

ESG investing and financing for pension funds – GPFA webinar

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"It's this balance between, 'What can you control? What can you actually achieve? How do we measure it, how to report it?'" said Osler partner Michael Innes, Co-Chair of the firm's Capital Markets practice, during a webinar presented by the [Global Peer Financing Association](#).

Michael joined Osler partners Timothy Hughes, lead of the firm's Capital Markets Tax practice, and host [Lisa Mantello](#), Banking and Financial Services, on the international panel to discuss the pressing issues and developments affecting environmental, social and governance (ESG) investing and financing, particularly for pension funds. Michael and Timothy have been at the forefront of structuring ESG investments for capital markets in Canada, and reviewed the different types of ESG products available, their benefits and uses, tax implications, associated challenges and where they see the market going.

Use-of-proceeds and sustainability-linked bonds

As ESG mandates for pension funds have exploded in popularity over the last several years, a key factor encouraging that growth has been the flexibility available to issuers. Following the lead of the European market, issuers can use the proceeds of a financing for an eligible ESG project (a use-of-proceeds bond), or choose a sustainability-linked bond in which pricing is linked to a set of agreed-upon KPIs, where failure to meet those targets results in financial penalty to the issuer.

In that case, Timothy warns, "that can result in accrual over the life of the instrument for tax purposes because governments are quite keen to ensure that you can't just push your return to the end and pay tax on it at that time, but rather pay tax over the term of the instrument."

While such tax considerations may have less relevance for the pension plans themselves, "it does matter to taxable investors, so that limits the liquidity of the instrument," Timothy says. "If instruments are being designed only for pension plans because the tax doesn't work to taxable investors, then you have to think about that and consider the value impact that that might have on the instrument."

"Each issuer decides what works for them, because not all issuers are able to find eligible green or eligible social projects," Michael explains, pointing to two notable Canadian examples. "Bell Canada did a social bond — or a use-of-proceeds bond — directed towards

green and social projects, and [Telus did a sustainability-linked bond](#), which had a financial consequence if they didn't achieve certain greenhouse gas emission reductions."

"As with everything, it's very issuer-specific, and industry-specific, as to what will work," he added.

Pension plan mandates

The panel also discussed the large role of pension plans' ESG mandates in the industry, noting how they can impact the products being offered as they look to make certain types of investments.

"If you have a bond that is suitable for pension plans, and perhaps not suitable for anyone else, then pension plan investors become very, very important, and I think can really turn a bond from being structured like this to being structured like that," says Timothy. "So, I think you have a great deal of influence because you are a primary target market for this type of instrument."

Michael sees a substantial benefit to wielding this sort of influence in working toward environmental and sustainability goals. "What the investor can say to the issuer is, 'We don't think your target's ambitious enough. If you want a five-basis-point greenium, we don't think your target's ambitious enough in terms of reducing greenhouse gas emissions.'"

Greenwashing concerns

One challenge in the industry is how to protect against "greenwashing," or portraying products as more environmentally friendly than they actually are. To combat this, Michael points out that a second-party opinion is required in order to issue a sustainability-linked bond to confirm that it aligns with the [sustainability principles](#) established by the International Capital Market Association for those products, but additional data and education are necessary.

"This market will develop and, as more issuers enter the market, there will be more — hopefully — uniformity or views on whether certain targets are aggressive or not aggressive enough to warrant a greenium, or what size of greenium an issuer can get," he says. "There need to be more deals and more of an educated investor base that can challenge issuers on targets that they set."

The future of ESG funds

As for where the ESG market is headed, both see further progress on the horizon.

"I actually think it is going to be a growing market, because it just makes too much sense for both issuers and investors to a certain extent," says Michael. "For the issuer, they look to get the greenium, which will reduce their borrowing costs over the life of the bond, and with the penalty on the back end to keep them honest and meet their targets."

Timothy agrees. "I think innovation will continue, both in terms of structure and the types of eligible uses for the proceeds."

To hear the full discussion, listen to the Peer Connections Podcast episode "Institutional Investors Matter in ESG Investing" on [the GPFA's website](#).