PERSPECTIVES SERIES
GREENING THE FINANCIAL SYSTEM: GREEN BONDS

ANGELA CHAN AND MARK CHAN
15 MARCH 2018
OVERVIEW

- Background to green finance and Green Bonds
- The Green Bond Principles (2017)
- Climate Bond Standards
- China’s Green Bonds Guidelines
- Green Bonds: Asia market overview and trends
- Legal and Documentation Considerations
- 2018 and beyond: regulatory and market developments
Recognition of the need to mobilise green, climate smart, environmentally friendly financing.

High on the agenda of regulators, governments and the institutional investor and financial communities globally.

Cumulation of this most recently in the Paris Agreement in 2015
• Multitude of initiatives aimed at turning finance “green”.

• Consistent theme supported by policy signals from national and supranational institutions is that private markets need to provide the majority of increased investment required to meet climate changes goals.

• Green bond market set to continue to play a crucial role (see strategy recommendations and proposals by G20 Green Finance Study Group, EU High-Level Expert Group on Sustainable Finance, World Bank and UN).
European Commission High-Level Expert Group on Sustainable Finance (HLEG)

Task Force on Climate-Related Financial Disclosures

G20 – Green Finance Study Group (GFSG)

Climate Bonds Initiative (CBI)

Green Bond Principles (GBP)
Green Bonds are any type of bond instrument where proceeds will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects.

Long standing debates on what constitutes “green” and therefore what Green Projects are.

BACKGROUND TO GREEN FINANCE AND GREEN BONDS

LACK OF STANDARDISATION AND TAXONOMIES

HOW STANDARDS PROLIFERATE:
(SEE: A/C CHARGERS, CHARACTER ENCODINGS, INSTANT MESSAGING, ETC.)

SITUATION: THERE ARE 14 COMPETING STANDARDS.

14?! RIDICULOUS! WE NEED TO DEVELOP ONE UNIVERSAL STANDARD THAT COVERS EVERYONE'S USE CASES. YEAH!

SOON:

SITUATION: THERE ARE 15 COMPETING STANDARDS.
THE GREEN BOND PRINCIPLES

INTRODUCTION

- **WHO**: Collection of investors, issuers and underwriters as members, electing an executive committee of 24 members, with ICMA as GBP secretariat.

- **WHAT**:
  1. Market practitioner-developed set of non-prescriptive principles designed to promote the growth of the market without imposing unduly high barriers to entry.
  2. Promote integrity to the market by setting out guidelines on transparency, disclosure and reporting.
THE GREEN BOND PRINCIPLES (Cont.)

INTRODUCTION (CONT.)

- RECOMMENDATIONS: Voluntary, industry-wide principles (most recently updated in June 2017)

- FOUR COMPONENTS:
  1. Use of proceeds
  2. Process for project evaluation and selection
  3. Management of Proceeds
  4. Reporting
THE GREEN BOND PRINCIPLES (Cont.)

USE OF PROCEEDS

Source: asyou sow.org
THE GREEN BOND PRINCIPLES (Cont.)

USE OF PROCEEDS (Cont.)

Renewable Energy going strong but low Carbon Buildings/Energy Efficiency post record growth

Source: Climate Bonds Initiative – Green Bond Highlights 2017 (Jan 2018)
THE GREEN BOND PRINCIPLES (Cont.)

PROCESS FOR PROJECT EVALUATION

• Issuer of a Green Bond should clearly communicate to investors:
  – the environmental sustainability objectives;
  – the process by which the issuer determines how the project fit within eligible Green Projects categories; and
  – the related eligibility criteria.

• GBP encourages a high level of transparency and recommend that an issuer’s process for project evaluation and selection be supplemented by an external review.
THE GREEN BOND PRINCIPLES (Cont.)

MANAGEMENT OF PROCEEDS

- Net proceeds (or equivalent amount) credited to sub-account, moved to sub-portfolio or otherwise tracked.

