ESG in finance transactions: an offshore legal perspective

2021 saw an unprecedented surge in ESG debt issuance, arguably underpinned by growing investor appetite for sustainable and green-linked investment options. The UK insurer Aviva reported that 55% of more than 500 investors in its survey claimed that the covid-19 pandemic influenced the likelihood of considering ESG when deciding how to invest. Meanwhile, sustainability and green debt more than doubled annually to USD680 billion in the first half of 2021, according to the Institute of International Finance (IIF).

Growth in ESG-linked finance

The IIF reported that there was an almost four-fold increase to USD160 billion in bonds issuance with a sustainability-linked pricing ratchet in the first six months of 2021 compared against the prevous year. Market participants almost certainly drove this increase because they recognised that implementing a sound ESG strategy facilitates access to new pools of capital and opportunities to lock-in favourable pricing.

For example, SSAB, a Swedish company that aims to be the first fossil fuel-free steel producer, has issued a USD230 million equivalent five-year senior unsecured sustainability-linked bond with a maturity date of 2026. Under the terms of the relevant bond instruments, a redemption premium will be payable at maturity if SSAB fails to meet specific sustainability performance targets linked to greenhouse gas emissions. We expect the volume of sustainability-linked bonds to continue to grow in 2022.

ESG-linked financing in Asia

The IIF has also reported that about 85% of all ESG-linked debt issuances occur in Europe and North America. However, there is evidence that ESG-linked debt is gaining traction in other regions. For example, Chinese real estate company Minmetals Land, Japanese real estate group Mori Hills, and India's Adani Electricity Mumbai have brought, or are reportedly planning to bring, various sustainable and green bonds to market.

In contrast to green bonds, where proceeds are used in certain green projects, general sustainability-linked financings have also been used for various corporate purposes and are based on specific ESG targets, rather than a limited set of green projects. This has further opened the market to a broader spread of issuers, a trend that we expect to continue in 2022.

Standards and greenwashing

With a growing focus on ESG-linked products, standards have intensified. While there are now a raft of regulations and proposals in the market, such as the Green Loan Principles, the European Green Bond Standard and the Sustainable Finance Disclosure Regulation, there are concerns that greenwashing may cloud the distinction between genuine ESG-linked debt issuance and opportunism.

Therefore, lenders and other finance parties committed to monitoring compliance with ESG targets must agree on reporting standards with the relevant obligor group, and must ensure appropriate external review mechanisms are implemented.

Offshore vehicles

Companies in the British Virgin Islands (BVI) and the Cayman Islands are widely used in cross-border finance transactions, including those with ESG-linked investing elements. These jurisdictions have various features that make them attractive to lenders and other finance parties, as well as borrowers and other obligors for ESG-linked financings. Some reasons for this are:

- The BVI and the Cayman Islands are widely recognised as creditor-friendly jurisdictions due to the range of self-help remedies available to secured creditors in an enforcement. The BVI also has a straightforward system of registering security interests that protects the priority of security interests.
- BVI and Cayman Islands companies may have unlimited objects and purposes, including in relation to ESG initiatives, and there is significant flexibility in how such companies are structured in terms of capital structure, management roles and shareholder involvement.
- BVI and Cayman Islands companies are subject to low ongoing maintenance costs. Financial statements do not need to be prepared in relation to companies that are not regulated by the BVI Financial Services Commission or the Cayman Islands Monetary Authority.
- Except for the payment of nominal filing fees in connection with the optional filing of a security interest that is granted by a BVI chargor, there are no income, corporate or capital gain taxes, withholdings, levies, registration taxes, or other similar taxes or charges imposed on companies in the BVI or the Cayman Islands in connection with the execution, delivery or performance of finance documents by a BVI or a Cayman Islands company, or the finance parties.

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