Financial Markets Law Committee ("FMLC")

Sovereign Debt Scoping Forum

Date: Friday 8 September 2017

Time: 8.30am to 10.30am

Location: Bank of England, Threadneedle Street, London, EC2R 8AH

In Attendance:

Jim Ho (Chair)	Cleary Gottlieb Steen & Hamilton LLP
Carter Brod	Morgan Lewis & Bockius LLP
Karl Clowry	Paul Hastings LLP
Emma Dickinson	Deutsche Bank AG
John McGrath	Sidley Austin LLP
Rodrigo Olivares-Caminal (dial in)	Queen Mary University of London
David Sabel	Cleary Gottlieb Steen & Hamilton LLP
Harriet Territt	Jones Day
Deborah Zandstra	Clifford Chance LLP

Guest Speakers:

Michael Bark-Jones (dial in)	White & Case LLP
Markus Demary (dial in)	Kompetenzfeld Finanz- und Immobilienmärkte
Mindy Hauman	White & Case LLP
Tallat Hussain	White & Case LLP
Jürgen Matthes (dial in)	Kompetenzfeld Finanz- und Immobilienmärkte

Regrets:

Nikita Aggarwal	Queen Mary University of London
Francis Fitzherbert-Brockholes	White & Case LLP
Leland Goss	International Capital Market Association ("**ICMA**")
Robert Gray	ICMA
Duncan Kellaway	Freshfields Bruckhaus Deringer LLP
Rosa Lastra	Queen Mary University of London
Yannis Manuelides	Allen & Overy LLP
Reena Parmar	Freshfields Bruckhaus Deringer LLP
Camilla Perera	P.R.I.M.E. FINANCE
Philip Wood QC	Allen & Overy LLP

Minutes:

1. Introduction.

1.1. Jim Ho opened the meeting and delivered a brief introduction.

2. Administration:

a. a short presentation on key FMLC statistics (Venessa Parekh);[1]

2.1. Venessa Parekh presented a selection of FMLC statistics covering the legal uncertainties analysed by the FMLC since 2003, FMLC publications, FMLC events, the international connections the FMLC have forged, and a glance at funding and expenditure. Information on how to get involved in the FMLC's work was included on the last slide.

b. present the draft 2018 Forward Schedule;[2]

2.2. The draft 2018 Forward Schedule was presented to the Forum members.

2.3. These dates will be recirculated for comment and confirmed at the Q4 meeting on Friday 1 December 2017.[3]

c. suggestions for the 2018 Forward Agenda.[4]

2.4. The Secretariat invited members to suggest items for the 2018 Forward Agenda.

3. Introduction to safe bonds (Markus Demary, Jürgen Matthes).

3.1. Markus Demary and Jürgen Matthes delivered to Forum members an introduction to and evaluation of Sovereign-backed Securities ("**SBSs**"), proposed by the European Commission as a class of safe assets for the euro area.

3.2. The speakers began their talk by outlining the concept of SBSs, which originated from a proposal by Brunnermeier et al. (2016) who established SBSs as European Safe Bonds ("**ESBies**"). SBSs or ESBies were proposed as a solution to two key problems in the architecture of the European Monetary Union ("**EMU**") where a bank-sovereign nexus or "doom loop" could cause: (i) a banking crisis which could trigger a sovereign debt

1 Please see Appendix I below.

2 *Ibid.*, slide 10.

3 If you have any suggestions or queries regarding the draft 2018 Forward Schedule, please contact Thomas Willett at forums@fmlc.org.

4 If you have any suggestions for the 2018 Forward Agenda, please contact Thomas Willett at forums@fmlc.org.

crisis, while a sovereign debt crisis can also trigger a banking crisis; and (ii) fragmentation of the euro area's capital market along national lines.

3.3. To mitigate these problems, SBSs are intended to create safe assets based on the securitisation of government bonds, which would generate an increased volume of safe and diversified assets in the euro area. SBSs were described by the speakers as: national sovereign bonds of euro-area countries which are purchased by a public or private agency based on criteria that define the degree of diversification. The bonds are then bundled into a portfolio which is transferred onto the balance sheet of a special purpose vehicle, designed to finance the purchase of the bonds from EMU countries by structuring the portfolio into safe senior and riskier junior tranches. This will, therefore, result in the SBSs acquiring a different risk profile than national sovereign bonds, generated by means of risk transfer.

