Green finance and ESG ratings: What these really mean for your company

Presented By: Glenn Reitman, Jim Row, Vince Molinari, and Jeffrey Bourdon
Agenda

• Introduction

• Products
  a. Green Bonds – structure
  b. Green Loans – structure
  c. Sustainable Financing – structure

• Principles and where to find them
  a. Green Bonds – ICMA
  b. Green and Sustainable Loans – LSTA/LMA/APLMA

• Benefits/disadvantages of products and principles

• Third party verification, reporting, and creating company standards

• Current Market for Products - Barriers to entry?

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Introduction

**Establishing Baseline**
- Green Financing
- Sustainable Financing
- Governance Schemes
  - Private
    - Green Bond Principles - ICMA
    - Green Loan Principles – LSTA, LMA, APLMA
    - Sustainability Linked Loan Principles – LSTA, LMA, APLMA
    - Climate Bonds Standard – Climate Bonds Initiative
  - Public
    - People’s Bank of China Announcement 2015
- Green Bonds/Loans
- Sustainability Linked Loans

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International Reach. Ørsted, Denmark’s largest energy company, issued senior green bonds to finance its investment in offshore wind in Taiwan. Source: Ørsted press release (May 11, 2019). Image source: Barrons.com
Overview

Slide Organization

- Describe high level benefits and disadvantages from each product and benefits of ESG ratings
- Distinguish green from sustainable products
- Outline steps to complete transactions
- Examine costs of ESG ratings
Benefits – Green Products

**Green Bonds and Loans**
- Potentially secure better financial terms
- Gain access to new markets
  - ESG focused investors
- Decrease risk across portfolios
- Satisfy regulatory and policy targets/commitments
- Positive impact on reputation and credibility
- Build stronger, values-driven relationship with shareholders
- Positive impact on environment
- Increased ability to attract and retain staff who prioritize SDG contributions from employers

Apple store at Champs-Élysées, one of Apple’s Green Buildings, which it funds through a Green Bond. Source: Apple Image source: Apple
Reasons For Issuing

Data provided by Climate Bond Initiatives in its 2020 Green Bond Treasurer Survey, which reflects the responses of 86 of 143 sampled treasurers from green bond issuers invited to respond. Issuers selected from Climate Bonds Green Bond Database to create a diverse sample with representation from emerging markets and developed markets. [Notable issuers Fannie Mae and China are not included in data]
Benefits – Sustainability Linked Loans

Sustainability Linked Loans

• Transition tool towards sustainable business model
• Potentially secure better financial terms
• Enhance borrower’s ambitions on ESG performance
• Incorporate ESG performance into lenders’ credit assessment
• Engage lenders to incentivize and support sustainability improvements
• Promote sustainable long term growth and profitability
• Display commitment to achieving sustainability goals with correlated economic impact
• Positive impact on reputation and credibility
• Build stronger, values-driven relationships with shareholders
• Increased ability to attract and retain staff who prioritize SDG contributions from employers
Disadvantages – Green and Sustainable Products

Risks

- Lack of Transparency
- Financial
  - Limited Liquidity
  - Missed Incentives
- Legal
  - Lack of Standardization
  - Verification
  - Compliance Costs
  - Greenwashing or Sustainability-Washing
    - Mislead on project or unambitious SPT
  - Disclosure Liability

Investor Complaints

Climate Bonds Initiative 2020 Treasurer Survey found that most respondents reported that investors wanted more information on the classification of how proceeds were used, including details on how the proceeds are segregated from other funds. Classification and transparency was more important for those investing in large issuers. 85% of investors surveyed in the Investor Survey reported that they would sell or be included to sell if post issuance reporting was poor.
Measuring Impact – Benefits of ESG Ratings

- Pricing advantages
- Investor mandates or requirements
- Third party review and verification of value
- Political risk reduction
- Proactive narrative and messaging
- Competitive advantage
- Organization/Company preparation
- Recruiting
- Regulatory preparation and risk management
- Insurance cost and litigation reduction
Measuring Impact – Green/ESG Finance

• Green (Environment):
  • Emissions, Carbon footprint/use, Waste, Biodiversity, Innovation, and Resource Use

• ESG
  • Inclusive of Environment, Social and Governance

• Part of the ESG Report
  • Transparency
  • Efficacy
  • Resilience
  • Efficiency

