CLIMATE BONDS:
SAVING THE PLANET; PRESERVING INTEGRITY; CONSIDERING REGULATION AND OPPORTUNITY

The Climate Bond Initiative has created "Climate Bonds," an iteration of green bonds. Climate Bonds bear a certification that issuers and investors can rely on as to the environmental standard of the assets and projects underlying eligible debt instruments. The certification scheme for Climate Bonds is structured to preserve certifier integrity, apparently avoiding some of the issues that plagued the credit ratings agencies during the subprime crisis. Like other, successful climate change initiatives, issuing Climate Bonds is voluntary.

According to its promotional materials, in 2008, the World Bank launched the first bond branded as a green bond in the amount of $440 million.[1] Research published by the Climate Bond Initiative earlier this month states that, globally, issuances of green bonds topped $100 billion in 2017 and are projected to exceed $150 billion in 2018.[2] The green bond market, however, remains fragmented. The bonds may, or may not, have been certified as green by any number of certifying entities, and, whether they are certified, issuers may in fact be greenwashing their actions.[3] The Climate Bond Initiative is working to make its Climate Bonds Standard a certification framework that both investors in and issuers of green bonds can rely on.

The work produced by the Climate Bond Initiative is comprehensive and helpful to understand what assets and projects should qualify for legitimate green bond financing. At the same time, the Climate Bond Initiative appears to have created a certification process that avoids some of the issues that plagued the credit ratings agencies ratings process and that contributed materially to the subprime crisis. Climate Bonds are, however, but a small set of the larger class of tools available to address climate change. Although pursuing climate change initiatives is important and pressing, governments would be wise to consider whether any action by them is required and, if so, what action should be.

This article:

1. describes green bonds briefly;
2. defines Climate Bonds;
3. explains how the Climate Bonds Standard preserves its integrity; and
4. positions Climate Bonds in the broader context of selected climate change initiatives to explain why governments should carefully and thoughtfully regulate, if at all.

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[1] The same promotional materials acknowledge that, in 2007, the European Investment Bank issued a €600 million equity-linked Climate Awareness Bond.

[2] Climate Change Initiative, Green Bond Highlights 2017, January 2018 (https://www.climatebonds.net/files/reports/cbi-green-bonds-highlights-2017.pdf) (Viewed January 18, 2018).

[3] See, e.g., Milhench, Claire, Emerging climate bonds boom, but are they really green?, *Reuters*, August 18, 2017 (https://www.reuters.com/article/us-emerging-bonds-green/emerging-climate-bonds-boom-but-are-they-really-green-idUSKCN1AY1F4) (Viewed on January 19, 2018) (Defining greenwashing as "promot[ing] green objectives but operat[ing] in a way that damages the environment," and describing examples of alleged Polish and Chinese greenwashing.).

1. Green bonds

Green bonds share at least three features with other bonds. They: (1) include a coupon (e.g., interest rate (fixed; floating; step up); index-linked); (2) include a use of proceeds provision; and (3) provide for recourse to a credit, a cash flow, and/or collateral. In 2014, the International Capital Markets Association (ICMA), based in London, first published the Green Bond Principles (GBP).[4] ICMA was clear that its purpose was to bring harmony to the green bond market. ICMA recommended transparency and disclosure to promote green bond market integrity. Compliance with the GBP is voluntary. The GBP identifies four features that should appear in green bond documentation: (1) use of proceeds provisions; (2) a transparent process for project evaluation and selection; (3) management of proceeds mechanisms; and (4) robust reporting obligations concerning features 1 through 3. In addition, auditors, consultants, and/or ratings agencies, among others, should verify features 1 through 4.

2. Climate Bonds

The Climate Bond Initiative, based in London, is an investor-focused non-profit started in 2010. According to its homepage, the Climate Bond Initiative is "the only organisation [sic] working solely on mobilising [sic] the $100 trillion bond market for climate change solutions." The Climate Bond Initiative has created the Climate Bonds Standard, which fully aligns with the GBP while expanding on them.[5] The Climate Bond Initiative has defined its own nomenclature, which this article adopts.