3.4. The speakers highlighted the potential advantages of SBSs, which include:

i. reducing the sovereign-bank nexus;

ii. generating a larger volume of safe assets;

iii. de-privileging sovereign bonds in banking regulation;

iv. strengthening market discipline and the no-bail out clause; and

v. monetary policy normalisation.

3.5. Addressing disadvantages of SBSs, the speakers emphasised potential problems in relation to the:

i. viability of the SBSs business model;

ii. demand for senior SBSs;

iii. vulnerability of junior SBSs in times of crisis;

iv. risk of mutualisation of sovereign debt in times of crisis;

v. danger of not de-privileging sovereign bonds; and

vi. distortions in national sovereign bond markets.

3.6. The floor was then opened to participants for questions. One Forum member asked if the demand for the junior tranche of SBSs might break down during a crisis. The speakers agreed that demand for the junior bonds may significantly soften in times of stress. Questions were also raised about the basic demand in the financial markets for subordinated debt.

3.7. One member asked if the junior bonds might be more attractive to junior investors if they were given control rights for the whole pool in a restructuring.

3.8. Participants then asked if such a bond structure would make it more difficult for a country to restructure its debt. The additional layer of securitisation will complicate how collective action clauses in sovereign bonds may be used in a restructuring. The speakers said that the purpose of SBSs was to reduce the likelihood of default but more consideration would need to be given on this issue in future research.

3.9. One Forum member asked if there would be a preference for private agencies to set up SBSs. Forum members and the speakers agreed that the issuing agency should be protected from political influence. A member then asked if the European Stability Mechanism ("**ESM**") had been considered as an issuer of SBSs. The speakers believed it likely that such considerations had been aired in relevant circles in Brussels.

3.10. The last question concerned the opinions of private investment banks on SBSs. The speakers stated that the German Association of Investment Banks had been sceptical. Forum members expressed similar concerns about SBSs, in particular owing to the lack of demand for the junior tranche of bonds.

4. Introduction to green bonds (Michael Bark-Jones, Mindy Hauman and Tallat Hussain).

4.1. Michael Bark-Jones, Mindy Hauman and Tallat Hussain introduced the concept of green bonds to Scoping Forum members.

4.2. The speakers began their talk by explaining that there is no current legal definition of green bonds. In a broad context, if the proceeds from the investment can be used to benefit the environment, it can be considered green finance. This definition covers a wide range of transactions and instruments, including climate finance, environmental and conservation finance, development funding and market-based instruments.

4.3. The speakers highlighted three key benefits of green bonds including:

i. tapping investor demand and diversifying investor base;

ii. enhancing public relations with stakeholders; and

iii. potentially providing issuers with pricing benefits and enhanced liquidity over traditional bonds.

4.4. The concept of sovereign green bonds was discussed next. The speakers highlighted the following main factors which are influencing sovereigns' growing interest in issuing green bonds:

i. their commitments under the Paris Agreement;

ii. the need for infrastructure finance; and

iii. the focus on clean/green power production.

Green bonds would then offer sovereign issuers:

i. easy access to a large and diverse funding pool;

ii. a low-cost capital to support investment in sustainable infrastructure projects, such as urban transport, water services or clean power which often compete for funding against other government projects; and

iii. an opportunity to meet international environmental obligations.

4.5. The speakers explained how sovereigns are in a unique position to create policy and implement change. Most sovereigns have a higher rating than other issuers and often see an increased demand for subscription. Sovereigns in the developing world also benefit from established regulatory infrastructure and experience which are equally applicable to green bonds. The issuance of sovereign green bonds by governments of developing countries might stimulate investment interest in quasi-sovereign and corporate green finance in those jurisdictions.

4.6. When addressing the frameworks for green finance, the speakers highlighted that some sovereigns such as China, France, Poland, Nigeria and Brazil have created mandatory regulatory regimes, guidelines and policy initiatives to address their specific national targets. Other securities exchanges, such as the Moroccan Capital Market Association, the Securities and Exchange Board of India and the London Stock Exchange, have facilitated green issuances by creating green bond listing guidelines and criteria and accessing green platforms in those markets.

4.7. The speakers then outlined challenges facing the issuance of green bonds, including:

i. a lack of uniformity;

ii. reputational risk;

iii. ongoing administrative obligations and resultant costs on the issuer to administer a green bond issuance; and

iv. the cost of "second party" opinions, and issuer's green bond selection criteria and project evaluation methodology and/or post issuance "third party" assurance.

