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CLO managers embed new EU sustainable disclosure language in docs after investor push

by Michelle D'Souza

The European CLO market is working together to embed language related to the European Union's Sustainable Finance Disclosure Regulation (SFDR) in deal documents, following a large push from Lupus Alpha.

Officials at the Frankfurt-based firm say they are working with CLO syndicates to insert language which requires managers to provide such additional ESG disclosure related to the new regulations.

BridgePoint's new issue Bridgepoint CLO II (Credit Suisse), Credit Suisse Asset Management's reset of Madison Park Euro Funding IX (Jefferies), HPS Investment Partners' reset of Aqueduct European CLO 2019-3 (Jefferies), and Pinebridge Investment's reset of Euro Galaxy IV (JP Morgan) are understood to be among recent deals to have included such language, and Creditflux understands several CLO syndication teams are in talks with managers in the pipeline.

Laura Coady, co-head of European securitised markets at Jefferies, says it is exciting to see the recent evolvement with respect to ESG language within European CLO docs.Laura Coady

"With the help of some key investors we are hopefully moving towards more uniform language that many managers will be able to embrace as standard practice going forward," says Coady. "In particular incorporating language from SFDR relating to adverse sustainability impact, which encourages managers to influence the disclosure provided by companies in which they invest with real metrics, is an important first step in the right direction. The feedback from investors on this language has been well received and already other investors are requesting it in future deals."

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The EU's SFDR, which came into effect on 10 March, is applicable for all financial market participants and aims to increase transparency around ESG and prevent 'greenwashing'. A key part of this regulation requires entity level disclosures about how an asset manager considers 'principal adverse' impacts of its investment decisions on sustainability factors.

The 18 principal adverse factors include greenhouse gas emissions, carbon footprint, whether a firm is compliant with UN Global Compact principles and board gender diversity.

CLO managers have a duty to investors

CLO managers, at least for now, are largely exempt from SFDR disclosures as the UK has not onboarded the regulations. Most European CLO managers are UK-based and therefore remain outside the direct scope of the regulations.

EU fund managers who invest in CLOs, however, may be required to do manager-level reporting on the principal adverse impact on their investment funds, says Michael Sholem, partner at Cadwalader.

"These EU-based CLO investors will be required to report using templates that are likely to apply from January 2022," London-based Sholem says. "They therefore need to gather information about underlying corporate borrowers from CLO managers, so that they can comply with their own SFDR obligations."

Sources say the new language in CLO docs requires managers to "use commercially reasonable efforts to provide principal adverse sustainability impacts statement available via the reporting website as soon as reasonably practicable". This would require asking questions to each of their underlying 200-300 borrowers about the companies' sustainability adverse impacts.

Frankfurt-based CLO investor Lupus alpha is said to have a key driver of implementing such language in deal documents, while other large triple A CLO investors are said to be supporting the initiative.

Michael Hombach, Lupus Alpha portfolio manager, says the firm has been working with CLO syndicates to engage with managers on the importance of the issue.

Michael Hombach"The EU green deal is a way to reach the goals of Paris Agreement and every market participant needs to think about how sustainable investing is working," says Hombach.

"As CLO investors, we need to report the APIs and CLO managers can act as an intermediary between their end investors and the companies," he adds. "CLO syndicates have been extremely forthcoming in helping managers understand the impact of the SFDR and their responsibility to sustainable investing."

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Michael Hombach
Portfolio manager,
Lupus Alpha

Lupus Alpha is understood to have a strict criterion whereby it will not invest in deals without this new SFDR language. It is not clear whether other triple A investors will also abstain from investing in deals without such language, but with a lack of triple A investors in the market and spreads widening, CLO managers may do well to comply.

David Quirolo, partner at Cadwalader says the firm has been "seeing a bigger focus on and are seeing more request from investors for language that the CLO manager obtain SFDR compliant information, regardless as to whether the CLO manager is actually subject to SFDR."

Implementing new language in deal documents however is a back-and-forth business, and Quirolo argues one of the biggest sticking points for CLO managers is that the templates are not final and there is concern over obtaining relevant information from underlying borrowers.