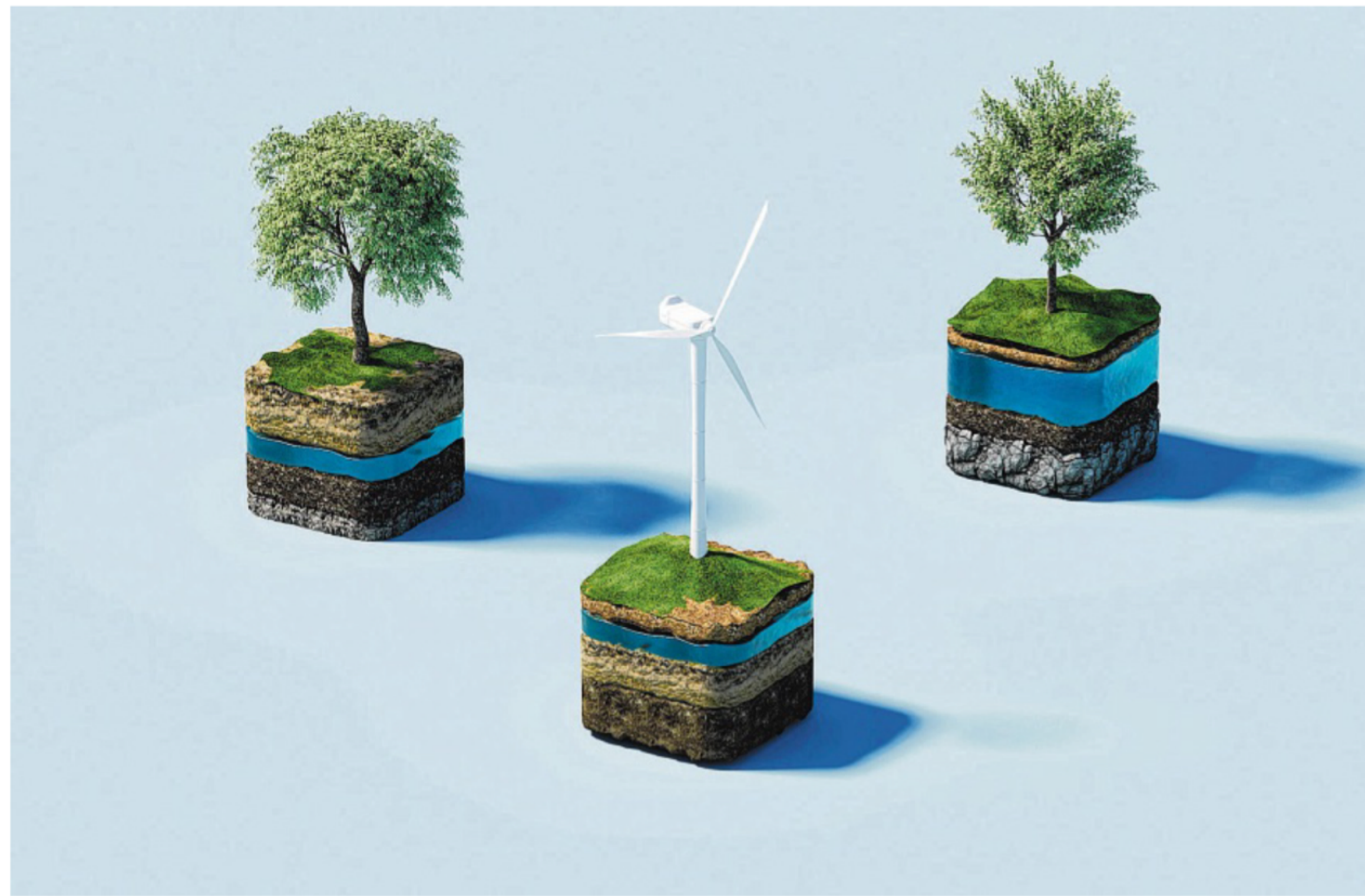


By Ezien Hoo, Wong Hong Wei, Andrew Wong and Alvin Song



Sustainability-linked bonds are designed to encourage issuers to modify their behaviour. PHOTO: PIXABAY

## Catalysing change across an issuer's operations

With the introduction of sustainability-linked bonds in the Singapore corporate credit market, we discuss what these are and what investors should look out for

THE Singdollar corporate credit market saw the first sustainability-linked bond (SLB) priced in February 2021 where the issuer raised S\$250 million. Since then, there have been four more SLB issuances, raising a total of S\$1.8 billion.

SLBs are intended to encourage issuers to modify their behaviour. These instruments are structurally linked to the issuer's sustainability targets, expressed through key performance indicators (termed sustainability performance targets, SPTs) which are measurable and trackable.

If structured appropriately, SPTs should catalyse change across the issuer's entire operations. SLBs are structured with a carrot and/or a stick where issuers enjoy cost savings for meeting the targets and/or bear a higher funding cost if targets are unmet within a specified timeframe.