- So long as Green Bond is outstanding, the balance of the tracked proceeds should be periodically adjusted to match allocations to eligible Green Projects made during that period.

- GBP recommend issuers’ management of proceeds be supplemented by the use of an auditor or 3rd party to verify the internal tracking method and the allocation of funds.
THE GREEN BOND PRINCIPLES (Cont.)

REPORTING

- Issuers should make, and keep readily available up to date information on the use of proceeds to be renewed annually until full allocation.

- A list of projects to which Green Bond proceeds have been allocated as well as brief description of the projects and amount allocated, and their expected impact.

- GBP recommend the use of qualitative performance indicators and where feasible, quantitative performance measures and disclosure of key underlying methodology and/or assumptions.
THE GREEN BOND PRINCIPLES (Cont.)

EXTERNAL REVIEW

- Recommendation that issuers use an external review to confirm the alignment of their Green Bonds with key features of GBP.

- Variety of ways:
  - Consultant Review
  - Verification
  - Certification
  - Rating

- Disclosure of external reviews.
## THE GREEN BOND PRINCIPLES (Cont.)

### PRACTICAL EXECUTION ISSUES

<table>
<thead>
<tr>
<th>Management Statement</th>
<th>Disclosure &amp; Other Reporting</th>
<th>External Review</th>
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<tr>
<td>• Preparation by management and review by parties involved.</td>
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<td>• Ensure coverage of 4 components.</td>
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<td>• Make available generally (uploading onto website).</td>
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<tr>
<td>• Use of Proceeds disclosure in offering document setting out eligible Green Projects List – ensuring sufficient disclosure.</td>
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<td>• Complete Green Bond information form (ICMA)</td>
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<td>• Engaging external review provider.</td>
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<td>• Most commonly auditors (verification), who will:</td>
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<td>‒ perform limited assurance procedures</td>
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<td>‒ complete external review form</td>
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<td>‒ issue assessment results and assurance report</td>
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<td>• Reviewing such documents (but these do not generally form part of the offering document).</td>
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CLIMATE BOND STANDARDS

INTRODUCTION

• **WHO**: Climate Bonds Initiative ("CBI") was launched in 2009 by the Network for Sustainable Markets.

• **WHAT**: CBI’s objective is to promote the widespread use of green bonds to finance a transition to a low carbon economy.

• **RECOMMENDATIONS**: primary focus to develop the Climate Bonds Standard and Certification Scheme.
In order to achieve the “Climate Bond Certified” label, a prospective issuer of a Green Bond must appoint an independent verifier to provide a verification statement that the bond meets the Climate Bond Standard.

Information about the bond is also reviewed by the Climate Bond Standards Board.

Intention is that the development of such a standard will lead to improved confidence, quality and transparency in the market for Green Bonds.
CHINA'S GREEN BONDS GUIDELINES

INTRODUCTION

• Policy direction on implementation of a green financial system outlined under China’s 13th five year plan in 2015.

• In support of this, various Chinese regulators have promulgated guidelines:
  – PBOC Announcement [2015] No. 39
  – NDRC Green Bond Guidelines [2015] No. 3504
  – CSRC Guidance on Green Bond Support and Development [2017] No. 6

• These are for domestic Green Bonds.
The type of projects recognised as being eligible as “green”.

- Eg: projects involving “clean” coal, refitting of fossil fuel power stations and the mixed use infrastructure projects (involving both renewable energy and fossil fuels) would be regarded as being green eligible projects under China’s Green Bonds Guidelines but not recognised under international standards such as GBP.
The restrictions over the use of bond proceeds.