The purposes for the Climate Bond Initiative[6] include: "align[ing]" the interests of stakeholders, including issuers and investors; creating a transparent, scientific framework that investors can trust and rely on to understand the environmental standards of the assets and/or projects underlying Climate Bonds; allowing investors to quickly identify green bonds and issuers without having to conduct due diligence or make judgments on the green characteristics of those bonds; and allowing issuers to: (x) quickly identify eligible projects and assets they can support with bond proceeds, and (y) structure green bonds that meet "industry standards for climate integrity, management of proceeds, and Transparency." Compliance with the Climate Bonds Standard is voluntary.

Bonds eligible for certification under the Climate Bonds Standard include: issuer-recourse bonds; cash-flow recourse bonds; project bonds where the bond holder has exposure to the project and may or may not have recourse to the issuer; securitized bonds; and any other debt instrument listed on the Climate Bond Initiative's website from time to time.

Bonds that satisfy the Climate Bonds Standard criteria receive a Climate Bond Certification. The Climate Bond Certification certifies only that a bond has met the Climate Bonds Standard. The Climate Bonds Standard includes an impressive taxonomy[7] that defines the qualifying sectors and areas[8] for investment along with eligibility criteria. The eligibility criteria refer to existing standards, such as LEED, and define other standards.[9] Climate Bond Certification is based on assurances (reasonable or limited)[10] and/or audits completed in accordance with relevant industry standards by Verifiers approved by the

[4] ICMA last updated the GBP in 2017. (See, https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/GreenBondsBrochure-JUNE2017.pdf).
[5] Climate Bonds Standard version 2.1, at 2 (https://www.climatebonds.net/standards/standard_download) (Viewed January 16, 2018).
[6] *Id.*, at 2 and 3.
[7] See, https://www.climatebonds.net/standards/taxonomy (Viewed on January 17, 2018) and https://www.climatebonds.net/files/files/Climate%20Bonds%20Taxonomy%20v1.xlsx (Viewed on January 17, 2018).
[8] For example, the taxonomy omits aircraft and aircraft manufacturers; however, it does include electric vehicles and trains, and it includes manufacturing and processing facilities for aviation biofuels.
[9] By their own terms, the eligibility criteria are a work in progress.
[10] Local securities laws and practices govern the fact and manner of disclosure to investors of the standard of assurances and the supporting documentation the Verifier provides to the Climate Bonds Standard Board. For example, the Metropolitan Transportation Authority published certification and verification documents relating to its Climate Bonds on its website. (See, http://web.mta.info/mta/investor/new/green-bonds.htm).

Climate Bonds Standard Board.[11] The issuer pays for the Verifiers to conduct their work and for the Climate Bonds Standard Board to issue the Climate Bond Certification.

Climate Bond Certification relates to environmental issues only. The Climate Bonds Standard is explicit that Climate Bond Certification is not a financial analysis, it has no impact on the financial analysis (including credit ratings), and investors must complete their own financial due diligence before investing. Upon receipt of Climate Bond Certification, an issuer may use the Climate Bond Certification Mark, a registered trademark, during its pricing and marketing process. Climate Bond Certification may also be applied for on a continuing basis during the life of the bond. Since 2014, almost $32 billion of Climate Bonds have been issued.[12]

3. Preserving integrity

Just as the credit ratings agencies stated that they used scientific, empirical, and objective criteria to evaluate the credit-quality of the mortgages underlying mortgage-backed securities, the Climate Bonds Standard emphasizes integrity, transparency, and a scientific approach to evaluating the asset or project underlying the bond to certify the bond as a Climate Bond. Further, just as the credit quality of the mortgages underlying the debt securities that led to the subprime crisis was material to investors, the environmental standard of the projects and assets underlying Climate Bonds may also be material to investors.

The Climate Bonds Standard includes mitigants for issues that undermined the credit ratings agencies' integrity and independence during the subprime crisis.[13] Unlike the credit ratings agencies who developed their ratings, the methodology for determining the ratings, and performed the analysis in accordance with the methodology to determine the ratings, the Climate Bonds Standard divides this labor among participants in the Climate Bond Initiative. The Climate Bonds Standard itself defines the methodology used to determine whether a bond can obtain a Climate Bond Certification. The Climate Bond Certification is not qualified. Verifiers, who are third-parties, perform the analysis (in accordance with industry standards) pursuant to that methodology and provide an assurance to the Climate Bonds Standard Board. The Climate Bonds Standard Board issues the Climate Bond Certification on the basis of that assurance. There may be other benefits to using those third-parties, such as avoiding the understaffing issues that also affected the credit ratings agencies during the subprime crisis.