• Costs
Distinguish – Green and Sustainable

**High Level**

- Green instruments focus on the use of proceeds
- Sustainability linked loans concentrate on SPTs
- Distinctions are reflected in four core components
- However, in practice, overlap exists
  - Green loans may also qualify as Sustainability Linked Loans

Prada signed a 5 year, €50 million sustainability term loan with Credit Agricole Group on November 5, 2019. Prada’s annual interest rates decrease as the house meets targets for using Re-Nylon, a sustainable nylon substitute. Source: Credit Agricole. Image source: V Magazine.
Distinguish – Green and Sustainable

**Green Bonds and Loans**

- Four Core Components
  - Use of Proceeds
    - Green Project (GGLP – “light green”)
  - Process for Project Evaluation
  - Management of Proceeds
  - Reporting
- Review
  - Consultant
  - Verification
  - Certification
  - Rating
- **Bonds listed on Stock Exchange**

Climate Bonds reports that as of Oct. 22, 2019, issuers raised USD$202.2bn in proceeds from green bonds with energy projects being the most frequently funded, at 33%, followed by low carbon buildings, 29%, low carbon transport, 20%, water, 9%, and waste and land use each at 3%. Graphic source: Climate Bonds.
Distinguish – Green and Sustainable

**Sustainability Linked Loans**

- Incentivize achievement of ambitious, predetermined SPTs
  - Example SPTs
    - Energy efficiency
    - Greenhouse gas emissions
    - Affordable housing
  - Four Characteristics
    - Relationship of SPT to Borrower’s Overall Sustainability Strategy
    - Target Setting – Measuring Borrower’s Sustainability
    - Reporting
    - Review (metrics, relationship, public information)

U.S. based Xylem Inc. became the fourth U.S. company to issue a sustainability-linked loan, with an $800 million revolving credit facility in March 2019, and the first general industrial company to commit to reducing its environmental footprint in this way. Source: Reuters. Image Source: Xylem
Distinguish – Green and Sustainable

**Differences Between Green and Sustainable**

- **Purpose of Product**
  - Use of Proceeds
    - Exclusively for Green Projects
    - Types of Projects
    - Finance or Re-finance
  - Pursue ambitious Specific Performance Target (SPTs)
    - Internal and External SPTs (US, trends internal; EU, trends external)
    - Sustainability Strategy
- **Types of Products**
  - Flexibility of debt size, structure, and rates
  - Reporting, Review, and Incentives
### Distinctions Summarized

<table>
<thead>
<tr>
<th></th>
<th>Use of Proceeds</th>
<th>Interest Rate Provision</th>
<th>Reporting</th>
<th>Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Green Bonds</strong></td>
<td>Net proceeds earmarked for eligible green projects</td>
<td>Similar to non-green bonds</td>
<td>Periodically provided</td>
<td>Issuers are not bound by indentures, though disclosures may subject them to SEC liability. Bondholders rely on tort claims and other sanctions generally available to bondholders</td>
</tr>
<tr>
<td><strong>Green Loans</strong></td>
<td>Net proceeds earmarked for eligible green projects</td>
<td>Similar to non-green loans</td>
<td>Periodically provided</td>
<td>Borrower is typically bound by loan agreement. Missed SPTs can trigger penalties, including an event of default or margin increase</td>
</tr>
<tr>
<td><strong>Sustainability-Linked Loans</strong></td>
<td>Net proceeds used for any purpose, including general corporate purposes</td>
<td>Dependent on borrower’s ESG rating or other performance standard. Rates may vary based on performance</td>
<td>Periodically provided</td>
<td>Borrower is typically bound by loan agreement. Missed SPTs can trigger penalties, including an event of default or margin increase</td>
</tr>
</tbody>
</table>

See What’s Market: Green and Sustainability Linked Loans, Practical Law Finance (Jan 7, 2020)
Steps to Complete – Eligibility

**Participants**

- Green Bond Issuers
  - Corporations
  - Sovereign
  - Sub National: Municipal, City, etc.
- Green Loan and Sustainability Linked Loan Borrowers
  - Any entity that may borrow in bilateral or syndicated loan market
- Investors
  - Institutions and Governments
  - Retail is rare
- Lenders
  - Largely private

In January 2017, France launched the first French sovereign green bond, the Green OAT 1.75% 25 June 2039, becoming the first country in the world to issue a sovereign green benchmark bond. Source: aft.gouv.fr. Image source: telegraph.co.uk
Steps to a Completed Transaction - Overview