4.8. A Forum member drew attention to the recent issuance by Tajikistan of an unsecured sovereign bond, the proceeds of which have been earmarked for a renewable energy project but which was not marketed as a green bond. The speakers highlighted that there were many examples of bonds in the market that technically could have been marketed as green bonds at primary offer, but were not for various reasons. These bonds may be picked up and included in green portfolios and indices in secondary trading if they meet the relevant criteria.

4.9. Another participant asked the law which applied to green bonds. The speakers explained that the determination about choice of law for a green bond is the same as for standard "vanilla" bonds.

4.10. A discussion ensued about the use of "second party opinions" of an issuer's green bond selection criteria and project evaluation methodology. Forum members stressed that the time, management and cost involved in obtaining a second party opinion might create too many barriers and challenges for issuers. The speakers offered the example of Poland which had used Sustainalytics to generate the second party opinion for their green bond issuance. The speakers also explained that, originally, secondary opinions were an option and were seen as an extra layer of comfort for investors. Recently, however, they have become market practice. Forum members stressed that there should be a move to evaluate second party opinion providers between new and experienced providers.

5. Update on the Russia/Ukraine sovereign bond dispute.

5.1. [This section of the meeting was held under Chatham House rule.]

5.2. Forum members agreed to return to this topic in the February meeting of the Forum.

6. *Ajdler v. Province of Mendoza – Pari passu* revisited (Jim Ho).

6.1. As the meeting had overrun, it was agreed that this topic would be deferred until the December meeting of the Forum.

7. Any other business.

7.1. No other business was raised.

Did you know ..?

A quick glance at some FMLC numbers

Venessa Parekh, Acting Project Manager

Addressing legal uncertainty

Since 2003, the FMLC has analysed and made recommendations to resolve legal uncertainties in 212 disparate topics.

Solvency II

E.U. Data Protection Reform

Brexit

Market Abuse Regulation

EMIR

Emissions Allowances

Benchmarks Reform

Bail-in

Capital Markets Union

Sovereign Debt Collective Action Clauses

Rome I

Bank Reform (Ring Fencing)

International Coordination of Law and Regulation

Regulation of Credit Rating Agencies

MiFID II

Bank Recovery and Resolution

Financial Market Infrastructures

Virtual Currencies

FMLC research is conducted through:

7 Scoping Forums

- Banking
- Brexit
- Buy-side
- Infrastructure
- Insurance
- Fintech
- Sovereign Debt

27 Working Groups

… were established since the beginning of 2016:

- 7 Working Groups are still active;
- 5 deal with matters related to Brexit; and
- 9 have published and are anticipating further work.

FMLC Publications

22 publications were produced in 2016

69 pages in our longest paper

5 publications were on the topic of benchmarks reform

2016-Present FMLC Events

10 formal events were held

45 guest speakers across all events

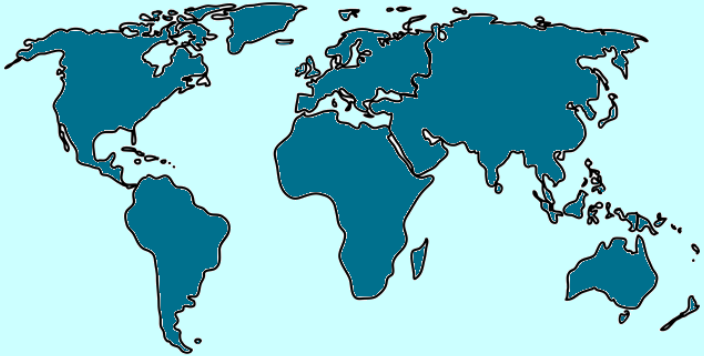
4 events examined legal uncertainties arising from Brexit

176 guests attended the 2016 Spring Colloquium on the anticipated U.K. referendum. This was the FMLC's most successful event in the past 3 years

