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[Recent Developments in Green Bonds: White & Case]

Brief Overview of Green Bonds

Green Bonds raise funds for new and existing projects with environmental benefits. They are similar to mainstream bonds with the difference residing essentially in a defined use of proceeds for specific green projects. From a credit perspective, Green Bonds are indistinguishable from other bonds. Operationally, Green Bonds largely function as conventional debt instruments. They are risk-weighted and credit rated in the usual way, based on the creditworthiness of the issuer, and they are generally listed, traded and regulated in the same way as other bonds in the international bond markets. Issuers and the dealers/managers expect pricing and transaction costs to be similar to the issuer's regular bonds.

However, there are a number of advantages to issuing a Green Bond as opposed to a regular corporate bond. From the issuer's perspective, a Green Bond (i) results in the diversification of its investor pool (e.g. greater numbers of asset managers and insurance or pension funds), and (ii) contributes to 'green' investor relations and corporate social responsibility initiatives. From a dealer/manager's perspective, Green Bonds can be marketed as premium products to their clients as many investors are required to invest in products such as Green Bonds in order to meet sustainability guidelines or criteria in their investment strategies.

Green Bond Market

The Green Bond market accounted for US$800m of issuance in 2007, but has expanded significantly every year since then. Moody's reported in February 2016 that Green Bond issuance for 2016 could exceed US$50bn2.

The Green Bond Principles3

In order to standardise Green Bonds, the Green Bond Principles ("GBP"), the first set of principles for verifying the credentials of Green Bonds, were launched in 2014 with the latest iteration published in June 2016. The GBP are voluntary guidelines that recommend transparency and disclosure and promote integrity in the development of the Green Bond market by clarifying the approach for issuance of a Green Bond. The GBP: (i) provide issuers guidance on the key components involved in launching a Green Bond; (ii) aid investors by ensuring availability of information necessary to evaluate the environmental impact of their Green Bond investments; and (iii) assist dealers/managers by moving the market towards standard disclosure which will facilitate transactions.

As there is no standard definition of what constitutes a 'Green Bond', the 'Use of Proceeds' section of a typical Green Bond Prospectus plays a key role in allowing investors to assess whether or not a given bond is "green enough" for them. The GBP reflect this, with disclosure of use of proceeds being central to the GBP. The GBP are not, however, prescriptive as to the form such disclosure should take. As a practical matter this means that an issuer will designate a "green" use of proceeds in the prospectus or other issuing documentation and then provide summarised information about the green uses, reporting and second party opinions (if any). Typically in a basic Green Bond, the use of proceeds, reporting and second party opinions do not form part of the terms and conditions of the Green Bond and do not create specific contractual obligations. However, they typically form part of the disclosure documents or are referred to in the disclosure documents.

Types of Green Bonds

The GBP identify four types of Green Bonds (additional types may emerge as the market develops):

Green Use of Proceeds Bond – a standard debt obligation for which the proceeds are moved to a segregated account or otherwise tracked by the issuer and attested to by a formal internal process that will be linked to the issuer's lending and investment operations for projects. The vast majority of Green Bonds currently fall within this category.

Green Use of Proceeds Revenue Bond – a debt obligation in which the credit exposure in the bond is linked to the pledged cash flows of the revenue streams, fees, taxes etc., and the proceeds of the bond are used to fund related or unrelated green project(s) such as a utility provider issuing a bond backed by fees on electricity bills.

Green Project Bond – this is a project bond for a single or multiple Green Project(s) for which the investor has direct exposure to the risk of the project(s) with or without potential recourse to the issuer.

Green Securitised Bond – a bond collateralised by one or more specific projects, including covered bonds, ABS, and other structures. The first source of repayment is generally the cash flows of the assets. This type of bond covers, for example, asset-backed securitisations of rooftop solar PV.