Four Phase Process - Bonds

- Market Exploration
- Pre-Issuance
  - Compiling Documents
  - Create Framework
- Verification
- Framework Certified
- Due Diligence
- Structure Instrument
- Issuance
  - Credit Rating
  - Listing/Qualifying for Stock Exchange
- Post-Issuance (Verifications/Reports)

<table>
<thead>
<tr>
<th>Name of Stock Exchange</th>
<th>Type of Dedicated Segment</th>
<th>Launch Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oslo Stock Exchange</td>
<td>Green bonds</td>
<td>January 2015</td>
</tr>
<tr>
<td>Stockholm Stock Exchange</td>
<td>Sustainable bonds</td>
<td>June 2015</td>
</tr>
<tr>
<td>London Stock Exchange</td>
<td>Green, social, &amp; sustainability bonds</td>
<td>July 2015</td>
</tr>
<tr>
<td>Shanghai Stock Exchange</td>
<td>Green bonds</td>
<td>March 2015</td>
</tr>
<tr>
<td>Mexico Stock Exchange</td>
<td>Green bonds</td>
<td>August 2016</td>
</tr>
<tr>
<td>Luxembourg Stock Exchange*</td>
<td>Green, social, &amp; sustainability bonds</td>
<td>September 2016</td>
</tr>
<tr>
<td>Italian Stock Exchange</td>
<td>Green &amp; social bonds</td>
<td>March 2017</td>
</tr>
<tr>
<td>Taipei Stock Exchange</td>
<td>Green bonds</td>
<td>May 2017</td>
</tr>
<tr>
<td>Johannesburg Stock Exchange</td>
<td>Green bonds</td>
<td>October 2017</td>
</tr>
<tr>
<td>Japan Exchange Group</td>
<td>Green &amp; social bonds</td>
<td>January 2018</td>
</tr>
<tr>
<td>Vienna Stock Exchange</td>
<td>Green &amp; social bonds</td>
<td>March 2018</td>
</tr>
<tr>
<td>NASDAQ Nordic &amp; Baltics**</td>
<td>Sustainable bonds</td>
<td>May 2018</td>
</tr>
<tr>
<td>The International Stock Exchange</td>
<td>Green bonds</td>
<td>November 2018</td>
</tr>
<tr>
<td>Frankfurt Stock Exchange</td>
<td>Green bonds</td>
<td>November 2018</td>
</tr>
<tr>
<td>Moscow Exchange</td>
<td>Green &amp; social bonds</td>
<td>August 2019</td>
</tr>
<tr>
<td>Euronext</td>
<td>Green bonds</td>
<td>November 2019</td>
</tr>
<tr>
<td>NASDAQ Sustainable Bond Network***</td>
<td>Green, social, &amp; sustainability bonds</td>
<td>December 2019</td>
</tr>
</tbody>
</table>

*LSE created LGX as a dedicated platform for green, social and sustainability bonds
**NASDAQ’s joint venture of sustainable debt segments are operated by Nasdaq Europe. Sustainable bonds are currently listed on Nasdaq’s sustainable bond markets in the Baltic, Copenhagen, Helsinki, Reykjavik, Stockholm and Viasus
***The Nasdaq Sustainable Bond Network is not a listing venue but a transparency platform open to all green, social and sustainability bonds meeting its inclusion criteria, regardless of the listing status.

Table created by Climate Bonds Initiative
Steps to a Completed Transaction – Loans

Four Phase Process - Loans

- Market Exploration
- Pre-Closing
  - Documentation
  - Create Framework
  - Verification
  - Framework Certified
- Due Diligence
- Structuring Instrument
- Closing
  - Credit Rating
- Post-Closing
  - Verifications/Reports

Criteria Guiding the Listing Venue Decision

<table>
<thead>
<tr>
<th>Criteria</th>
<th>% of Yes replies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Critical mass</td>
<td>23%</td>
</tr>
<tr>
<td>Local to head office</td>
<td>25%</td>
</tr>
<tr>
<td>Local to domicile of target investors</td>
<td>15%</td>
</tr>
<tr>
<td>Fiscal considerations</td>
<td>3%</td>
</tr>
<tr>
<td>Familiarity</td>
<td>29%</td>
</tr>
<tr>
<td>Other</td>
<td>23%</td>
</tr>
</tbody>
</table>

