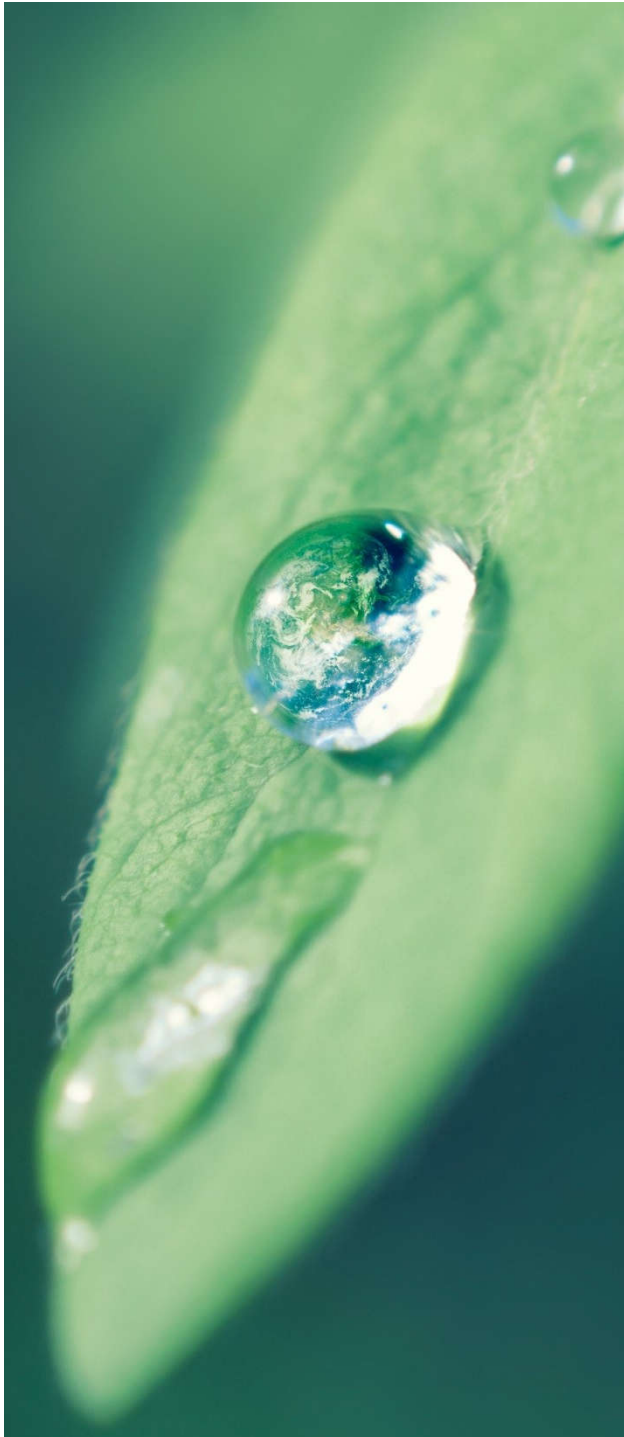




# Green Bonds – An Overview

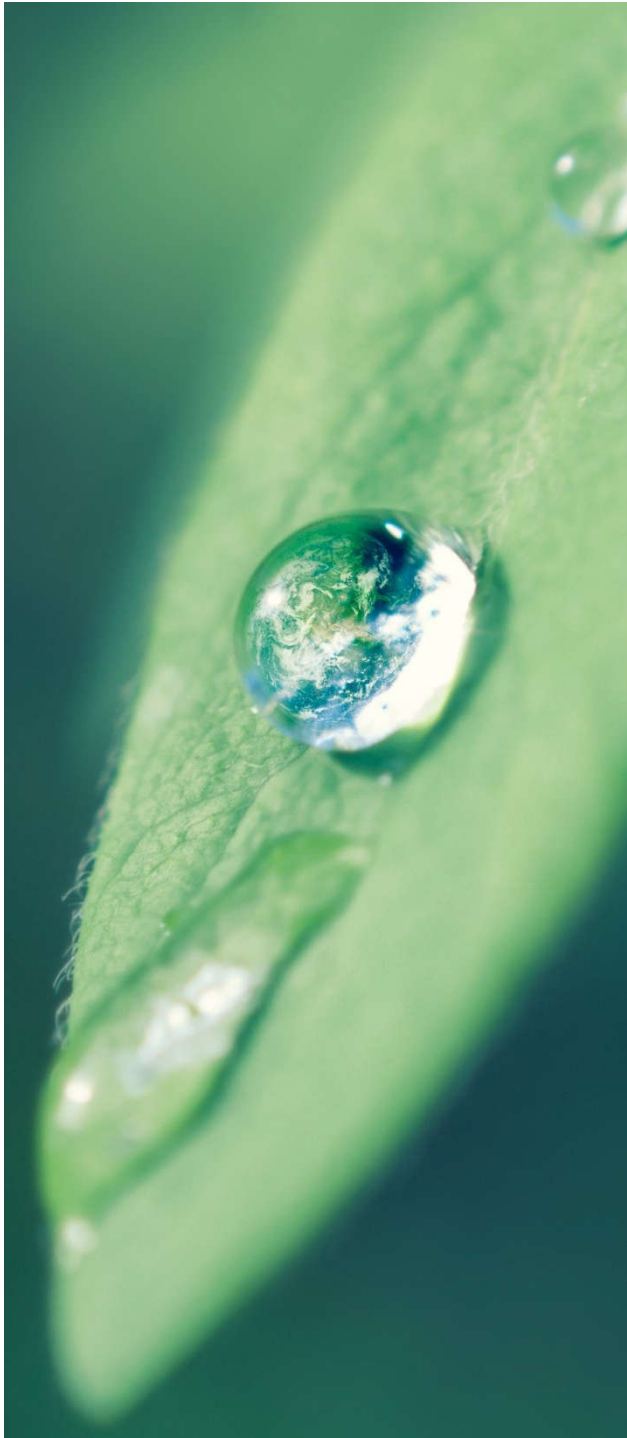
May 2019 – London – Michael Doran & James Tanner





