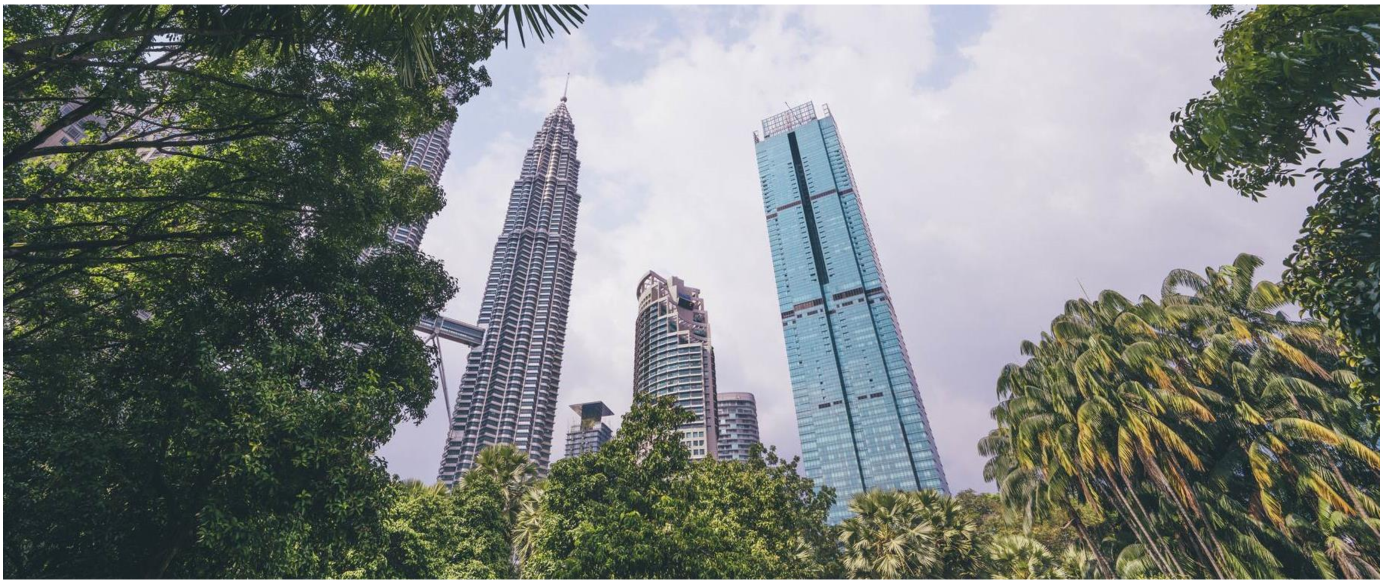
Stakeholder insight on Second-Party Opinions



The Carbon Trust and the Impact Investing Institute ran a recent "think-in" on the topic of Second-Party Opinions (SPOs). With the increaseing growth and urgency in moving capital to the companies and activities that are aligned with the Paris goals, the SPO has an important role in debt capital markets transactions, providing reassurance of the issuance's sustainability credentials and mitigating the risk of greenwash.

The key questions discussed by a cross section of arrangers, underwriters, investors and assurance providers included:

- What is the role of SPOs and are they fit for purpose in today's market?
- Do SPOs provide the detail and breadth of information that investors need?
- Are there questions of impartiality to be raised in the relationship between issuer and verifier?
- Beyond thematic use of proceeds bonds, how do we assure transition/sustainability linked transactions to the satisfaction of investors?
- And finally, where next for SPOs?

Views on the role of SPOs were broadly consistent but highlighted some interesting maturity and geographical nuance. Fundamentally, it was felt SPOs address the information asymmetry between the issuer and the investors, they provide an independent technical review and they align with voluntary market standards. The SPO forms a part of the investor's decision-making criteria but should not be relied on as the only source of information on a transaction's level of sustainability. However, the level of detail that should be provided prompted debate. Some felt that it was incumbent on investors to undertake their own research, so the SPO should be a check on standard elements of green issuance requirements; whereas others felt the SPO should provide a level of detail for less informed investors that goes as far as exploring individual underlying assets. Two areas of firm agreement were that SPOs should be opinionated and that for verifiers to accede to an issuers desire to be given a "clean" opinion didn't help investors. And verifiers should have technical experience related to the use of proceeds and not simply assurance experience.

The notion of the clean opinion catalysed the discussion of impartiality. The fact that the issuer both pays for and benefits from the opinion was considered suboptimal but the discussion stopped short of exploring alternative models. Some reassurance was taken from the fact that reputational risk is borne equally by all parties in the issuance so it is in the general interest to put the credentials of the issuance to the test and provide robust opinions.

The current state of sustainability linked bonds prompted strong reaction ranging from descripttion as a powerful tool for combatting climate change to "uninvestible." The key to this was an unease about being able to reliably assess the company's KPIs, in terms of ambition, benchmarks, practicality and sincerity. More work needs to be done by issuers in presenting credible targets with detailed plans, governance and incentives. Equally, an assurance solution needs to be found that makes sense for all parties. As one assurance provider put it, we *could* provide assurance but the issuer probably won't like the timelines, the cost, and maybe the answer. All this being said, it was felt that SPOs were a tool to make this market stronger and we should not let the perfect be the enemy of the good.

Three further important areas were timelines, cost and impact. The consensus was that a commitment to impact measurement was important and any pre-issuance estimates were helpful, although in some quarters it was felt that this should not be a substitute for proper investor due diligence. Regarding timelines and cost, there was a cry for help from the SPO providers who are trying to respond to very short turnarounds whilst demand is very high.

Coupled with growing requirements of SPOs, for example in the latest iteration of the Green Bond Principles, and pricing that has to a degree been commoditised, SPOs are beginning to present commercial challenges for verifiers.

So where next for SPOs? The group was asked, if they could have a wish for the development of SPOs, what would it be. A selection of the key answers is below:

- Fund SPOs from sources other than the issuer (in the way that ESG ratings are effectively being paid for by the investors).
- SPOs should be more nuanced and robust in their views than they currently are.
- Focusing on outcome metrics rather than output metrics focusing on aspirational goals.
- Greater linking to the issuers' objectives, even to the level of their scenario analysis. There are no links to internal scenario analysis – should/ could SPOs feed into those processes?

This report is informed and shaped by our ongoing dialogue with market participants. We are grateful to the Impact Investing Institute for its part in supporting this dialogue, in particular, through hosting the think-in with investors, SPO providers and industry stakeholders on the utility and impact of Second-Party Opinions.

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