The Climate Bonds Standard also appears to address the conflicts of interest issue that plagued the credit ratings agencies during the subprime crisis. At that time, the issuers and their bankers appointed and paid the credit ratings agencies. If a credit ratings agency did not give the issuers the ratings they demanded, the issuers would not appoint that credit ratings agency on future transactions. In contrast, the Climate Bonds Standard defines a single outcome: receipt of the Climate Bond Certification. Consistent with the practices of the credit ratings agencies, the issuer pays the Verifiers to conduct this analysis and the Climate Bond Initiative to issue a Climate Bond Certification. The mitigants to these conflicts of interest include: the Climate Bonds Standard Board approves the Verifiers; the Climate Bonds Standard Board relies on the Verifiers work product to issue its Climate Bond Certification; the Verifiers are institutions that appear to have sufficiently diverse and robust work-streams so that services provided in connection with Climate Bond Certification should represent only a small portion of the total business of each; and the Climate Bond Initiative has an immaterial financial incentive to certify any particular bond. The Climate Bond Initiative is a non-profit whose funding comprises primarily grants from other non-profit and public organizations, revenue from public sector contracts, and negligible

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[11] See, https://www.climatebonds.net/standards/assurance/approved-verifiers (Viewed January 17, 2018). The list includes: such as environmental consultants, classification societies, certifiers, auditors, and one credit ratings agency.

[12] https://www.climatebonds.net/standards/certification

[13] Comparing and contrasting credit ratings agencies with the Climate Bonds Standard is an imperfect exercise. The Climate Bond Certification, at this point, is a feature that distinguishes a class of bonds as Climate Bonds. Some Climate Bonds have been and may continue to be rated by the credit ratings agencies, which means that they could be affected by issues endemic to the credit ratings agencies, despite any improvements or increased oversight that may have occurred since the subprime crisis.

subscription fees paid by its partners annually. By comparison, its share of the fees issuers pay for certification is minor.[14]

4. Careful, thoughtful regulation, if at all

Climate Bonds are a subset of the larger class of green bonds and other initiatives[15] available to support environmentally friendly initiatives. Despite this, the Climate Bonds Standard is useful because it defines a framework for thinking about the sectors and areas where investment in the right green initiatives could have a meaningfully positive effect, and it, like other voluntary initiatives, is successful. A risk is that ambitious politicians may be inspired by these successes to impose regulations geared towards addressing climate change that are redundant, ineffective, or counterproductive.

The Paris Agreement, a U.N.-sponsored initiative, is merely aspirational, imposing no obligations on the parties to it.[16] Some signatories to the Paris Agreement have stated their intent to enact legislation geared towards helping them meet the objectives of the Paris Agreement. Riding the wave of interest in climate change initiatives, France enacted Article 173 of the French Energy Transition Law, which is intended to work in tandem with the Paris Agreement[17] by redirecting investment to support the transition to alternative energy sources.[18] The French legislation, as initially conceived, turns out to be redundant with market practices[19] and effective only in creating a paper mill of reporting on those practices.[20] Jarringly, the law omits any metrics that can be used to evaluate its effectiveness, such as measuring whether the regulated entities have, in fact, reduced their carbon footprint.[21] Its ineffectiveness is compounded by the omission of any consequences for failure to comply, other than a continuing obligation to explain any failures to the regulator.[22] China, also a signatory to the Paris Agreement, appears to have taken an aggressive, centralized approach to regulation that has backfired. Though efficiently enacted, in many instances China's regulation has failed to address the right kinds of change required, and its regulation has negatively affected businesses, including due to politically expedient enforcement.[23]