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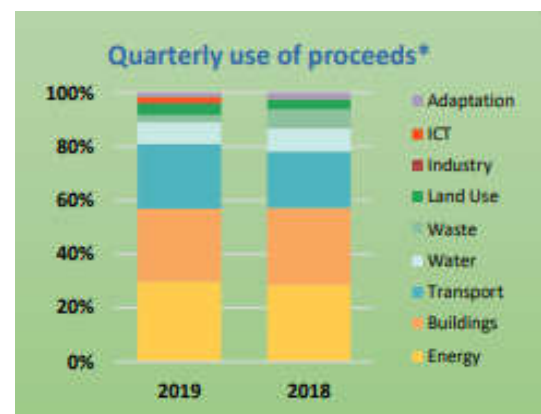
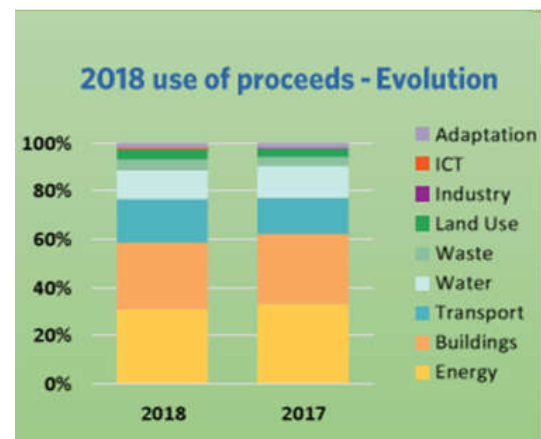
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## Green Bonds – An Overview

# What is a Green Bond?

- No global legal definition of a Green Bond exists
- Several industry associations (ICMA) / stock exchanges have set out certain base criteria / essential elements
- A bond which:
  - (i) includes an express covenant **to use the cash proceeds** to finance new or existing projects that have positive environmental and climate benefits;
  - (ii) discloses a “second opinion” certifying the green aspects of the bond; and
  - (iii) imposes a reporting obligation.
- Use of proceeds is varied within green / sustainable universe
- In all other respects just regular bonds

