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## Kramer Levin: Sorting Through the Options as Green Bonds Gain Popularity.

Global green bond issuance approached $40 billion in November, the busiest month for the environmentally minded fixed-income products to that point in 2015. This increase in activity pushed green bonds past the total amount from 2014, when issuers produced $36.59 billion worth of green bonds – the proceeds of which are used by public and private entities alike to fund investments with environmental benefits, such as to reduce carbon emissions or the construction of renewable energy infrastructure.

Although final figures for 2015 are not yet available, global rating agency Moody's expects the surge to continue through the end of the year, particularly following the United Nations Framework on Climate Change Conference that was held in Paris in December. Banks, companies and organizations as diverse as The World Bank, HSBC Holdings, GDF Suez and Southern Power have all completed green bond offerings, illustrating the bonds' popularity with a diverse set of issuers.

The bonds have also proved popular with investors, who continue to search out green assets for their portfolios. The New York Common Retirement Fund and Goldman Sachs recently formed a $2 billion fund to invest in low carbon emitters, part of an overall $3.4 trillion divestment from fossil fuels. In addition, Microsoft founder Bill Gates is leading an investor group – including Soros Fund Management chairman George Soros, Facebook CEO Mark Zuckerberg and Virgin Group founder Richard Branson – forming a $2 billion fund focused on clean energy investments. The Forum for Sustainable and Responsible Investment identified $6.6 trillion worth of AUM invested in sustainable projects in the U.S. in 2014, a 76% increase from 2012.

However, as a growing number of funds and other investors seek to add these bonds to their portfolios, a key question remains largely unanswered: What specifically qualifies as a green bond? Significant ambiguity exists as the category remains vaguely defined and without a universally recognized standard. As a result, some issuances may not necessarily be as "green" as others.

One benchmark that has emerged as a recognized measure of a green bond's level of authenticity is the International Capital Market Association's ("ICMA") Green Bond Principles. Created in 2014 and updated in 2015 in response to the rapidly developing market, the set of guidelines was developed in consultation with both investors and issuers. They have since gained the support of 55 of the world's biggest investors, bond issuers and intermediaries, including Bank of America Merrill Lynch, Citibank, Credit Agricole, JPMorgan Chase, Goldman Sachs and HSBC.

The principles include four primary components:

- **Use of Proceeds** – Green project categories should provide clear environmentally sustainable benefits, which, where feasible, will be quantified by the issuer.
- **Process for Project Evaluation and Selection** – The issuer should outline the decision-making process it follows to determine the eligibility of projects using green bond proceeds.
- **Management of Proceeds** – Bond proceeds should be appropriately tracked by the issuer using a

formal process.
- **Reporting** – Issuers should provide, at least annually, a list of projects that bond proceeds have been allocated toward, including a description of the projects, the amounts disbursed and the expected environmentally sustainable impact (as confidentiality and/or competitive considerations allow).

Through these guidelines, ICMA is not attempting to act as a regulator or enforcement agent. Rather, the principles are intended to encourage transparency and disclosure and "promote integrity in the development of the green bond market" and increase environmental benefits "without any single authority or gate keeper."

The not-for-profit Climate Bonds Initiative also manages a certification scheme that assesses, prior to a bond issuance, whether a bond meets certain standards, as determined by an appointed third-party verifier. The group's standards board then confirms the certification once the bond has been issued and the proceeds have been allocated to recognized projects and assets.

Green bond principles align well with the increased origination of property assessed clean energy ("PACE") assessments and PACE bonds in the U.S. All proceeds of PACE assessments are allocated to the construction of renewable energy and energy efficiency improvements to real property. According to the federal Energy Information Administration, residential and commercial buildings accounted for 41% of total U.S. energy consumption in 2014, demonstrating the tremendous potential that exists for such energy efficiency programs to reduce demand. Since 2011, Renovate America's HERO program, in conjunction with several California municipal entities, has financed more than $1 billion worth of environmentally friendly home improvements, resulting in five PACE bond securitizations. The most recent HERO Funding Trust PACE bond securitization indicated that it satisfied the ICMA Green Bond Principles, establishing a significant precedent for energy efficiency projects.

Gaining designation as a green bond is highly valuable for the issuer, as it opens the door for funds and others with assets to invest in environmentally friendly products. It also benefits green-specific fund managers, as it demonstrates to investors that they're fulfilling their objective of investing in sustainable projects. With an estimated gap of $650 billion to $860 billion of investment required to combat climate change every single year between now and 2030, the prominence of green bonds – and the importance of properly identifying them – is likely to continue.

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*The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.*

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