Investor Appetite

The initial demand in the Green Bond market was largely driven by environmentally and socially responsible investors and this segment of the market has continued to grow (e.g. dedicated Green Investment Funds are developing rapidly). However, the market has quickly become mainstream with institutional investors and Green Bonds are developing into their own asset class. With the growth in diversity of issuer type and structure, the investor base for the Green Bond product has expanded to include more pension funds, insurance companies, asset managers, and retail investors. For their investors, Use of Proceeds Green Bonds are fixed income products that meet their underlying financial requirements, but which in addition enable them to show support for initiatives they deem to be important global priorities.

For all categories of investors, providing certainty and transparency on the use of proceeds and investments are, and will continue to be, important requirements. Green Bonds are part of a wider trend toward increased focus on social and environmental responsibility among companies and financial institutions. This trend is strongly encouraged by governments, public and other regulatory authorities, NGOs and even the community at large.

Recent Developments in the Green Bond Market

The GBP provide a minimum standard of process guidelines that recommend transparency and disclosure in the Green Bond market. As a result, the environmental undertakings of Green Bonds issuers are only partially reflected in transaction documentation. A microcosm has developed around the GBP in support of the Green Bond market that involves standard providers, certifiers and assurance providers (including accountancy firms, ESG analysts and academics). Some markets and jurisdictions have begun to integrate elements of the voluntary GBP guidelines into domestic Green Bond regulations and mandatory market criteria. In many jurisdictions adopting mandatory regimes, the GBP are the minimum starting point to which additional mandatory requirements are added. The regulator in these regimes takes a more active role in setting out: (i) rules for listing Green Bonds; (ii) the liability and covenant requirements; and (iii) the Green Bond catalogue of sectors and projects which define “green” for that market.

There has been a difference in the approach to the development of Green Bond markets in different jurisdictions. They are roughly split into those markets which, for the time being, rely on a voluntary approach to criteria and reporting and those which have implemented codified criteria and/or enshrined it in legislation. There is some market debate on the need: (i) to provide greater clarity on what a Green Bond is and what distinguishes it from regular bonds; (ii) for independent certification; (iii) for green catalogues and definitions; and (iv) for green covenants and liabilities. While standardisation of disclosure will support credibility and provide criteria for independent validation in the Green Bond market, a balance has to be struck between enhancement and over-regulation. It is important nonetheless to be aware of regional differences in the developing Green Bond market.

In terms of recent market trends, we have noticed an increase in the demand for specific products, including both investment grade and high-yield corporate Green Bonds, bespoke structured deals such as project bonds and securitisations and nationally driven products (e.g. Pfandbriefe, Schuldscheine and green Sukuk). There is increased interest from emerging market issuers in developing Green Bond frameworks, for example in India, China and Mexico and we are seeing prominent global stock exchanges dedicating separate platforms to Green Bonds.

Considerations for Green Transactions

We have worked closely with a number of issuers, dealers/managers, financial intermediaries and trade bodies in the Green Finance sector and our considerable experience in this field means we are well placed to help structure your green transaction and advise you on green requirements and market expectations. These are some of the key points you will need to consider including in your Green Bond:

- Types of Green Bonds
- Types of ‘green’ investors
- Green Bond Listing Venues
- Structuring and Offering Green Bond
- Reporting
- Disclosure requirements (including specific green risk disclosure)
- Key “green” terms included in Green Bond documentation
- Expectations of Green Bond Market Participants

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White & Case is an international law firm that serves companies, governments and financial institutions. The global presence of White & Case gives us both an opportunity and a responsibility to provide legal counsel and assistance through our social responsibility programme and green initiatives.

Footnotes

1 The vast majority of which are in the area of renewable energy and energy efficiency
2
www.moodys.com/research/Moodys-Green-bond-issuance-could-exceed-50-billion-in-2016–PR_34323
4
3 See the latest iteration of the GBP at
www.icmagroup.org/Regulatory-Policy-and-Market-Practice/green-bonds/

Mindy Hauman, a Professional Support Lawyer at White & Case, assisted in the development of this publication.