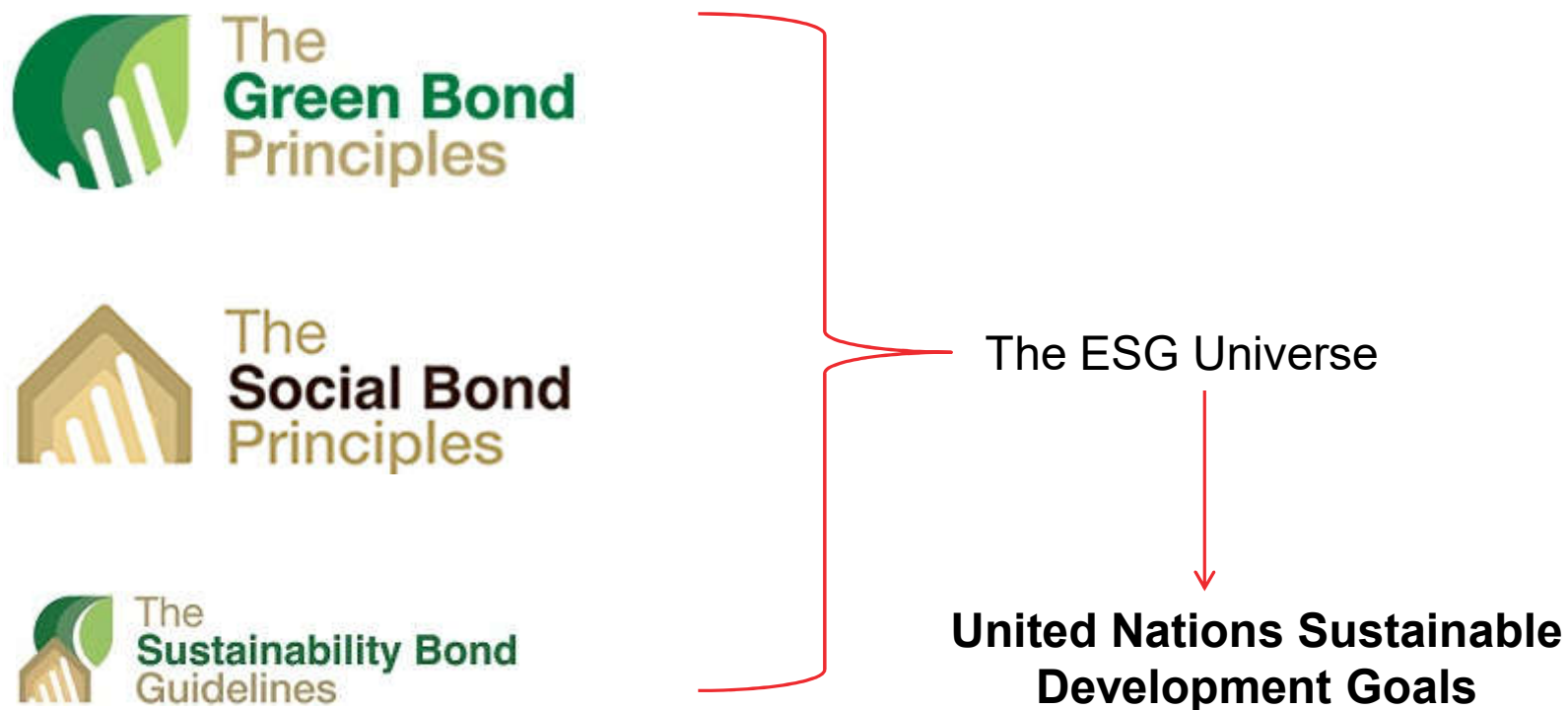


Source: Climate Bonds Initiative

## Green Bonds – An Overview

# ICMA Classification of Green / Sustainable Bonds

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By way of illustration – the recent EUR 2.5 billion bond issues by The Community of Madrid and City of Barcelona are not included in Green Bond databases due to a large percentage of proceeds being for social projects rather than environmental purposes – these are "Social Bonds".

## Green Bonds – An Overview

# Types of Green Bonds

Type	Proceeds raised by bond sale are	Debt recourse	Example
"Use of Proceeds" Bond	Earmarked for green projects	Recourse to the issuer: same credit rating applies as issuer's other bonds	EIB "Climate Awareness Bond" (backed by EIB); Barclays Green Bond
"Use of Proceeds" Revenue Bond or ABS	Earmarked for or refinance green projects	Revenue streams from the issuers though fees, taxes etc are collateral for the debt	Hawaii State (backed by fee on electricity bills of the state utilities)
Project Green Bonds	Ring-fenced for the specific underlying green project(s)	Recourse is only to the project's assets and balance sheet	Invenergy Wind Farm (backed by Invenergy Campo Palomas wind farm)
Securitisation (ABS) Bond	Refinance portfolios of green projects or proceeds are earmarked for green projects	Recourse is to a group of projects that have been grouped together (e.g. solar leases or green mortgages)	Tesla Energy (backed by residential solar leases); Obvion (backed by green mortgages)
Covered Bond	Earmarked for eligible projects included in the covered pool	Recourse to the issuer and, if the issuer is unable to repay the bond, to the covered pool	Berlin Hyp green Pfandbrief; Sparebank 1 Bolligkredit green covered bond
Other debt instruments	Earmarked for eligible projects		Convertible Bonds or Notes, Schuldschein, Commercial Paper, Sukuk, Debentures

Source: CBI

## Green Bonds – An Overview

# Green Bonds are not Blue Bonds!

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- “Blue” Bonds are cousins of Green Bonds and are inspired by the green bond concept
- Bonds issued to finance **marine and ocean-based projects** that have positive environmental, economic and climate benefits. Also known as "dolphin debt".
- Republic of Seychelles first sovereign issuer of Blue Bond
  - USD15 million, privately placed with three investors, 10 year maturity
  - financial support from the World Bank (partial guarantee) and the Global Environment Fund (concessionary loan subsidising the coupon payments)
  - provides financing for marine and ocean-related activities in Seychelles Exclusive Economic Zone that contribute to the transition to sustainable fishing

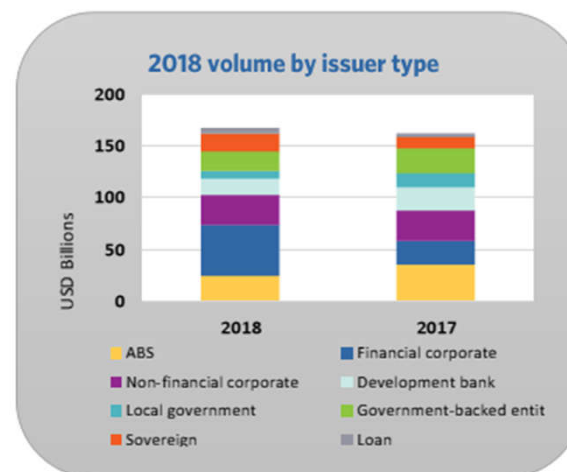


*Flag of Seychelles*

## Green Bonds – An Overview

# Who issues Green Bonds?

- Fannie Mae was largest global issuer in 2018 - USD20.1 billion
- China's Industrial Bank Co was largest corporate issuer in 2018
- Green Issuers - in the business of "green" – e.g. renewable energy companies
- “Brown” / traditional Issuers & corporates – **but** green Use of Proceeds
- Issuers include sovereigns, state agencies and state owned entities, supranationals, financial institutions, municipalities and corporates