- Eg: NDRC Green Bond Guidelines permit state-owned enterprise green bond issuers to use up to 50 per cent. of bond proceeds to repay existing bank loans and invest in general working capital whereas in contrast, at least 90 to 95 per cent. of the bond proceeds would be required to be linked to green assets or projects before being eligible under international standards.
The labelled green bond market is growing rapidly

Source: Climate Bonds Initiative – Green Bond Highlights 2017 (Jan 2018)

2017 in numbers
USD155.5bn – total green bond issuance
78% growth on 2016
1500+ issues
37 countries of issuance on all 6 continents
239 different issuers
146 new issuers
USD10.7bn – largest single green bond
3 sovereign green bonds
GREEN BONDS: ASIA MARKET OVERVIEW AND TRENDS

The US, China and France dominate 2017 Issuance

China is a major player within a growing global green bond market

Source: Climate Bonds Initiative – Green Bond Highlights 2017 (Jan 2018)
GREEN BONDS: ASIA MARKET OVERVIEW AND TRENDS

2017 GREEN BOND ISSUANCE: CHINA IS A MAJOR PLAYER WITHIN A GROWING GLOBAL GREEN BOND MARKET

Source: Climate Bonds Initiative – China Green Bond Market 2017 (Feb 2018)
GREEN BONDS: ASIA MARKET OVERVIEW AND TRENDS

A CLOSER LOOK AT CHINA...

Onshore market dominates the green bond issuance

Commercial banks are still the largest source of green bond issuance

Source: Climate Bonds Initiative – China Green Bond Market 2017 (Feb 2018)
The Big-4 account for more than half of external reviews

<table>
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<th>Chinese green bonds certified by Climate Bonds Initiative</th>
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<tr>
<td><strong>Issuer</strong></td>
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<tr>
<td>China Three Gorges</td>
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<td>Industrial and Commercial Bank of China</td>
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<td>China Development Bank</td>
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<td>Bank of China</td>
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Source: Climate Bonds Initiative – China Green Bond Market 2017 (Feb 2018)
LEGAL AND DOCUMENTATION CONSIDERATIONS

- Maturation of the Green Bonds market and heightened focus on legal and documentary issues.
- Events of defaults and covenants
- Greenwashing risk
- Risk factors and disclaimers
- Commercial incentives
Some interesting deals:


- Bank of China’s green covered bond (2016) – backed by assets consisting of a portfolio of onshore green securities traded on the CIBM.
Some interesting deals (Cont.):

- Xinjiang Goldwind’s offshore issuance (2015) – first issue of bonds assessed under the GBPs carried out by a PRC-incorporated corporate.

Others: first One Belt One Road Climate Bond (Chinese and International Standards), first green retail bond and first green bond issued through Bond Connect.
• Hot off the press:

**First sovereign green sukuk by Indonesia**

Issuance of a US$3 billion dual tranche sukuk (comprising 5-year "green" sukuk and 10-year sukuk). The transaction was the world's first-ever sovereign green sukuk, and the first issuance under the Republic's green bond and green sukuk framework.
2018 AND BEYOND: REGULATORY AND MARKET DEVELOPMENTS

TRENDS

• A greener Belt and Road Initiative.
• Increasing green sovereign and sub-sovereign issuance.
• Progress on common international standards and definitions.
• Hong Kong initiatives:
  – a proposal to submit a resolution to the Legislative Council for the launch of a green bond issuance programme of up to HKD 100 billion; and
  – a Green Bond Grant Scheme to subsidise qualified green bond issuers using the Green Finance Certification Scheme.
CLIFFORD CHANCE CAPITAL MARKETS INSIGHTS
– GREEN FINANCE AND GREEN BONDS

USEFUL LINKS

Clifford Chance briefing “Greening the Financial System”

Clifford Chance briefing “Make our planet great again - Green, Social and Sustainability Bonds”
https://www.cliffordchance.com/briefings/2017/06/make_our_planet_greatagain-greensocialan.html

Clifford Chance briefing “Green bonds - is green the new black?”
https://www.cliffordchance.com/briefings/2015/12/green_bonds_is_green_the_new_black.html

“Climate change, green finance and renewables”
https://www.cliffordchance.com/thought_leadership/climate_change.html
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