MWB GREEN

SUSTAINABLE FINANCING OPTIONS
—#1 in a Series of Briefs on Sustainable Financing

INTRODUCTION
Businesses and organisations are becoming increasingly aware of the importance of operating in an environmentally and socially responsible way. Many have committed to soft law codices in which they undertake to achieve certain benchmarks such as CO2 reduction or increased use of recyclable materials.

The need for sustainable financing products has emerged in the wake of the worldwide political pressure to make sustainability a priority on the corporate agenda. These products make it easy and cheaper for the borrower to finance investments in the transition to more ESG-friendly operations. The products are also required for investors to satisfy ESG asset allocations in their investment policies.

To establish towards stakeholders that proceeds are used for sustainable projects, many issuers and lenders opt to follow a standard which imposes certain obligations on the issuer or borrower, primarily the obligation to use proceeds towards sustainable projects and report sustainability metrics on an on-going basis.

The purpose of this briefing note is to introduce the different sustainable financing products and their respective standards. Currently, bonds are the most prevalent sustainable financing instrument, but sustainable loans are starting to get traction.

BONDS

Green Bonds
The most established form of sustainable bonds is green bonds. Green bonds are much like conventional bonds but require the issuer to allocate proceeds to green projects. In 2019, total green bond issuances amounted to USDbn 263, and in 2020 issuances worth of USDbn 350-400 are expected.

The leading standards are the International Capital Market Association's (ICMA) Green Bond Principles and Climate Bonds Initiative's Climate Bond Standard.

Currently, the EU is working on an EU green bond standard and a taxonomy on sustainable finance, the first having been published in final draft form and the latter to enter into force in the coming months.

As an example of a green bond, Apple issued USDbn 2.2 of six and 12-year green bonds in Europe in November 2019 to finance reduction of Apple's emissions in corporate and supply chain facilities, e.g. sensors and controls, energy management systems, and facility design, commissioning, and retrofits, and sourcing materials with recycled or renewable content. In Denmark, Ørsted has issued several green bonds, the largest issue being EURm 750 bonds with an interest rate of 1.5% due 2029 to fund investments in the development, construction, or installation of offshore wind farms, e.g. investments related to wind turbines, blades, foundations, cables or transmission assets.

Social Bonds

Social bonds are bonds where proceeds must be used towards funding of projects with positive social outcomes. In 2019, total social bond issuances amounted to USDbn 20.

The leading standard is ICMA's Social Bond Principles, which imposes similar obligations on the issuer as the Green Bond Principles.

The African Development Bank has completed several social bond issuances and launched a social bond framework, in which eligible projects are e.g. rural electrification, provision of farm infrastructure for rural farmers, soft commodity finance facilities, water supply and sanitation delivery, affordable housing, skills development for employability and entrepreneurship and construction of hospitals.

Another example is a EURbn 1 social bond issued by the Italian Development Bank. Proceeds will be used e.g. to finance construction of healthcare facilities, medical equipment, construction of schools and student housings, rail transportation for public use and recreational facilities such as public parks and spaces.

Sustainability Bonds and SDG Bonds

Sustainability bonds are bonds where proceeds must be used to finance a combination of green and social projects. From 2017 to 2018, sustainability bond issuance value increased by 114%, up to USDbn 21, and from 2018 to 2019 by more than 300%, amounting to a total value of sustainability bond issuances in 2019 of USDbn 65.2.

If linked to achieving certain of the UN's Sustainable Development Goals (SDG), the bond may be referred to as an SDG bond. Contrary to green and social bonds, where funding is earmarked for specific green and/or social assets or projects, the cost of funding for sustainability or SDG bonds may rely on sustainability improvements at organisational level.

There is currently no standard for sustainability or SDG bonds, but ICMA has published the Sustainability Bond Guidelines, which aim to facilitate the application of the Green Bond Principles and the Social Bond Principles to the sustainability bond market.

ICMA has also published a High-Level Mapping to Sustainable Development Goals to assist issuers in evaluating the financing objectives of a green, social or sustainability bond against the SDGs.

Starbucks issued USDbn 1 3.55% sustainability bonds in May 2019. Proceeds will be used both for environmental and social purposes – the social aspect comprised by investments in ethically sourced coffee and the environmental aspect comprised by investments in more energy efficient and sustainable Starbucks buildings.

In 2019, Italian energy producer Enel issued the world's first SDG linked bond, i.e. a bond that is KPI-linked to achieving UN's Sustainable Development Goals. The terms include a KPI which Enel commits to achieving by 2021 – the increase of its renewable energy installed capacity to at least 55% (from 46% as of H1 2019) of total capacity. If Enel has not achieved the KPI at the time of review at the end of 2021, the coupon rate will be increased by 25 bps. The review is carried out as part of Enel's annual audit.

Blue Bonds

Blue bonds target the sustainable use of ocean resources and ocean preservation. They came into existence with the launch of the Sustainable Blue Economy Finance Principles by the European Commission and United Nations Environment Programme - Finance Initiative in 2018.

