Sustainability-Linked Derivatives (SLDs)

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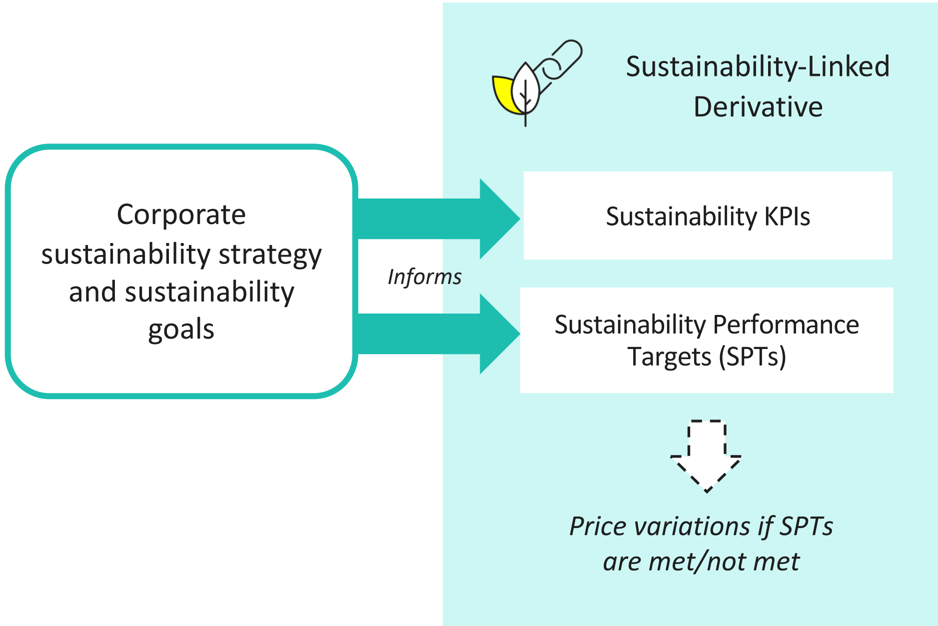
What is a Sustainability-Linked Derivative (SLD)?

- An SLD is a derivative with pricing linked to a counterparty’s performance against pre-agreed Sustainability Performance Targets (SPTs)
- SPTs for an SLD can be established for the transaction or reference existing sustainability-linked structures
- Most conventional hedging instruments can be structured as an SLD (FX forwards, interest rate swaps, cross currency swap)
- SLDs can be employed as a standalone hedging instrument or overlaid on use of proceeds, sustainability-linked or vanilla debt structures

Sustainability-Linked

Outcomes tied to agreed targets that drive improved environmental or social outcomes.



Sustainability-Linked Principles

A Sustainability-Linked structure allows a corporate to work towards achieving further improvement against their most material ESG issues. To ensure a robust and credible transaction, CBA strongly recommends adhering to market principles that promote transparency and disclosure.

Selection of Key Performance Indicators (KPIs)

- KPIs should align and be material to organisational objectives and strategy
- Relevant, core and material to issuers business
- Measurable or quantifiable
- Ability to be benchmarked

Calibration of Sustainability Performance Targets (SPTs)

- Ambitious
- Represent material improvement and beyond “Business as Usual” trajectory
- Comparative to a benchmark or external reference (e.g. peers, past performance and science)

Reporting

- Up to date information on performance of KPI’s
- Verification assurance report relative to SPT
- Information for lender and investors to monitor level of ambition of SPTs

Bond / Loan / Derivative Characteristics

- Potential trigger events in event of reaching or not reaching SPT’s
- Performance against SPT’s linked to pricing

Review / Measurement/ Verification

- Second Party Opinion (SPO) providers are highly recommended to analyse the SPTs against your business strategy and past performance to determine suitability and give credibility to the transaction
- External review is mandatory and is independently and annually verified

Why use a Sustainability-Linked Derivative (SLD)?

To demonstrate commitment and credibility of your sustainability strategy

- Align your risk management strategy with your sustainability targets
- SPTs are expected to be assessed by a Second Party Opinion Provider for materiality and ambition

To incentivise sustainability performance

- Create additional incentive to achieve ambitious SPTs

To employ a flexible & bespoke solution

- SLDs are tailored to your business needs and industry requirements, and can be: overlaid on any form of debt; or employed as a standalone hedging instrument

Example 1: SLD hedging a Sustainability-Linked Loan (SLL)

- The structure of the SLD can be designed to mirror the pricing mechanism of the underlying SLL
- SPTs on the SLD can match those on the underlying SLL

Diagram 1:

- The counterparty pays the vanilla (non-SLD) credit margin at inception and performance against pre-determined SPTs is assessed at the end of each year
- Subsequently, a penalty or discount is applied to the SLD for the following year
- In this example, the counterparty has not met SPTs in Y1 to Y3. As a result, a penalty is applied to the SLD and the SLL in Y2 to Y4, respectively
- SPTs were met in Y4 and Y5, resulting in a discount on the SLD and SLL for Y5 and Y6, respectively

