

Environmental, social and governance considerations in sustainable finance decisions

By Daniel Buoniconti

Takeaways

- Sustainable finance means taking ESG into account when making investment decisions in the financial sector
- The sustainability criteria and related benefits and penalties vary by facility and borrower and are negotiated on a facility-by-facility basis
- Rendezvous clauses in facilities provide flexibility to change provisions as market standards evolve



Sustainable finance involves taking environmental, social and governance (ESG) considerations into account when making [investment decisions in the financial sector](#).

Environmental considerations capture a broad range of factors, including biodiversity, climate change, pollution mitigation, and more. Social considerations include issues of [inequality, inclusiveness, labor relations, investments in communities, consumer rights, and human rights](#). Governance factors address the [management, employee relations, and compensation practices of both public and private organizations](#).

Over time, sustainable finance can stimulate the flow of private investment into the transition to a climate-neutral, resource-efficient economy. Investment is up in businesses and projects that follow sustainable ESG practices, and demand is also up for finance professionals with expertise in this niche field. We foresee similar growth in the legal services field as borrowers and lenders rely on counsel to properly evaluate and effectively advise on relevant issues and existing standards in these areas.

Provisions addressing ESG and sustainability finance can vary widely across facilities as different lenders have developed their own template languages. The potential benefits and penalties of these sustainability mechanics vary by facility and borrower.

In our experience, however, some common features are usually present. A lender (or a group of lenders) typically acts as the sustainability coordinator. Facilities generally include an adjustment to the applicable margin, known as the sustainability margin adjustment. The sustainability margin adjustment is negotiated as a commercial term between the parties and can increase or decrease the applicable margin of a facility depending on the borrower's performance in connection with defined sustainability criteria during a certain period. Typically, the borrower will deliver a certificate from time to time, under which it vouches for its performance in accordance with the applicable sustainability criteria and the sustainability margin adjustment.



The sustainability criteria and related benefits and penalties vary by facility and borrower, and these are negotiated on a facility-by-facility basis. As we continue to prepare additional facilities containing these legal components, more frequent market standards and applications will emerge. The evolving market standards have inspired parties to include a rendezvous clause in facilities, which provides flexibility to change facility provisions as market standards evolve. A rendezvous clause enables the parties to operate in good faith to address and accommodate potential substantive changes to the methodologies or standards in place at the time of the initial agreement.

This burgeoning area within the financial markets will continue to expand in importance and capacity in 2022 and beyond. Reed Smith will continue to work at the forefront of this area by negotiating market-leading transactions featuring these standards and provisions.

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Dan is a partner in the firm's Energy and Natural Resources Group in Chicago. He concentrates his practice on trade finance, structured finance, receivables finance, inventory finance, and commercial lending. Dan advises clients in connection with international and domestic securitizations, receivables discounting facilities, revolving and term credit facilities, borrowing base facilities, repo and consignment transactions, and bilateral facilities. He also represents clients in connection with commercial arrangements involving the use of logistical assets for the storage, transportation, and processing of physical commodities.