As blue bonds may be comprised by ICMA's Green Bond Principles, no stand-alone standard for blue bonds currently exists. However, a report named Blue Bonds: Financing Resilience of Coastal Ecosystems, prepared by Blue Natural Capital Financing Facility and 4Climate, outlines approaches on a possible definition, principles and key requirements for a commonly accepted understanding of blue bonds.

The Republic of Seychelles issued the first blue bond globally in October 2018 with a frame of USDm 15 and a maturity of 10 years. Proceeds will be used towards marine protection, fishery management and other projects to safeguard the ocean economy that the country depends on.

In January 2019, the Nordic Investment Bank issued a five-year SEKbn 2 Nordic Baltic Sea blue bond. Proceeds will used to fund projects covering wastewater treatment, prevention of water pollution and water-related climate change adaptation.

Transition Bonds

Transition bonds are targeted at companies operating in industries with high greenhouse gas emissions. The instrument is very similar to a green bond, but proceeds can be used for business activities that are not green per definition, e.g. instalment of new gas or oil pipelines to reduce leakage. Transition bonds are thus designed to help the issuer shift to more sustainable business activities.

No standard exists for transition bonds, but in 2019 Climate Bonds Initiative and Credit Suisse entered into a partnership to develop a framework for transition bonds. AXA Investment Management has also published a set of proposed Transition Bond Guidelines.

Crédit Agricole Corporate and Investment Bank has issued a 10-year EURm 100 0.55% transition bond. An amount equal to the proceeds will be earmarked by the bank for loans made to projects in carbon intensive sectors that contribute to a low-carbon economy, such as LNG-powered ships, investments in energy efficient industries as well as gas power assets in countries where power generation currently relies on coal.

Adaptation and Resilience Bonds

These bonds aim at directing proceeds towards measures which are meant to prevent losses due to weather and climate-related events, e.g. development of new heat-resilient building materials, flood resistance and infrastructure upgrades.

Adaption and resilience bonds can usually be comprised by a green bond standard, but Climate Bonds Initiative has developed the Climate Resilience Principles, which provide high-level guidance for determining when assets and projects are compatible with a climate resilient economy.

The European Bank for Reconstruction and Development is the first institution to issue a climate resilience bond in line with the Climate Resilience Principles with a maturity of five year, generating proceeds of USDm 700. Proceeds can be used towards climate resilient infrastructure, climate resilient business and commercial operations and climate resilient agriculture and ecological systems, e.g. water irrigation infrastructure in water-stressed areas (e.g. Morocco) and resilience-specific upgrades to a large hydropower plant in Tajikistan.

BANK LOANS

Green Loans

Green loans are loans where the borrower undertakes to use the proceeds for green and sustainable projects. In 2019, USDbn 10 worth of green loans were committed.

The Loan Market Association (LMA) has published the Green Loan Principles and Guidance on Green Loan Principles, which help lenders and borrowers determine use of proceeds and offers guidance on application of the Green Loan Principles to revolving credit facilities. The fundamental determinant of a green loan is the use of proceeds towards Green Projects, as defined in the non-exhaustive list in appendix 1 to the Green Loan Principles. The Green Loan Principles requires the eligible projects and the use of proceeds to be described in the finance documents.

National Grid, a multinational electricity and gas utility company, has taken on a USDm 743 credit export agency guaranteed green loan. Proceeds will be used towards a EURbn 2 subsea electricity interconnector between the UK and Denmark, known as Viking Link, which will supply renewable energy to 1.4 million households across the UK.

Sustainability Linked Loans

Sustainability linked loans are loans that incentivise the borrower's achievement of predetermined sustainability objectives, which may be measured against key performance indicators or external ratings. In 2019, USDbn 122 worth of sustainability linked loans were committed. Consequently, committed capital for this loan type far exceeds that of green loans.

Compared to green loans, the use of proceeds is not a determinant in categorising the loan as sustainability linked and most often proceeds will be used for general corporate purposes. Instead, sustainability linked loans look to improve the borrower's sustainability profile by incorporating the borrower's performance against certain KPIs into the loan terms, e.g. performance aligned with margin redetermination. This might explain why sustainability linked loans are more popular than green loans; they relate to an overall increase of the borrower's sustainability, not a set of predefined projects, and are therefore better at leveraging the revolving aspect of the loan.

LMA has published the Sustainability Linked Loan Principles and Guidance on Sustainability Linked Loan Principles. These principles require sustainability performance targets to be incorporated in the finance documents. The sustainability performance targets should be tied to a sustainability improvement in relation to a predetermined performance target benchmark and be related to the borrower's overall CSR strategy.

Danish transportation behemoth, A.P. Moller Maersk, has secured a five-year USDbn 5 sustainability-linked revolving credit facility under which the margin is dependent on certain CO_2 performance targets. The margin will be adjusted based on Maersk's progress to meet its target of reducing CO_2 emissions per cargo moved by 60% by 2030.

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