F M L C

International connections

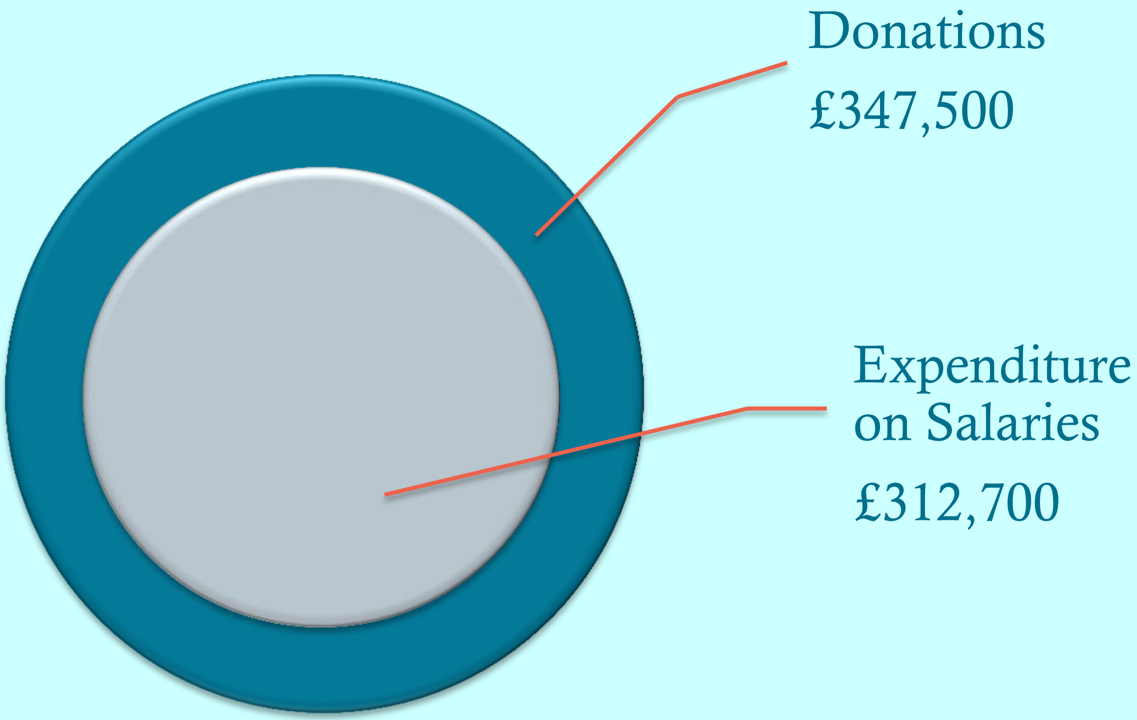
- **18** speeches were given by the FMLC CEO in 5 different countries
- **4** calls are held every year with the Financial Markets Lawyers Group (“FMLG”) (New York)
- **3** sister organisations (associated with the Federal Reserve, the ECB and the Bank of Japan) participate in an annual conference with the FMLC
- **7** jurisdictions (E.U., Hong Kong, Japan, Switzerland, Singapore, U.K. and U.S.) hold a biannual information-exchange video conference



People and the FMLC

- 39 patron organisations
- 35 average members per Scoping Forum
- 26 Committee Members
- 15 average members per Working Group
- 11 staff at the FMLC Secretariat (plus one volunteer!)

Looking under the hood …



89% of the FMLC's charitable income is spent on Secretariat salaries

You can get involved in the FMLC's work by becoming a:

- **patron**—for a sample Patrons' Newsletter, a copy of the FMLC donation pack and any other enquiries, please contact: Barbara Martin (patrons@fmlc.org);
- **stakeholder**—for a sample Stakeholders' Newsletter and any other enquiries, please contact: Rachel Toon (executivesupport@fmlc.org); or
- **recipient to our general mailing list**—should you wish to receive regular notifications about new FMLC publications, please contact: Amy Shaw (secretarial@fmlc.org).

2018 Forward Schedule

FMLC

Tuesday 6 March	8.30am to 10.00am (U.K.)
Tuesday 5 June	8.30am to 10.00am (U.K.)
Tuesday 11 September	8.30am to 10.00am (U.K.)
Tuesday 4 December	8.30am to 10.00am (U.K.)

Conclusion / The End

Financial Markets Law Committee
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WHITE & CASE