Source: Climate Bonds Initiative



## Green Bonds – An Overview

# Why do Issuers issue Green Bonds?

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- Most obviously - to raise funds for green / sustainable initiatives / operations
- Other benefits include:
  - Advertising green and sustainable plans of Issuer - positive reputational / customers/clients impact
  - Fits nicely within CSR – “good corporate citizen”
  - Investor diversification / access to green-only investors – no impact on pricing as yet
  - Internal organisational / cultural benefits of linking finance teams with sustainability operations teams
    - Starbucks, after issuing its \$500m sustainability bond, noted:  
“...integrating our corporate sustainability strategy with a core part of our capital structure has raised our level of integration and cooperation”
  - Currently there is no tax benefit for issuers in issuing green bonds – customary tax analysis applies (quoted eurobond exemption).

## Green Bonds – An Overview

# Who buys Green Bonds and Why?

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- Institutional investors, often with either an ESG (environment, social and governance) mandate or an environmental focus
- Other usual buy-side:
  - investment managers
  - corporate investors
  - governments / supranationals
    - ECB Eurosystem corporate sector purchase programme held approximately EUR 6 billion in green corporate bonds in 2018
- Retail investors are relatively rare
- There is currently no tax advantage for buying / holding Green Bonds
- The Netherlands debut Green Bond in May 2019 saw ESG investors given a priority allocation worth up to 10% of their bids



## Green Bonds – An Overview

# Evolution of the Green Bond Market

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- **2007** – EIB and World Bank issue first Green / Climate Awareness Bonds
- **December 2010** – The Climate Bond Initiative launches the Climate Bond Standard and Certification Scheme
- **March 2013** – IFC sells the first benchmark USD 1 billion Green Bond
- **June 2013** – first muni Green Bond was issued by Massachusetts
- **October 2013** – Gothenburg issues the first City Green Bond
- **November 2013** – SolarCity (now Tesla Energy) issues the first solar ABS
- **2014** – ICMA establishes its Green Bond Principles
- **November 2014** – Vasakronan, a Swedish property company – issues first corporate Green Bond – this has a dynamic impact on market
- **2015** – United Nations Sustainable Development Goals
- **2018** – ICMA updates and revises its Green Bond Principles
- **31 December 2018** – Green Bond issuance in 2018 hits **USD 167.3 billion**
- **January 2019** – Green Bond issuance in 2019 estimated at **USD 250 billion**



## Green Bonds – An Overview

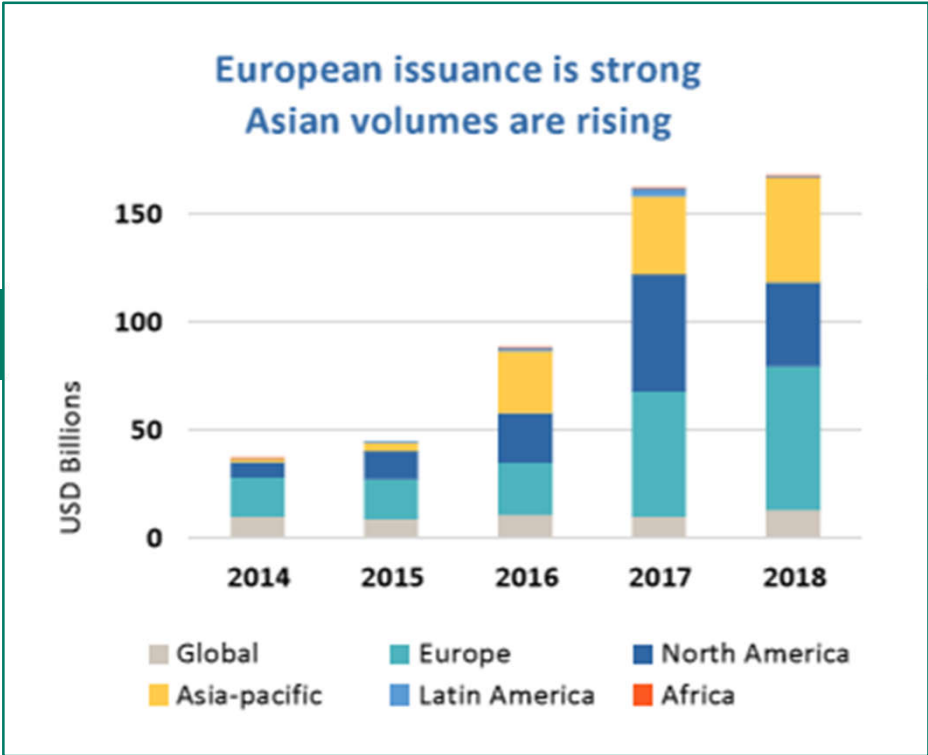
# Green Bond Market in 2018

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- > USD167.3bn total Green Bond issuance
- > 3% growth on 2017
- > 1,543 Green Bond issues from 320 issuers
- > 204 new issuers, bringing the total to 625 issuers
- > 44 countries, of which 8 new countries
- > EUR4.5bn (USD5.5bn) – largest single Green Bond, issued by the Kingdom of Belgium
- > New sovereign Green Bonds from Belgium, Indonesia, Ireland, Lithuania, and Poland and two taps of France's green OAT (GrOAT)

