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MIDDLE EAST
THE EVOLUTION OF SUSTAINABLE
CAPITAL MARKETS

GROWING THE GREEN ECONOMY

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In keeping with global trends which have seen sustainable finance continue to expand to the level where, at the start of 2018, global sustainable investment in five major markets across the globe amounted to roughly USD30.7 trillion (*source*: Global Sustainable Investment Alliance), the development of sustainable finance, including through the use of green bonds, green sukuk and green loans, continues to evolve across a region more readily associated with its conventional energy resources, oil and gas.

Despite a legacy of substantial oil and gas production across the Middle East, governments and corporates in the region continue to show increasing sensitivity to environmental issues and a desire to develop their economies in a sustainable manner, and this push towards sustainable development seems likely to encourage further growth in ESG capital markets origination going forward given the clear political and social mandate to do so. For instance, the United Arab Emirates includes developing a “Sustainable Environment and Infrastructure” amongst its Vision 2021 National Agenda goals, with an emphasis on “improving the quality of air, preserving water resources, increasing the contribution of clean energy and implementing green growth plans” (*source*: UAE Vision 2021). The Emirate of Dubai has similarly set itself a number of sustainability goals to be advanced by its hosting of Expo 2020 next year. Further, the Dubai Financial Services Authority has also published its own Green Bond Best Practice Guidelines as of August 2018 to offer infrastructure and guidance in relation to green issuances in the capital markets. Sustainability initiatives in the region are not only limited to the United Arab Emirates, however, with the Kingdom of Saudi Arabia (which remains the world’s second largest oil producer) including sustainability objectives as part of its National Transformation Programme (one of 13 programmes developed with the intention of achieving the Kingdom’s Vision 2030).

ESG sukuk

Historically, the first Middle East green bond was issued by a financial institution, First Abu Dhabi Bank, in 2015. With no new ESG issuance for the next two and a half years, the region lacked further development in sustainable finance until 2019 which witnessed the launch of a number of green sukuk issuances by key regional issuers. The issuances were heralded by a USD600 million issuance by Majid Al Futtaim Holding LLC in May 2019. Majid Al Futtaim is one of the largest developers and operators of shopping malls and hypermarkets in the Middle East and North Africa

region and the issuance marked the first green sukuk issuance by a corporate issuer in the GCC. This highly successful issuance was followed by a second USD600 million green sukuk issuance by Majid Al Futtaim in October 2019. In November 2019, The Islamic Development Bank completed its debut green sukuk issuance. This EUR1 billion issuance is the first ever AAA-rated green sukuk in the global capital markets. With 57 member countries, The Islamic Development Bank is a multilateral development bank which was founded for the purpose of fostering economic development and social progress in its member countries in accordance with the principles of *Shari'a*.

As is the case with a ESG conventional bond, the defining feature of a ESG sukuk is that the issuance proceeds must be used for environmental, social and/or governance purposes, while the key distinction is that the issuance will assume a *Shari'a*-compliant structure rather than a conventional issuance structure. Depending on the nature of the issuance in question, the use of proceeds may be for a specific project or operation; it is also common for the proceeds to be used for unspecified present or future projects in compliance with certain criteria set out in the offering document. In the case of Majid Al Futtaim, the issuance proceeds were to be applied in accordance with the company's Green Finance Framework for any one of four eligible project categories: green buildings; renewable energy; sustainable water management; and energy efficiency. Similarly, The Islamic Development Bank has established a Sustainable Finance Framework for the purposes of financing or refinancing green projects (being projects within any of the following categories: renewable energy; clean transportation; energy efficiency; pollution prevention and control; environmentally sustainable management of natural living resources and land use; and sustainable water and wastewater management) or social projects (being projects within any of the following categories: employment generation/small and medium enterprise financing; affordable housing; affordable basic infrastructure; access to essential services; and socioeconomic advancement and empowerment). Its November 2019 issuance was earmarked for green projects.

Of course, these green sukuk issuances cannot be divorced from commercial considerations – namely, diversification of the issuer's investor base, liquidity and cost of funds. A positive development in this regard is portfolio managers' awareness of including sustainable assets as part of a diversified portfolio, and managed funds becoming increasingly decisive in their desire to invest in yielding sustainable assets. From a commercial perspective, particularly where an issuer has an existing credit curve of conventional bonds and/or sukuk, a key consideration in the decision to issue a ESG bond/sukuk will be pricing in line with the existing credit curve. This is particularly the case when the establishment by the issuer of a green/ESG framework is taken into consideration, together with the management infrastructure involved in that process. In the absence of political considerations, that pricing outcome will remain a key determinant of the speed at which issuers across the region embrace sustainable funding in the capital markets.

Opportunities and next steps

With international energy markets ever sensitive to extraneous geopolitical events and technological disruption, commercial and political emphasis in the region will likely continue to move towards sustainable forms of development. In addition to the growing global consensus on the need for environmental sustainability, the nature of Government and corporate issuers in the region also leaves the Middle East well primed to take advantage of increasing opportunities provided by sustainable finance. Many frequent entrants into the capital markets in the region may well determine that their businesses lend themselves to sustainable development strategies: for example, real estate developers may seek to construct more energy and resource-efficient buildings; and transport and logistics corporates may wish to utilise advancements in renewable energy sources and more energy efficient technologies. Indeed, a number of other regional issuers have already, or are in the process of, establishing sustainable financing frameworks. For instance, following DP World PLC's execution of a green loan in 2018, where the loan pricing was linked to DP World's carbon emission intensity and therefore incentivised the company to reduce its greenhouse gas emission, the company (which is one of the largest and most geographically diversified logistics, marine and inland container terminal operators in the world) has recently established its Sustainable Development Financing Framework for financing or refinancing eligible projects which fall within the "Green/Social/Sustainability Bond Principles" promulgated by the International Capital Market Association. The recent green sukuk transactions have provided a timely advance in the region's use of sustainable finance and, with other issuers looking to establish ESG finance frameworks, the prognosis for ESG sukuk in the region remains positive.

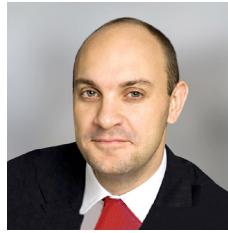
CONTACTS



Matthew Oliver
Associate
T: +971 4503 2759
E: matthew.oliver@cliffordchance.com



Alekhya Prakash
Senior Associate
T: +971 4503 2688
E: alekhya.prakash@cliffordchance.com



Stuart Ure
Partner
T: +971 4503 2659
E: stuart.ure@cliffordchance.com

GROWING THE GREEN ECONOMY



This article was initially published in **GROWING THE GREEN ECONOMY: ADDRESSING THE SUSTAINABILITY CHALLENGES AND OPPORTUNITIES**, our far-reaching look at developments in ESG and sustainable finance.

The severe warnings on climate change starkly documented by the IPCC report and others demonstrate why urgent action to meet the goals of the Paris Agreement is needed. The public, governments and legislators are taking notice and taking action. Much of the legislative effort to date has been focused on the financial system but there is an increasing emphasis on non-financial entities and the requirements that are beginning to be expected of them. These requirements stem from legislation, public pressure and possible litigation.

GROWING THE GREEN ECONOMY reflects the breadth and depth of the impact of these environmental and sustainable factors. Visit www.cliffordchance.com/greeneconomy to read and download the publication in full.

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