An Introduction to Sovereign Green Bonds

White & Case

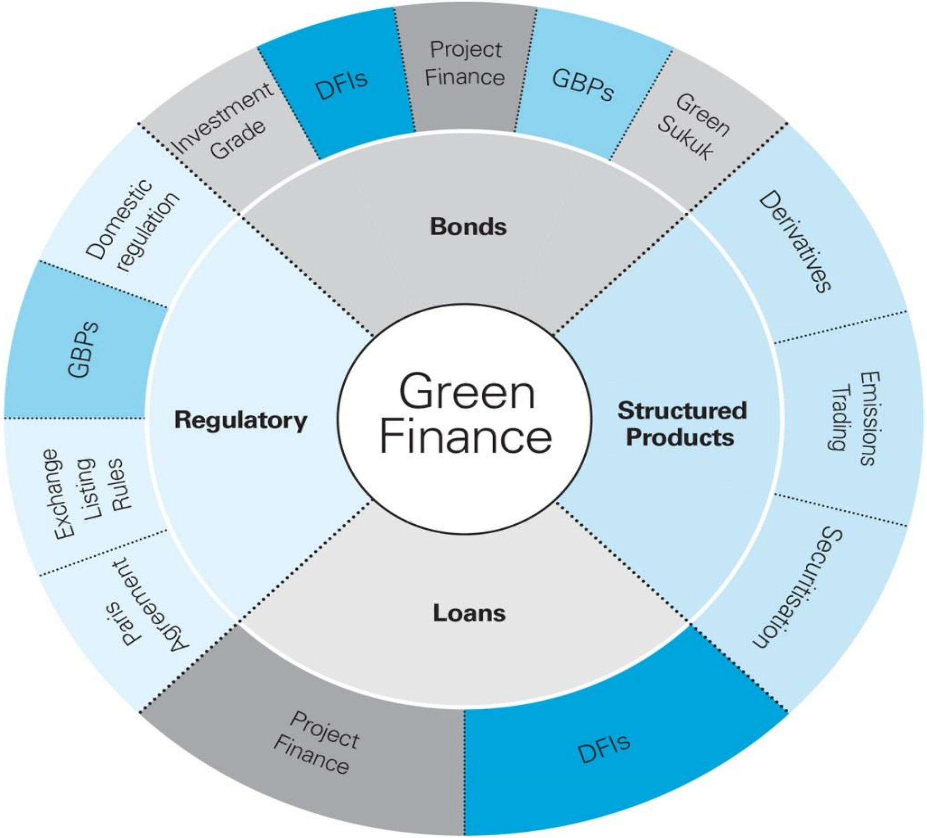
Tallat Hussain, Michael Bark-Jones and Mindy Hauman

September 2017

What is green finance

- G20 Green Finance Study Group:
  - “*financing of investments that provide environmental benefits in the broader context of environmentally sustainable development*”
- UK Green Finance Initiative:
  - *Environmental pillar of sustainable finance - “the integration of environmental, social and governance (ESG) dimensions into financial decisions*”
- Covering a wide range of transactions and instruments
  - Climate finance (clean energy, low-carbon transport, energy efficiency and climate resilience)
  - Environmental and conservation finance (to fund green growth and protect and restore natural environments, forest and water resources, biodiversity and eco-systems)
  - Development funding
  - Market-based instruments (green equity investments including infrastructure investment trusts and indices; environmental and climate risk insurance; carbon trading; green bonds and green loans)

Green finance market



Green bonds

- Any type of bond instrument where the proceeds will be **exclusively** applied to finance or refinance ‘green’ projects (e.g., environmental protection, sustainability, climate change solutions and renewable energy projects)
- “Shades of green” – no legal definition of a green bond
  - Green bond market has developed on a self-regulatory and voluntary basis through such initiatives as the Green Bond Principles (“**GBP**”) – GBP and other similar standards are sets of voluntary guidelines to help clarify the issuance of green bonds
  - Some countries, such as China, have complemented the GBP with policy-backed issuance guidelines, for a more determined focus on directing investment into green projects
  - Labelled green bonds vs unlabelled/climate-aligned bonds