# Green Bonds – An Overview

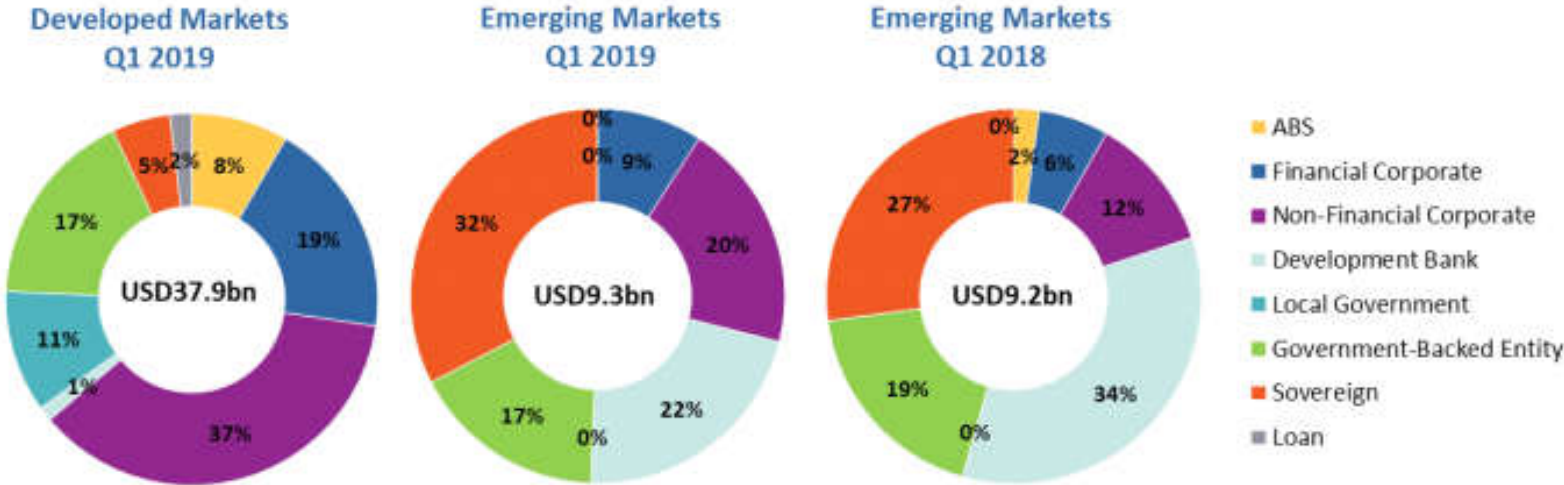
## Green Bond Market – Geographic Distribution | 1



Source: Climate Bonds Initiative

# Green Bonds – An Overview

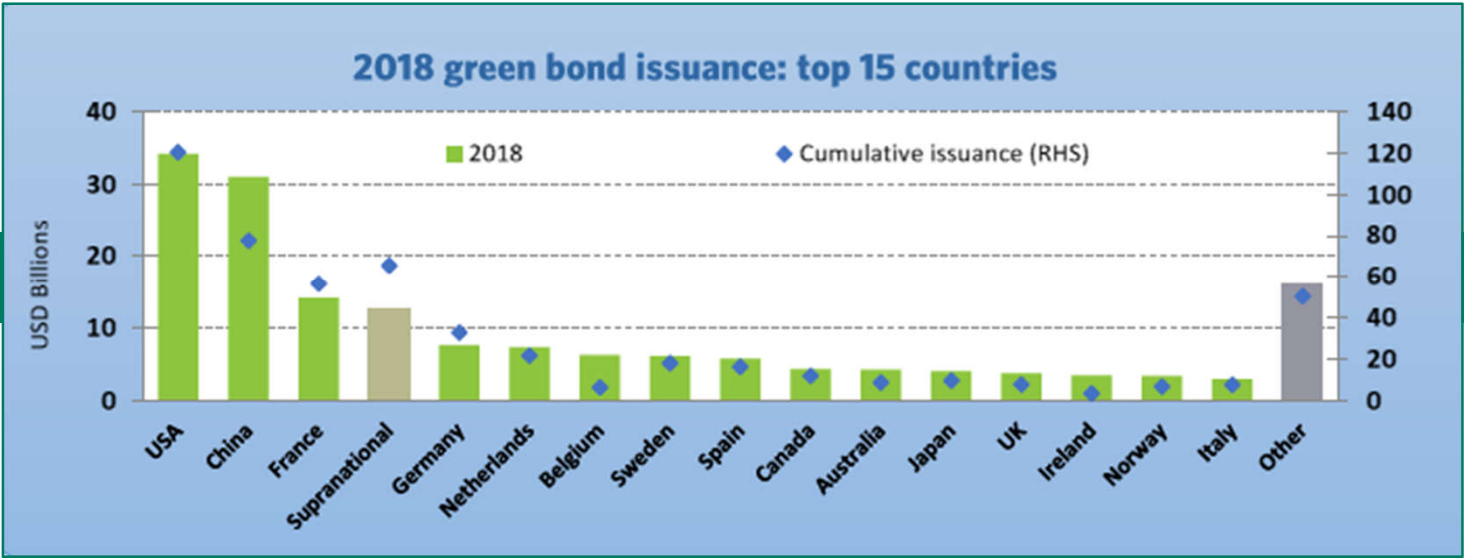
## Green Bond Market – Geographic Distribution | 2