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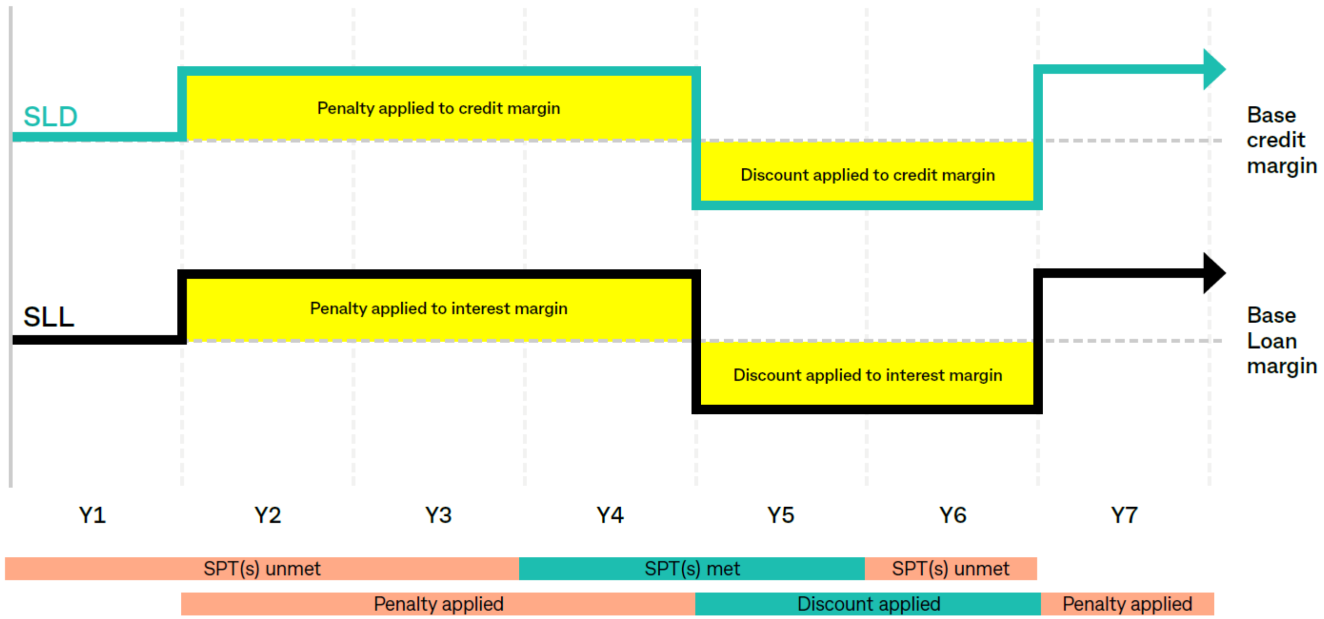
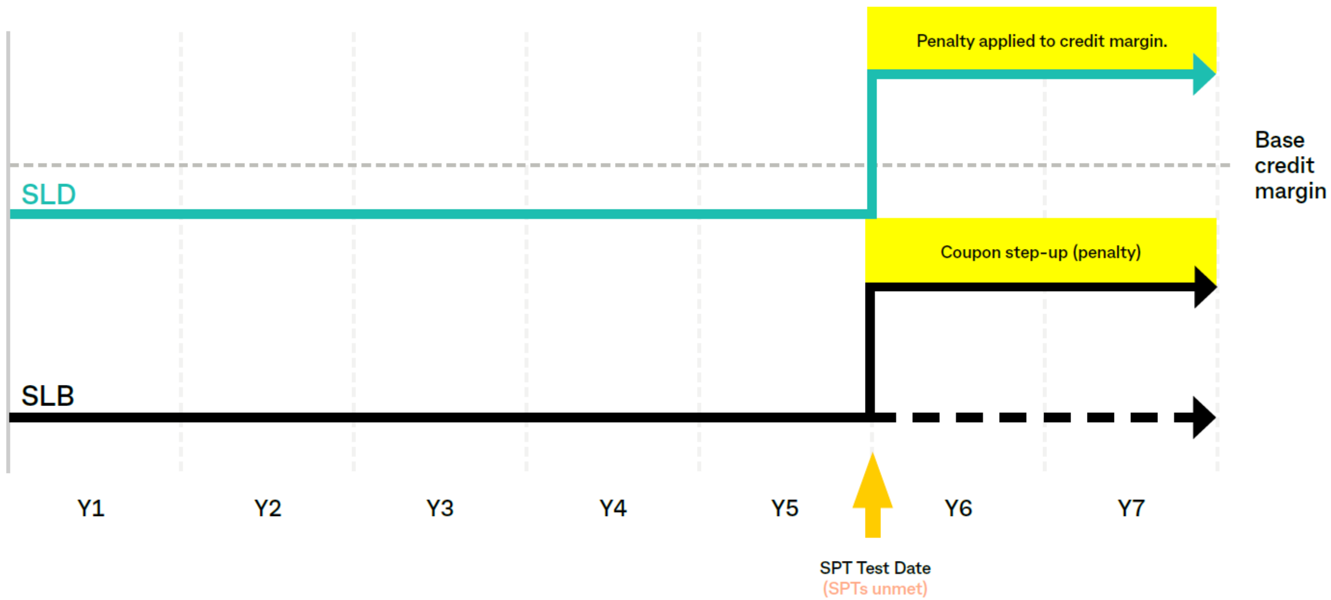


Example 2: SLD hedging a Sustainability-Linked Bond (SLB)

- The structure of the SLD can be designed to mirror the pricing mechanism of the underlying SLB
- SPTs on the SLD can match those on the underlying SLB

Diagram 2:

- An upfront discount is provided on the credit margin for the SLD relative to pricing for a vanilla derivative to incentivise the counterparty to achieve its SPTs
- On the SPT Review Date at the end of Y5, a penalty is applied to the SLD and SLB for the remaining tenor of both instruments if counterparty performance **fails to meet SPTs**
- If SPTs are met, the upfront discount on the SLD will carry over for its remaining tenor



Pricing & Documentation

- Currently no standardized approach for documenting - bespoke terms
  - ESG terms, KPI's detailed in individual trade confirmation
  - Key terms contained in separate agreement. E.g. Sustainability Term Deed Poll
- Standardisation around ESG terminology will assist

Conventional (non-ESG) hedging instruments

Bespoke terms and cash flows