Social Bond Principles

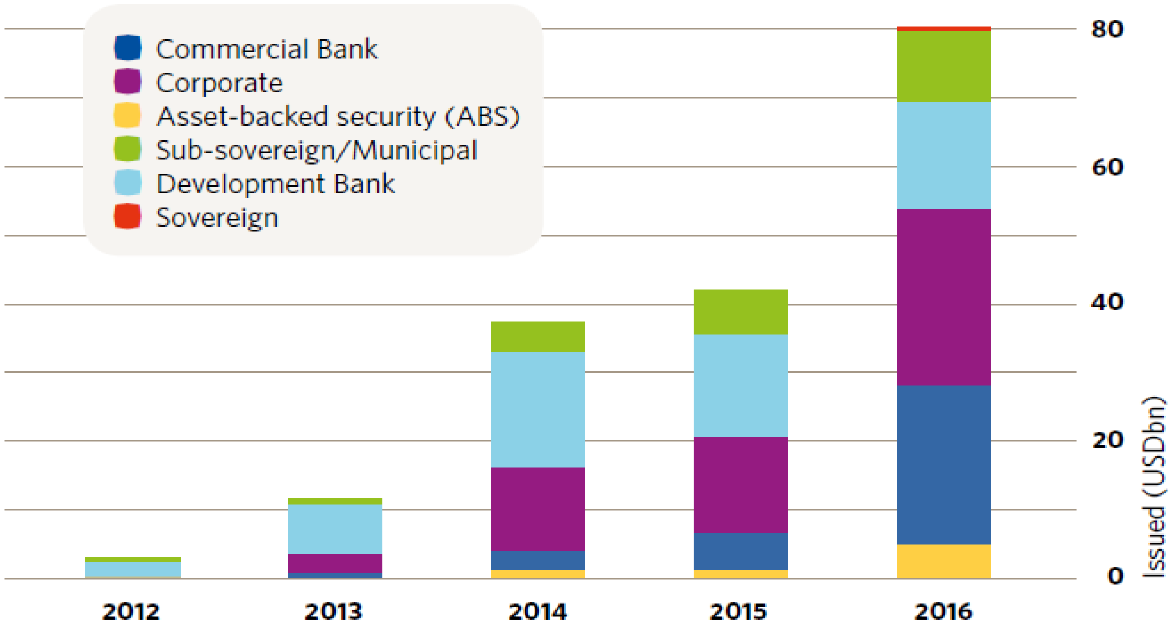
ICMA (2017) new releases:

- Social Bond Principles
  - in support of bonds raising funds for projects with positive social outcomes, including affordable housing, employment generation, food security and socioeconomic advancement and empowerment
- Sustainability Bond Guidelines
  - published to provide guidance for bonds combining green and social projects
- Participation
  - Social and sustainability bond market participants are eligible to become members of the GBP and become fully integrated in its governance

Why issue green bonds

- Tapping investor demand and diversifying investor base
  - Investors are increasingly demanding socially responsible investment (SRI) opportunities and institutional investors are using green bonds to address ESG (Environment, Social, Governance) mandates
- Public relations
  - Issuers can use green bonds to enhance public relations with their stakeholders by marketing themselves as environmentally conscious, sustainable and responsible
- Cost of funds
  - Green bonds can potentially provide issuers with pricing benefits over traditional bonds (due to oversubscription and socially responsible trade-off), but the market is not large enough yet to make definitive comparisons