Source: Climate Bonds Initiative

# Green Bonds – An Overview

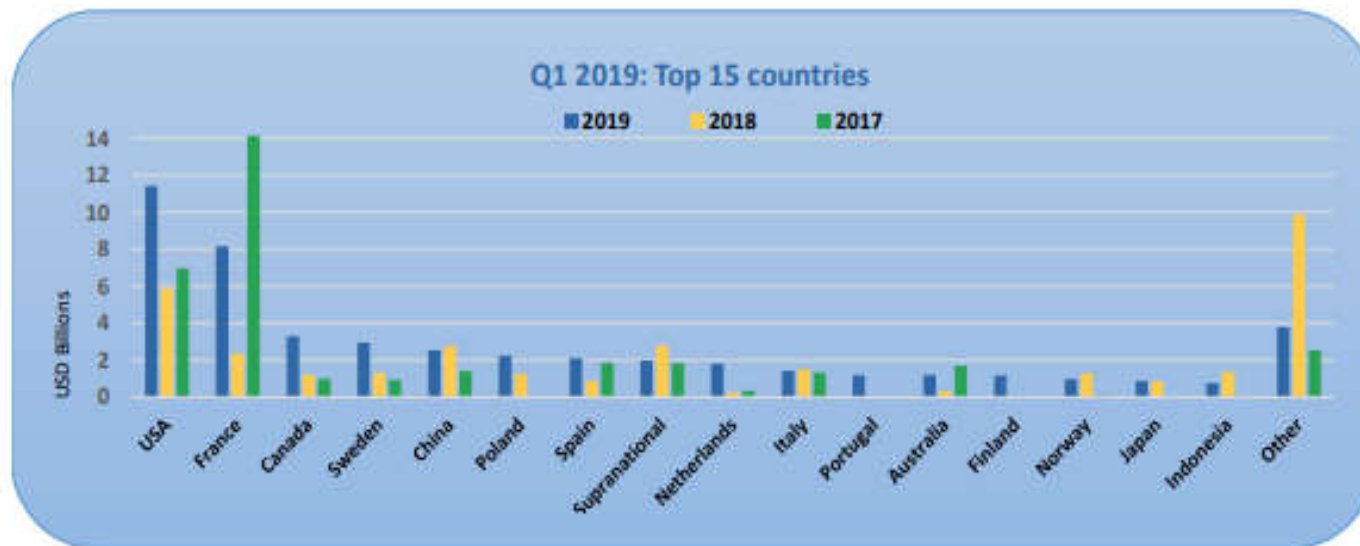
## Green Bond Market – Geographic Distribution | 3



Source: Climate Bonds Initiative

## Green Bonds – An Overview

# Green Bond Market – Geographic Distribution | 4



Source: Climate Bonds Initiative



## Green Bonds – An Overview

# The Political / Legal / Regulatory Dynamic

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- **2015** – UN General Assembly – **Sustainable Development Goals** and **2030 Agenda** for Sustainable Development
- **December 2016** – **Paris Agreement** on Climate Change – ratified by 170 countries
- **December 2016** – EU Appointment of High-Level Expert Group (HLEG) on Sustainable Finance
- **June 2017** – Mid-Term Review of Capital Markets Union (“CMU”) – HLEG input
  - *EU Commission recognises that a “**deep re-engineering**” of the financial system is necessary for investment to become more sustainable*
- **July 2017** – Interim Report of the HLEG
  - *Sustainability to be integrated into the core processes of finance/capital to be mobilised*
  - *Key recommendations on accounting changes / fiduciary duties of investors / non-financial reporting*
- **January 2018** – Final Report of HLEG “*Financing a Sustainable European Economy*”
  - *a transformation of the entire financial system, its culture and its incentives*
  - *a comprehensive blueprint for change*
  - *the bible!*
- **March 2018** – EU Commission publishes **Action Plan on Sustainable Finance**
- **December 2018** – **Katowice Agreement** on implementing Paris Agreement

## Green Bonds – An Overview

# EU Action Plan – Sustainable Growth

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- EU Commission Action Plan - March 2018.
- Four key legislative proposals for EU Parliament / Commission in May 2018 plan:
  - **Taxonomy** – agreed definitions of sustainable economic activity
  - **Disclosure and duties** – create obligations on institutional investors to include ESG factors in investment decisions / disclose how they use ESG factors in investment
  - **Benchmarks** – amend Benchmarks Regulation to create low carbon / positive carbon impact benchmark
  - **Sustainability preferences (consultation)** – feedback solicited for updating MiFID II / PRIIPs to include ESG considerations in investor advice