Source: Climate Bonds Initiative 2020 Treasurer Survey. Decisions regarding where to issue might indicate reasons for borrowers to select lenders.
Pre-Transaction – Green and Sustainable Products

Process: Step 1 of 4

• Documentation
  • Create Framework – Necessary for Certification
    • Create Sustainability Strategy/Green Bond Framework
    • Company Specific
  • Decide How to Employ Proceeds
    • Proceeds
    • Tranches
  • Establish Tracking and Reporting Mechanisms
  • Precedent Available Online
• Disclosures – Relate to Representations in Documents
  • ESG Risks
    • Material Risks for Investors/Lenders
Pre-Issuance: Framework

Example Framework – TOC from Green Bond Framework of the Netherlands (2019)

• Introduction
  • Dutch vision on global climate action
  • Sustainable finance as a driver of climate action
  • Background of State of the Netherlands’ Green Bond Framework

• Green Bond Framework
  • Use of Proceeds
  • Process for expenditure, evaluation, and selection
  • Management of Proceeds
  • Reporting
  • Allocation of proceeds reporting
  • Impact reporting
  • External review
  • Second Party Opinion
  • Verification
  • Certification
Pre-issuance

Process: Steps 2 and 3

- Verification
  - Second-Party Feedback
  - Second-Party Review
  - Strategy/Framework Certified
- Due Diligence
  - Know the Party
  - Risks
    - Disclosures (Prospectus, Loan Documents, etc.)
    - Reputation
  - Scope
    - ESG Risks
    - Past Compliance

Time to issuance for first time green bond issuers

Source: Climate Bonds Initiative 2020 Treasurer Survey. 88 percent of responding issuers answered that their first green bond issuance required less than a year once the decision to issue it was made. 47 percent responded that issuing took less than six months.
## Pre-issuance

### Process: Step 4 of 4

- Structuring
  - Market Considerations
  - Bonds
    - Standard Use of Proceeds
    - Green Revenue Bond
    - Green Project Bond
    - Green Securitized Bond
  - Loans
    - Any Type
    - Price Reduction
    - Two-Way Pricing

<table>
<thead>
<tr>
<th>Type</th>
<th>How Proceeds are Used</th>
<th>Debt Recourse</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Use of Proceeds”</td>
<td>Earmarked for Green Projects</td>
<td>To issuer</td>
</tr>
<tr>
<td>Green Revenue Bond</td>
<td>Earmarked for related or unrelated Green Project(s)</td>
<td>Non-recourse Exposure is to pledged cash flows, fees, taxes etc.</td>
</tr>
<tr>
<td>Green Project Bond</td>
<td>Earmarked for single or multiple Green Projects</td>
<td>Possibly to issuer</td>
</tr>
<tr>
<td>Securitization (ABS) Bond</td>
<td>Earmarked for Green Projects</td>
<td>Generally first to cash flows of assets</td>
</tr>
<tr>
<td>Covered Bond</td>
<td>Earmarked for Green Projects included in pool</td>
<td>First to the issuer</td>
</tr>
<tr>
<td>Other Debt Instrument</td>
<td>Earmarked for Green Projects</td>
<td>Case by case</td>
</tr>
</tbody>
</table>

See Appendix I Green Bond Principles
Cost of the Label

Why Seek Certification?

- Reasons to be unlabeled
  - Costly undertaking: reporting, disclosure, and verification
  - Additional costs outweigh benefits
  - If necessary, label can be secured later

- Reasons to be labeled
  - Potentially better terms
  - Reputation benefits
  - New markets
Conclusion

- Growing Market
- Benefits
  - ESG Ratings
  - Reputation
  - Finance Transition
  - Incentives
- Risks
- Distinction between Products
  - Use of Proceeds vs. SPTs
- Few Additional Steps to Transaction
- Expected Terms

Investor demand for green bonds vs vanilla bonds of green bond issuers

The 2020 Treasurer Survey showed that none of the respondents received less interest in their green bonds compared to vanilla equivalent. As concluded by the Climate Bonds Green Bonds Pricing (2016), green bonds tend to be more oversubscribed and subject to a greater spread tightening during book building as compared to vanilla equivalent.

Issuers’ Plans for the Future

The 2020 Treasurer Survey showed that 88% of respondents stated they planned to issue more green bonds, suggesting it is a positive experience for the issuer.
Thank you

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