### An instrument that finances transition

Transition finance is important to fund decarbonisation efforts and we see sustainability-linked instruments as key tools in meeting transition needs. While transition-labelled bonds exist,

such instruments are few and far between, when compared to the global SLB market which by amount outstanding has grown to exceed S\$200 billion. In our view, the quantum of SLBs that could be potentially issued by corporate credit issuers is higher compared with green bonds, since SLB issuers are not restricted by industry sector. In contrast, use of proceeds for green bonds are limited to green projects.

It is perhaps no coincidence that the largest SLB issuer in the Singapore dollar corporate credit market is Sembcorp Industries Ltd. Whilst Sembcorp still generates power using fossil fuel, the company is transitioning to becoming greener and is speeding up its investments in renewable power.

In the Asiadollar market, India-based UltraTech Cement Ltd priced its debut SLB in February 2021. Cement is a high carbon-emitting industry that is hard to decarbonise, although UltraTech is targeting to reduce the carbon content of its products. Beyond corporates, Chile became the first sovereign SLB issuer glob-

ally in March 2022.

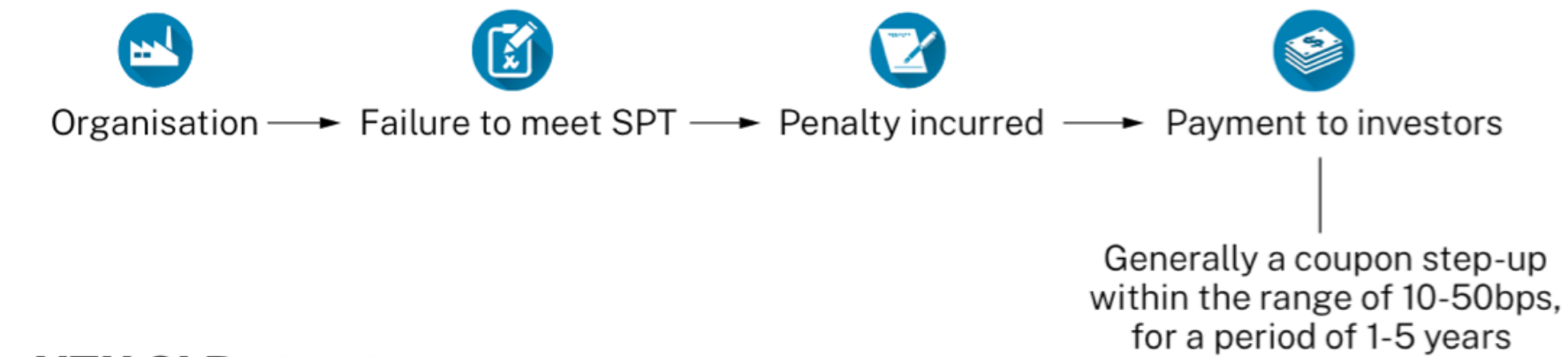
### Tackling investor concerns

One factor limiting the appeal of SLBs for investors is the lack of comparability, both within the issuer's own curve against its conventional bonds and against SLBs from different issuers. This is because SPTs are unique and specific to the issuer and their circumstances.

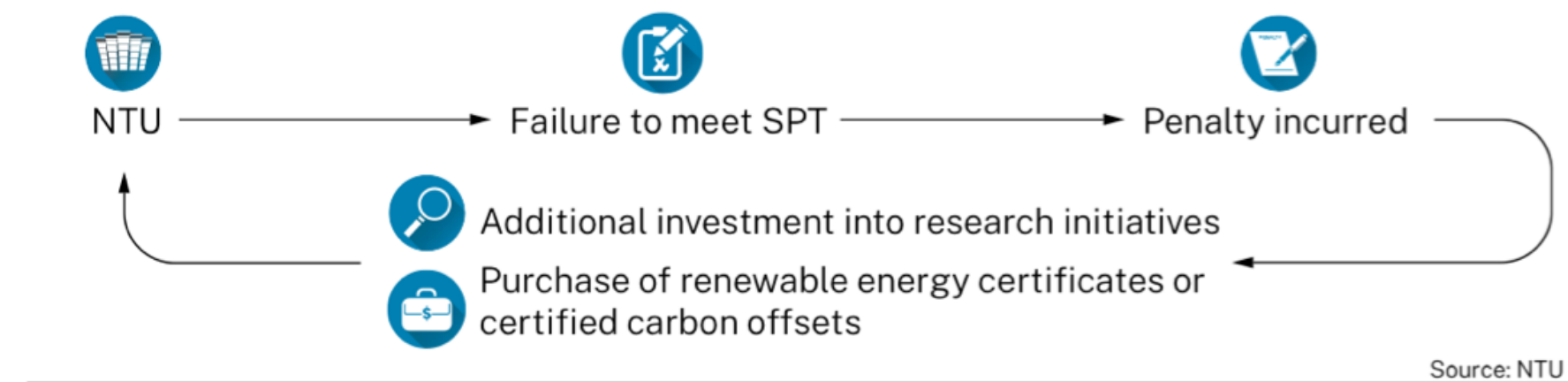
It is also more challenging for investors to perform relative valuation across SLBs. Whilst sustainability-linked loans are negotiated bilaterally or with a relatively small group of bank lenders, debt capital markets thrive on being an efficient way to raise large sums from dispersed investors.