## Green Bonds – An Overview

# Timeline for EU Action Plan

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EU Action Plan includes a timetable for all actions that will be rolled out by Q2 2019:

- In May 2018, Commission put forward proposals on the duties of institutional investors and asset managers regarding sustainability and the principles and scope of an EU taxonomy for climate change and other environmental and social activities.
- In Q2 2018, the Commission was scheduled to amend Markets in Financial Instruments Directive (MIFID II) and the Insurance Distribution Directive (IDD) delegated acts to enhance sustainability in suitability assessment.
  - Consultations took place in Q2 2018 but no actual amendments as of March 2019
- In Q1 2019, the expert group was scheduled to publish a report on a taxonomy on climate change activities.
  - Published January 2019
- This will be followed in Q2 2019 by a report on a taxonomy on climate change adaptation and other environmental activities as well as a report on green bond standards.
  - Currently anticipated June 2019
- In Q2 2019, the Commission will publish its fitness check of EU legislations on public corporate reporting and amend its non-binding guidelines on non-financial reporting. The Commission will also adopt a delegated act on the content of the prospectus for green bond issuances and publish a comprehensive study on sustainability ratings and research.
  - Consultation on non-binding guidelines launched February 2019

## Green Bonds – An Overview

# ICMA - Green Bond Principles

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### Green Bond Principles (GBP)

- Published in 2014 and last updated in June 2018
- Aim of the GBP was to strengthen the integrity of the Green Bond market
- Voluntary market guidelines – not law or regulation
- The GBP have 4 components :
  - 1. Use of Proceeds** - typically similar to "to finance and/or refinance, in whole or in part, Eligible Green Projects."
  - 2. Process for Project Evaluation and Selection** - varies based on individual nature of projects and selection criteria.
  - 3. Management of Proceeds** - in some cases "ringfenced" into separate accounts
  - 4. Reporting** - using external verifier or can be self-reporting. Generally reports published at least annually (e.g. on website of issuer)

## Green Bonds – An Overview

# Other Regional Industry Association / Jurisdictional Standards

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Globally several industry associations / jurisdictions/regions have developed / are developing their own guidelines including:

- ASEAN Capital Markets Forum:
  - Green Bond Standards
  - Social Bond Standards
  - Sustainability Bond Standards
- Japan - Green Bond Guidelines
- China
  - People's Bank of China Announcement 2015
  - Green Bond Catalogue of Sectors and Projects
- Kenya - Policy Guideline Note



## Green Bonds – An Overview

# Climate Bond Initiative 2010

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### Climate Bond Initiative (CBI) certification

CBI establishment in 2010 of independent third party labelling / certification of Green Bonds was a critical step in the development and credibility of the market

- **Project nomination** – identify eligible projects and physical assets associated with the Green Bond
- **No contamination; environment and social integrity** - ensure that proceeds are not contaminated by activities inconsistent with low carbon economy and disclose the environmental and social aspects of chosen projects
- **Issuance of certificate** - the CBI's Standard Board issues a certificate based on the report submitted by the verifier
- **Report of non-compliance** - if the Green Bond becomes non-compliant after issuance, the Issuer must disclose this fact to the Standard Board

## Green Bonds – An Overview

# Green Bonds – Specific Legal Challenges / Risks

- **Prospectus liability** - If the issuer states that it would use the proceeds of the issuance for certain eligible investments, and does not, there may be criminal / civil liability. Bondholders who suffer a loss as a result of a breach in terms and conditions may be able to claim compensation from the issuer in certain jurisdictions
- **Breach of reps/warranties = indemnity claim** - liability to the managers if there is a breach of any rep in the subscription agreement that the offering materials are accurate, complete and not misleading. Managers may have a claim under customary indemnity from the issuer if they suffer loss
- **Liability for periodic reports** - market transparency regimes in many jurisdictions under which issuers may be liable for certain misstatements and omissions in ongoing disclosures, including in periodic reports
- **Breach of green undertakings** - Some tailored limited recourse Green Project Bonds and Green structured finance Bonds may include "green" undertakings to Bond / Security Trustees, breach of which could result in an actual / potential event of default
- **No EoD** - Green Bonds do not trigger an event of default if the use of proceeds is not complied with. Bondholders have no contractual rights – so long as interest / principal is paid

# Green Bonds under EMTN Programmes

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- Easy to do as Programmes have flexible legal architecture
  - Final Terms
    - Use of Proceeds
  - Supplemental Prospectus
    - Use of Proceeds
    - Enhanced “Green” Risk factors
  - Amended and Restated Dealer Agreement
- Annual Technical Update
  - A good time to “refit” the Programme
- Green EMTN Programmes





## Green Bonds – An Overview

# Green Bonds and Rule 144A

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- Rule 144A v. Regulation S
- There are market concerns about Green Bonds + Rule 144A
- Rule 144A issuance involves:
  - strict liability standards
  - a rigorous disclosure approach
  - third party green bond certification in the offer document
  - enhanced risk of investor litigation
  - greatly enhanced management and legal due diligence
  - law firms giving 10b-5 disclosure letters
- Issuers / underwriters need to be mindful of best disclosure practices:
  - describe in general terms, rather than specifically characterise, the underlying sustainable activity
  - disclose in detail / robustly any risk factors related to the sustainability credentials
  - do not omit "negative" disclosure that would be material to the sustainability credentials

