enough.

4 *"For non-dynamic portfolios where allocation is complete, each outstanding green bond will finance a designated sub-portfolio of projects. In such cases, the impact report should clearly state the estimated impact of each sub-portfolio/bond. Reported impact data should preferably and if feasible also be aggregated for all outstanding green bonds, so that is possible to associate all bonds from the same issuer with one aggregated set of impact results. Using the aforementioned approaches should serve to meet reporting demands both from investors which prefer impact reporting data relevant to the specific bond that they have purchased as well as from investors who prefer an aggregated approach"* (Source: NPSI Paper, at page 17)

5 In such cases, the World Bank recommends that *"when confidentiality or practicality prevents an issuer from reporting at individual project level, the issuer can aggregate the projects by categories according to its eligibility framework or other meaningful way to aggregate results. If this approach is chosen, the issuer is encouraged to provide more qualitative information about the portfolio as a whole, and where feasible supply quantitative results measures"* (Source: "Green Bond Proceeds Management & Reporting", A World Bank Guide For Public Sector Issuers, 2018)

Metrics used in impact reports should be clearly defined and reflect generally-accepted market practice where available.

- With a view to achieving greater consistency in metrics used in impact reporting, the ICMA Papers and the NPSI Paper also set out recommendations for core indicators relating to selected project categories which are eligible under the ICMA Green Bond Principles and Social Bond Principles. To the extent appropriate, and to facilitate comparability, issuers should strive to adopt the recommended metrics in their reporting. Should they choose to use alternative metrics, the issuer should explain their reasons for doing so and demonstrate the relevance of the selected metrics to the social/environmental issue or outcome. However, even when comparing impact reports that present data using the same metrics, investors should remain cognisant of the fact that because assumptions and methodologies can vary significantly, a degree of caution must necessarily be applied when comparing the impact outcomes of projects or portfolios[6].
- Similarly, where anticipated data has been presented, issuers should also explain material deviations from their expected outcomes in their next (annual) report, as well as the anticipated effects of the underlying causes on the future performance of the project, and whether there are any mitigating measures in place. While reporting such information is not a requirement under the ICMA Papers or the NPSI Paper, the availability of such additional disclosure – in addition to information on the expected impact outcome for the next reporting period – would allow bondholders (and potential investors of future bond tranches and those in the secondary market) to calibrate their expectations and assess the performance of the project or portfolio at later stages. This could be of particular importance for long-term projects and useful for investors with narrower investment parameters.

The methodology used, and its assumptions and limitations, should be disclosed and explained clearly.

- The report should disclose in detail the methodology used and be transparent about the limitations and any assumptions built into it. Where there is no common method in the relevant industry for calculating a particular indicator used, the issuer may develop its own methodology to measure impact outcomes that are specific to its industry, project and/or geographical context. In this regard, the CBI recommends that as a matter of good reporting practice, context permitting, it can be beneficial for issuers to adopt an existing framework or work with experts to develop an individual methodology.
- To enhance the robustness and reliability of the data in impact reports, the ICMA Papers recommend that issuers make available any independent assessment from consultants, verification bodies and/or institutions with recognized expertise in the relevant subject matter. This should be of particular note for issuers who have chosen to modify established methodologies or have developed novel ones on their own to suit their specific circumstances.

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6 The NPSI Paper also states: *"While we strive to deliver reporting that is possible to compare and aggregate between issuers, we recognize the challenges related to different methodologies and metrics being used. Hence, we suggest caution to be exercised when such comparison or aggregation is undertaken."*

Hogan Lovells is proud to be a member of the ICMA Social Bond Principles Sub-Working Groups on Investor Survey and Impact Reporting for FY2019/2020.

The baselines and benchmarks used should be clearly defined and come from legitimate and independent sources.

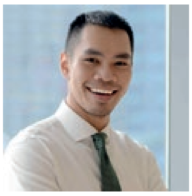
- Core indicators, although useful for understanding the impact of a project, can be misleading if they are presented without reference to relevant and reliable baselines and/or benchmarks. Contextual information, meaning baselines and benchmarks for the relevant geography (local, regional and national) and industry/project type, should be included as they provide an additional layer of granularity to the report and help investors to properly understand the extent to which outcomes have been achieved. For these reasons, the ICMA Papers[7] and the NPSI Paper emphasize that issuers should use baselines and be transparent about the sources of those baselines selected. In addition, the CBI recommends quantifying data in relation to an established benchmark or industry/company-specific baseline as one of the best practices for impact reporting[8].

Final thoughts

To help strengthen the integrity of the green and social bond market and to foster greater investor confidence in the authenticity of the financial product, issuers - regardless of the issue size, geography, project type and industry sector - should strive to provide investors with credible post-issuance impact reports to account for the environmental and/or social impact they promised at the issuance stage. Ultimately, the key principle that underlies several of the industry frameworks and guidelines is that of transparency. However, bearing in mind how time consuming and complex impact reporting can be, investors must necessarily tailor their expectations according to factors such as the size of the bond and how frequently the particular issuer accesses the capital markets.

Whether or not post-issuance impact reporting on actual outcomes will eventually be mandated under future editions of the ICMA Green and Social Bond Principles, the NPSI Paper or the CBI Standard remains to be seen. Given that development banks and other market leaders are keen to see the market grow even more rapidly – in terms of issue size and volume as well as issuer type across industries and geographies – to serve the funding demands of green, social and sustainability programmes across the globe, it would seem unlikely that additional reporting obligations will be imposed on issuers in the near future.

Contacts



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7 *"For comparability and transparency, it is highly recommended that issuers provide background on the methodology and assumptions used for the calculation of social impact indicators. Most notably, issuers are encouraged to explain if indicators represent incremental change between a baseline and a target (relative figure) or the total future figure without consideration of the baseline starting point (absolute figure)."* (Source: "Working Towards a Harmonized Framework for Impact Reporting for Social Bonds", ICMA, June 2019

8 In the March 2019 CBI Report, it was found that 79% of green bond issuers are measuring impact on an absolute basis, whereas only 3% are contextualising changes relative to a pre-determined baseline or benchmark, and 18% are disclosing some combination of the two.