These market characteristics favour standardised terms and conditions where investors can compare the risk-return profile of their investments with ease. In our view, the growth in the SLB market is currently driven primarily by issuer-specific sustainability considerations and it will take time before we see standardised SPTs.

### Conventional SLB structure



### NTU SLB structure



For SLBs, investors may be concerned that targets are not set high enough, such that behaviour is changed for the better. The solution to overcoming lack of comparability and greenwashing allegations is twofold.

On the demand side, investors would need to perform an in-depth assessment of issuers to ensure that they are undertaking material changes to enhance their sustainability performance. On the supply side, issuers would need to set sustainability performance targets that go beyond a "business as usual" trajectory for SLBs to effect change.

Market developments aimed at introducing best practices to the green, social, sustainability and sustainability-linked (GSSSL) bond market are not without criticism. However, these developments provide some rigour to an otherwise unregulated market.

In June 2020, the International Capital Market Association (ICMA) Sustainability-Linked Bond Principles 2020 rolled out voluntary guidelines covering the selection of key performance indicators, calibration of the SPTs, bond characteristics, reporting and verification that help promote market integrity for this new instrument.

In June 2022, further guidance was released by the ICMA. The Science Based Targets initiative (SBTi) – a joint initiative by the CDP, the United Nations Global Compact, World Resources Institute and the World Wide Fund for Nature – helps define and promote best practices in emissions reduction, which is in line with climate science and provides technical assistance to companies that want to set meaningful targets.

A number of major Singapore dollar corporate credit issuers have committed to or set targets based on SBTi, where such targets can be linked to sustainability-linked instruments. In May 2022, the Green Finance Industry Taskforce, convened by the Monetary Authority of Singa-

### NTU SLB Sustainability Performance Targets by 2035

Achieve **carbon neutrality** in the NTU Yunnan Campus\*

Reduce **gross carbon emissions intensity** by at least 50% from 2019 baseline\*

\*Yunnan campus is the biggest of NTU's 3 campuses, with a GFA of 1,404,030m<sup>2</sup> as of 2020

\*\*2019 baseline: gross carbon emissions intensity of 56kgCO<sub>2</sub>e/m<sup>2</sup>

Source: NTU

pore and comprising market participants, published the second version of Singapore's green and transition taxonomy for public consultation. In our view, the eventual roll-out of this taxonomy means less scope for greenwashing to happen as arrangers, issuers and investors alike would have a commonly accepted reference point when assessing an issuer's activities.

### Case study: Nanyang Technological University

Nanyang Technological University (NTU) priced a S\$650 million 15-year senior unsecured SLB in October 2021, sending a strong signal to the market of its vision to become a Smart Campus and to attain the rank of the greenest university campus globally.

The university plans to achieve carbon neutrality by 2035, together with a 50 per cent reduction in its gross carbon emissions intensity by the same date. Amongst other objectives, the manifesto declared that NTU will achieve 100 per cent Green Mark Platinum certification for all eligible buildings on the main NTU campus (the



A number of major Singapore dollar corporate credit issuers have committed to or set targets based on SBTi, where such targets can be linked to sustainability-linked instruments. PHOTO: BLOOMBERG

Yunnan campus in the west of Singapore) and NTU's net energy utilisation, water usage, and waste generation will decrease by 50 per cent by March 2026 (compared to the baseline levels of 2011).

In October 2021, NTU shared its Sustainability Manifesto alongside its Medium Term Note programme and Sustainability Framework. The SPT is similar to its commitment in its Sustainability Manifesto and can generally be split into two parts.

The penalty incurred tends to be allocated to investors should the issuer fail to meet the SPT. NTU's SLB is unique in that it allocates the penalty "back" to the university. Specifically, an amount equivalent to 50bps of the outstanding principal amount or S\$3.25 million based on the current amount outstanding will be allocated to investments into research initiatives in the fields of climate research or climate mitigation or adaption technology, or the purchase of renewable energy certificates or certified carbon offsets.

According to Capital Monitor, a trade publication for the sustainable sector, this is the second SLB ever that features this unique structure, the first being All Nippon Airways' SLB priced in June 2021.

One critique of SLB structures is that investors should not be benefiting from a company's inability to meet their sustainability targets. NTU's innovative structure helps to negate a criticism of SLBs, while staying true to the primary goal of helping an organisation commit to its sustainability journey.

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