# Green Bonds and the Rating Agencies

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- “Green bond rating” / “Green bond assessment” - a number of rating agencies (including Moody’s and S&P) assess the bond’s alignment with the Green Bond Principles and the integrity of its green credentials
  - For example Moody’s, which started providing such assessments in 2016, provides ratings from GB1 (Excellent) to GB5 (Poor)
  - May be used in addition to normal credit ratings on the issuer / bond
  - Distinct from “second party opinions” or “third party assurance” (provided by ESG service providers, audit firms and scientific firms)
- Rating agencies increasingly including and highlighting ESG factors as part of their credit analysis (even for non-green bonds)

## Green Bonds – An Overview

# Green Bonds vs Green Loans

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- Green Loan Market smaller (EUR 19 billion volume outstanding in Europe 2018) and younger (starting around 2014) than Green Bond market
- Many similar advantages to borrowers as with issuers of green bonds
- LMA / APLMA Green Loan Principles issued in March 2018 - very similar to ICMA Green Bond Principles (same four central components)
- LMA has indicated it will also develop social / sustainable loan principles tracking ICMA bond equivalents
- Use of proceeds disclosure, while usual in traditional bonds, is new feature for most loan documents
- Green tranches on existing corporate loan facilities are possible
- Bespoke green loans possible, e.g. ING 2017 loan to Phillips where interest rate coupled to borrower's meeting sustainability targets (concept adopted by many subsequent borrowers)

## Green Bonds – An Overview

# Listing Green Bonds - General

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- There are a growing number of Green Bond markets or recognised market segments within several Stock Exchanges e.g. London, Luxembourg, Oslo, and Mexico, India and Shanghai
- Why ?
- Green Bonds must comply with the listing rules of the Green Bond segment of the relevant Stock Exchange in addition to all non-green regulatory listing requirements for bonds
- Common features of green listing markets / segments / exchanges:
  - Proceeds must be used for green projects (with definition of "green" varying by venue)
  - External review document certifying objectively the true “green” nature of the bond

## Green Bonds – An Overview

# Listing - Green Bonds and The London Stock Exchange

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- Lets examine the LSE which has been very successful in establishing itself as green exchange
- Green bonds listed on LSE have raised in excess of \$25.3 billion in seven currencies.
- For LSE listings, Green Bonds have the same regulatory status of equivalent “non-green” bonds and can normally be issued using standard prospectuses.
- To admit green bonds to LSE's dedicated ‘Green Bond’ segments, issuers must provide LSE with a “second opinion” document that certifies the ‘green’ nature of the bonds. Certification provider must be an entity:
  - with a registered office in the EEA / Switzerland with financial resources to conduct the verification
  - independent of the entity issuing the bond, its directors, senior management and advisers
  - remunerated in a way that prevents any conflicts of interests as a result of the fee structure
  - specialising and with sufficient expertise in assessing the framework of the bonds’ environmental objectives and performing an assessment of the use of proceeds

## Green Bonds – An Overview

# Listing - Green Bonds and The London Stock Exchange | II

LSE has dedicated Green Bond Segments on the Orderbook for Retail Bonds (ORB), Orderbook for Fixed Income Securities (OFIS), and Trade Reporting only segments

Trading Service	Segment Code	Sector Code	Sector Name	London Stock Exchange Market	ESMA status: Regulated Market (RM) or Multilateral Trading Facility (MTF)	Listing Status
Order book for Retail Bonds	UKCP	UKGR	ORB GREEN BONDS	MAIN	RM	UKLA Official List - Standard
Order book for Fixed Income Securities	GRNC	CGDQ	CORP WHOLESALE GREEN DEBT CONT. QUO	MAIN	RM	UKLA Official List - Standard
Order book for Fixed Income Securities	GRNC	CGRQ	CORP RETAIL GREEN DEBT CONT. QUO	MAIN	RM	UKLA Official List - Standard
Order book for Fixed Income Securities	GRNE	CGDE	CORP WHOLESALE GREEN DEBT CONT. QUOTING	MAIN	RM	UKLA Official List - Standard
Order book for Fixed Income Securities	GRNE	CGRE	CORP RETAIL GREEN DEBT END OF DAY	MAIN	RM	UKLA Official List - Standard
Order book for Fixed Income Securities	GRPQ	PGRQ	PROFESSIONAL DEBT GREEN CONT. QUO EXCH REG	PSM	MTF	UKLA Official List - Standard
Order book for Fixed Income Securities	GRPE	PGRE	PROFESSIONAL DEBT GREEN EOD EXCH REG	PSM	MTF	UKLA Official List - Standard
Fixed interest (Trade reporting Only)	CWTU	UICU	PROFESSIONAL DEBT GREEN TRADE REPORTING	PSM	MTF	UKLA Official List - Standard
Fixed interest (Trade reporting Only)	PSTR	UIDP	REGULATED MARKET GREEN TRADE REPORTING	MAIN	RM	UKLA Official List - Standard

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