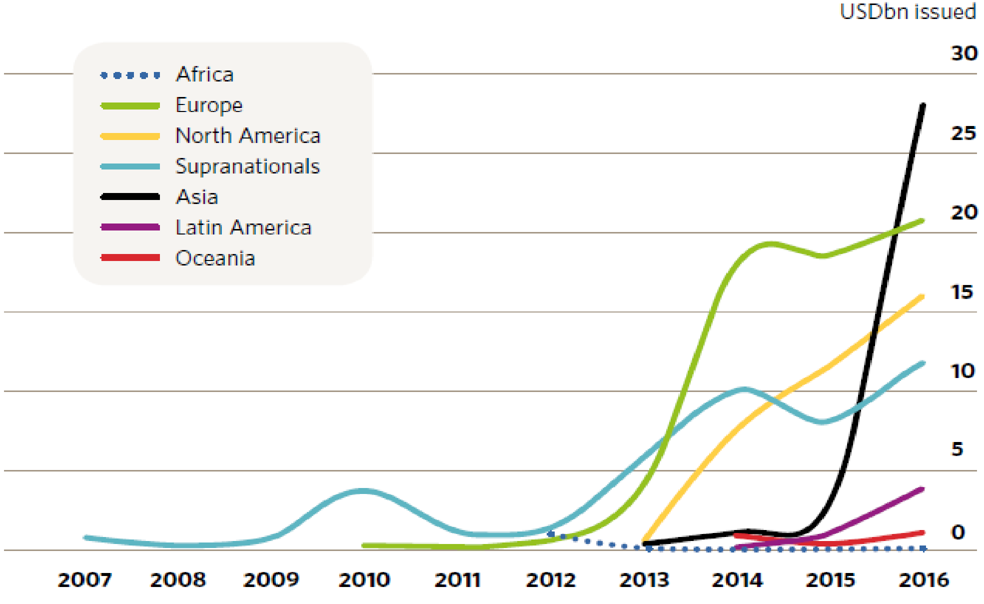
Green bonds – market size



Source: Climate Bonds Initiative

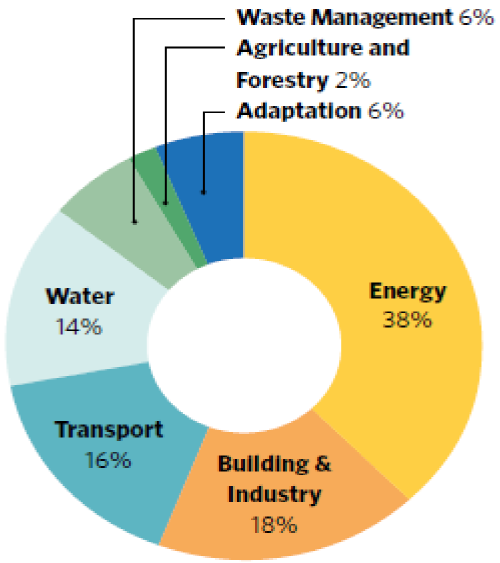
Green bonds – allocation

Green bonds by region



Source: Climate Bonds Initiative

Green bond use of proceeds 2016



Sovereign green bonds

- A number of factors are influencing sovereigns’ growing interest in issuing green bonds:
  - their commitments under the Paris Agreement;
  - the need for infrastructure finance; and
  - the focus on power production
- Green bonds offer sovereign issuers:
  - easy access to a large and diverse funding pool;
  - a low-cost capital to support investment in sustainable infrastructure projects; and
  - an opportunity to meet international environmental obligations

The answer to infrastructure funding

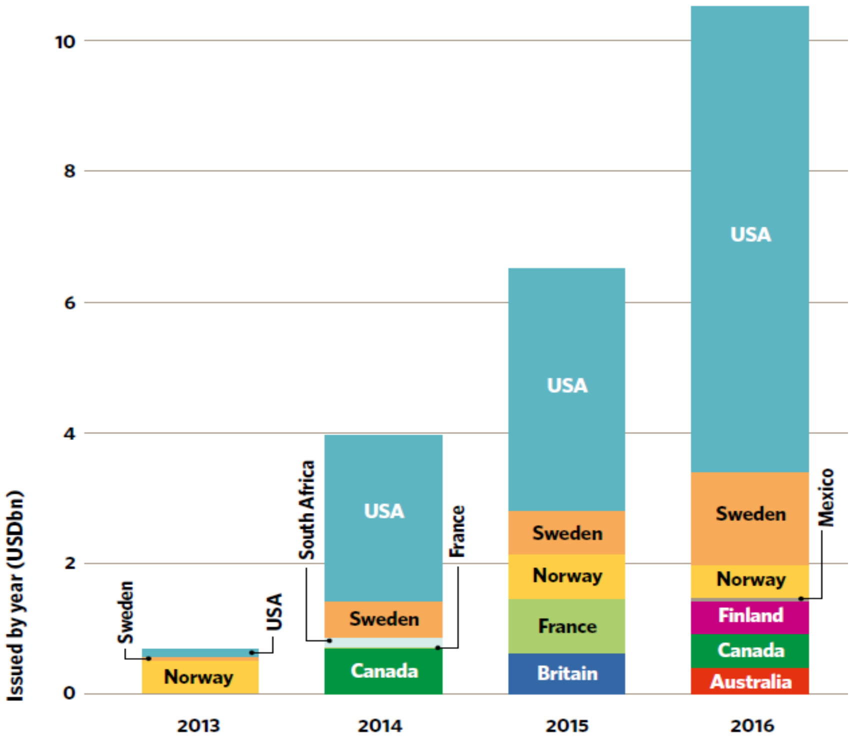
- Most countries, whether economically developed or developing, have a need for infrastructure—and “green infrastructure” such as urban transport, water services or clean power compete with other government projects for funding
- A large portion of these projects could be financed through green financing initiatives that tap into investors appetite for exposure to green assets
- It is estimated that from 2015 to 2030 global demand for new, climate resilient infrastructure could surpass US$90 trillion, and green bonds can be a key tool to drive this growth
- The strong creditworthiness of many sovereigns, along with their ability to make very large-scale issuances, makes them attractive to investors

Uniqueness of sovereigns

- Sovereigns are in the unique position of being able to create policy and implement change
  - incentives (PACE stands for Property Assessed Clean Energy in US and similar in Europe and China)
  - subsidies (Singapore Green Bond Grant)
  - tax credits (which investors receive in lieu of an interest payment on their investment – US Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds programmes)
- Ratings - most sovereigns have a higher rating than other issuers in their jurisdiction and have an easier time with subscription appetite
- Most sovereigns will have already issued bonds so most of the required regulatory infrastructure and experience would be available for issuing a green bond

