SUSTAINALYTICS

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SUSTAINALYTICS
SUSTAINABLE FINANCE SOLUTIONS

Transition Bond Second-Party Opinions

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Introduction to Transition

The green bond market has seen major growth in recent years. There is, however, a strong recognition that achieving international climate goals will require significant reduction of GHG emissions from carbon-intensive industrial activities that to date have not been the focus of green finance and for which low-carbon solutions are generally not yet available at scale due to major technological and/or systemic barriers. Those are commonly referred to as transition sectors.

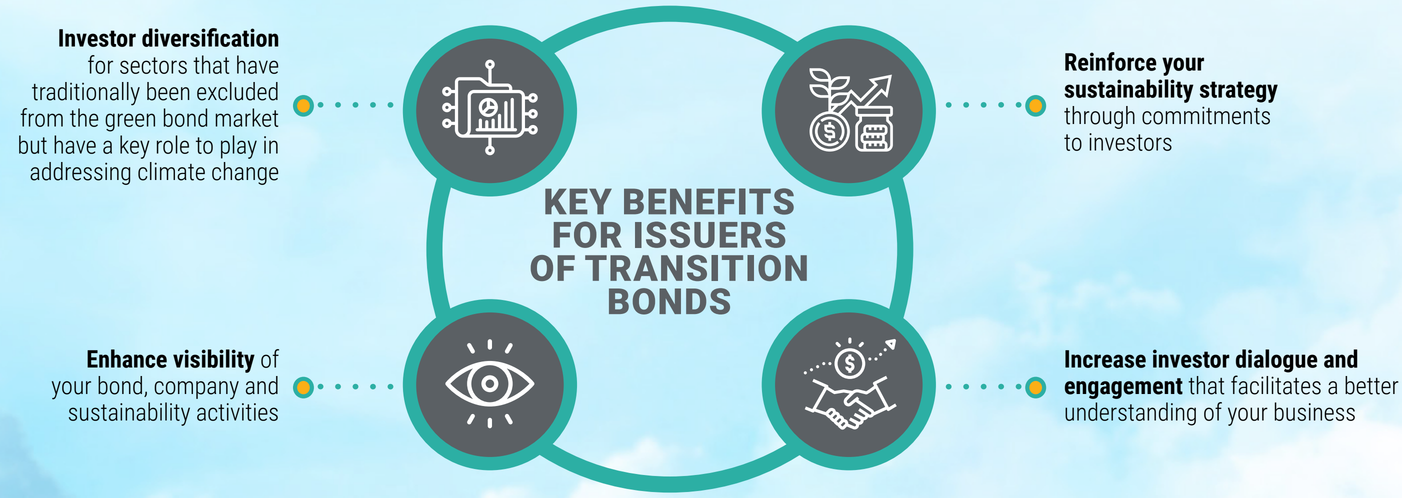
According to climate models, achieving climate change mitigation ambitions as outlined in the Paris Agreement requires a global decarbonization by 2050.[1] Achieving low-carbon production over time will require significant amounts of capital for the transition sectors to develop technologies and modify production processes. An increasing number of financial institutions, regulatory and industry initiatives are focusing on the inclusion of carbon-intensive industries in the sustainable finance market with the aim of helping to incentivize their decarbonization.

While international climate goals are defined at the level of the economy as a whole, achieving climate goals requires the decarbonization at the level of economic activities. Due to a distinct set of challenges and barriers faced by each economic activity, the transition pathway differs across different industries – from steel production to cement production to shipping, among other areas. Major international organizations such as the International Energy Agency and the Intergovernmental Panel on Climate Change (IPCC) have carried out extensive research and analysis to map out pathways for various industries that are aligned with the overarching goals of the Paris Agreement.

Transition through Use-of-Proceeds Bonds

The sustainable finance market has seen several initiatives emerge that speak to transition finance, such as the Transition Pathway Initiative and the Science Based Targets Initiative, under which a growing number of companies are setting emission reduction targets and reporting on their progress. The International Capital Market Association (ICMA) has established a Transition Finance Working Group, and the EU Taxonomy explicitly classifies some activities as transition activities.

Use-of-proceeds bonds are emerging as an important instrument to finance transition activities and projects. When supported by clear eligibility criteria and a credible transition strategy, transition bonds can facilitate a shift of a company´s business activities along a transition pathway compatible with long-term climate goals.



1 IPCC 2019: https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15_Summary_Volume_Low_Res.pdf

Our Approach to Assessing Transition Bond Frameworks

"Transition" can be considered at the level of whole economies, sectors, companies, or the individual economic activities that they carry out. When it comes to use-of-proceeds bonds, however, it is at the level of activities that transition operates. Sustainalytics' approach, therefore, focuses on transition as the decarbonization of economic activities along emissions-reduction pathways that are consistent with the economy-level goal of net-zero carbon by 2050.

Evaluating the alignment and credibility of a transition bond framework requires an assessment of both ***issuance-level*** considerations and ***issuer-level*** considerations. Our issuance-level assessment relies on Sustainalytics' own transition taxonomy, which defines sector-specific eligibility criteria that are grounded in international science-based targets. Given that the transition of many industrial activities will occur over decades, Sustainalytics' framework assessment also gives importance to an issuer's long-term transition strategy.

ISSUANCE-LEVEL CONSIDERATIONS

a) Use of proceeds: Alignment of financed business activities and projects with Sustainalytics' transition eligibility criteria
b) Project evaluation and selection
c) Management of proceeds
d) Allocation and impact reporting

ISSUER-LEVEL CONSIDERATIONS

a) Alignment of the issuer's transition strategy and commitments with internationally established decarbonization pathways
b) Alignment of the use of proceeds with the issuer's strategy and implementation plan

SPO-Key Benefits

An SPO demonstrates the credibility of the use-of-proceed bond and is required by many investors in the sustainable finance market. It provides potential investors with assurance that the use of proceeds, as set out in the framework, are aligned to market practices and expectations.

Independent Opinion that provides additional assurance to investors

Support issuers in positioning themselves favorably in the market and widen their investor based

Align with market best practices

Why Sustainalytics

25 YEARS
of developing innovative solutions

35% MARKET SHARE
on sustainable bonds in 2019*

600
of the world's leading asset managers and pension funds

Awards

Green Bond Awards – Climate Bonds

Environmental Finance – Sustainable Investment Awards

GlobalCapital – SRI Awards

IRRI Survey – Independent Research in Responsible Investment

* Source: Environmental finance: Sustainable Bonds Insight 2020

Are you interested in learning about how a Second-Party Opinion can support your transition strategy?
Contact us today to connect with our team of experts.

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