Muni green bonds

Green City Bonds Issuance (2013 - 2016)



Green finance frameworks

- Frameworks
  - Some sovereigns have created mandatory regulatory regimes, guidelines and policy initiatives to address its specific national targets. However, most bespoke frameworks are to some degree aligned with the GBP
  - China, France, Poland, Nigeria, Brazil (corporates only) and The Financial Services Authority of Indonesia (also in compliance with Shari’ah law)
- Securities/exchange regulation based
  - Listing mechanisms, green bond guidelines and practical instructions that will facilitate green issuances through a series of listing requirements
  - The Moroccan Capital Market Association, The Securities and Exchange Board of India and the London Stock Exchange

Green bonds – challenges

- Lack of uniformity
- Reputational risk / “green washing” / legal liabilities
- Administrative obligations
  - Ongoing obligations (and resultant costs) on issuer to administer a green bond issuance, including compliance-related activities such as monitoring and reporting on use of proceeds and environmental outcomes
- Costs of issuance / funding
  - Need for “second party” opinions of an issuer’s green bond selection criteria and project evaluation methodology and/or post issuance “third party” assurance
  - Additional costs beyond the usual costs of issuance for traditional bonds

Potential liabilities for the Issuer

- Prospectus Liability of Issuers
  - Bondholders could claim compensation for certain loss suffered for material inaccuracy in, or omission of information from, the Prospectus, which causes investors to suffer loss or where formal procedures to be followed for tracking proceeds or designating proceeds to a specific account
- Breach of Warranties/Representations/Undertakings/Indemnity
  - Breach of accuracy of information representation/warranty in the subscription agreement
- Transparency
  - Issuer vulnerable where secondary market transparency regimes exist (including periodic reporting) for misstatements and omissions
- Bond Covenants
  - Although rarely included, “green” covenants in the documentation, if breached, could trigger an event of default or lead to cross-default of other agreements

Mitigating risk as an Underwriter

- Is there an increased risk with green bonds?
- Potential underwriter approach for mitigating any potential/perceived risks through provisions in the documentation:
  - Specific Risk Factors
  - Disclaimer Language
    - For example, *"No Joint Lead Manager makes any representation as to the suitability of the Green Bonds to fulfil environmental and sustainability criteria required by prospective investors. The Joint Lead Managers have not undertaken, nor are responsible for, any [assessment of the Eligibility Criteria], any verification of [whether the Eligible Green Projects meet the Eligibility Criteria], or the monitoring of the use of proceeds. Investors should refer to the [Issuer's website, Annual Report and Second Party Opinion] for information. [The Second Party Opinion provider has been appointed by the Issuer]"*
  - Issuer Undertakings
    - Agreement/confirmation from the Issuer (and any guarantors) to apply the proceeds of the issue of the Notes in compliance with the "Use of Proceeds" section in the Prospectus; <u>or</u> to refrain from applying the proceeds in a manner which would be inconsistent with the agreed terms

Representative examples of green bonds

Issuer	Jurisdiction	Date of Issue	Amount	Class
World Bank	Global	Various since 2008	Total approx. USD9bn	Global Market Developer
EBRD	Global	Various	Total approx. €5.3 billion	Global Market Developer
DC Water	United States of America	July 2014	USD350m	Project/Infrastructure Green Bond
City of Gothenburg	Sweden	September 2013	SEK2bn	Municipal Green Bond
Queensland Australia	Australia	March 2017	AUD 750 m	Solar, Low Carbon Transport
Mexico City	Mexico	December 2016	Mexican Pesos1billion	Potable water, waste water, public lighting
City of Cape town	South Africa	June 2017	R1bn	Adaptation and mitigation initiatives
Canadian province of Ontario	Canada	October 2014	CAD$500 million	Public transport
Rural Electrification Corp.	India	June 2017	USD450m	solar, wind and biomass power and sustainable water and waste management projects
Brazilian Development Bank	Brazil	May 2017	USD1billion	Environmentally sustainable projects
Bank of China	China	November 2016	USD500m	Pioneer in Covered Green Bond policy and development in China
Republic of Poland	Poland	December 2016	EUR750m	Pioneer Sovereign Green Bond
Republic of France	France	January 2017	EUR7bn	Sovereign Green Bond

Any Questions?

Thank you