Increasing public support for climate change initiatives and carrots offered by governments can effectively incent businesses and individuals to take actions that support green initiatives. For example, earlier this week, an article described the letter that Laurence Fink, the founder and chief executive of Blackrock, sent to a number of the largest public companies. Fink told the companies that Blackrock expected them to contribute to the social good, including environmental initiatives, or risk losing Blackrock's support. Consumer demand that responsible capitalism entails more than merely making

[14] https://www.climatebonds.net/about/funders (Viewed on January 18, 2018).
[15] These tools include, among other things: equity investments, project finance, corporate finance, construction finance, municipal finance, philanthropy, traditional export credit agency support, lobbying, thoughtful legislation, government and privately sponsored voluntary programs, subsidies, and other practical initiatives.
[16] This is not to suggest that the U.N. could or should have done more.
[17] French Treasury, Assessing climate change related risks in the banking sector, at 1-2, [Publication date absent.], (https://www.tresor.economie.gouv.fr/Ressources/File/433465) (Viewed on January 19, 2018).
[18] Forum Pour L'Investissement Responsable, Article 173-VI: Understanding the French regulation on investor reporting, at 6, October 2016 (http://www.frenchsif.org/isr-esg/wp-content/uploads/Understanding_article173-French_SIF_Handbook.pdf) (Viewed on January 21, 2018).
[19] Rust, Susanna, France aims high with first-ever investor climate-reporting law, *IPE* (https://www.ipe.com/countries/france/france-aims-high-with-first-ever-investor-climate-reporting-law/10011722.fullarticle) (Viewed on January 19, 2018). (The article also states that smaller and mid-sized regulated entities objected to the French law on the basis that it imposes a significant burden; however, smaller companies are exempt from detailed reporting.).
[20] Principles for Responsible Investment, French Energy Transition Law Global Investor Briefing, at 13, April 22, 2106 (https://www.unpri.org/download_report/14573) (Viewed January 19, 2018) (Stating, "The law is expected to cause more analysis of climate risk and more reporting about exposure levels by investors. **As yet, no official information has been provided about who will use the data or how the information will be used by the regulator**." (Emphasis added.)). (Note: Principles for Responsible Investment is a U.N.-backed initiative, and this document is broadly supportive of the French legislation.).
[21] *Id.*, at 8.
[22] *Id.*, at 7.
[23] Huang, Yanzhong, Why China's Good Environmental Policies Have Gone Wrong, *The New York Times*, January 14, 2018 (https://www.nytimes.com/2018/01/14/opinion/china-environmental-policies-wrong.html) (Viewed on January 18, 2018).

profits drove Blackrock's actions in part.[24] Like the French legislation, Fink's initiative seeks reporting that may be redundant with market practices. Unlike the French legislation, Fink's initiative is entirely voluntary because companies have the freedom to choose to fail to comply, which results in two obvious consequences. The first is that those companies do not have a continuing obligation to explain themselves; the second is that they may lose Blackrock's support. Fink's initiative could be criticized because it is framed negatively, and facially does not appear to be a market-leading initiative. In contrast, initiatives that create opportunities can be positive, both for the environment and for market participants.

The Energy Star program, started by the Environmental Protection Agency in 1992 during the George H.W. Bush administration, is an example of effective partnership between the public and the private sectors to pursue voluntary green initiatives on the basis of consumer demand. Subject to third-party verification, businesses voluntarily certify that their products and/or practices comply with various criteria defined by the EPA in order to gain a competitive edge in the market. Energy Star's success[25] is such that Energy Star certified products used in multifamily real estate new construction and renovations form one of the bases for Fannie Mae's green DUS MBS program (started in 2013), which issued $24.9 billion in green mortgage backed securities just in 2017. The Climate Change Initiative has acknowledged the success of the Fannie Mae program, which is substantially the reason the United States was the leader among countries in green bond issuances for 2017, and cumulatively.[26] Along with the United States, France and China rounded out the top three issuers of green bonds, both in 2017 and cumulatively.

In 2017, the Trump administration proposed both eliminating the Energy Star program and withdrawing from the Paris Agreement. More than 1000 businesses countered by expressing[27] their support for continuing the Energy Star program, and the Energy Star program survives. In response to potential withdrawal from the Paris Agreement, many businesses along with State and local governments reaffirmed their commitment to climate-friendly policies and initiatives and reached out to their counterparts internationally to continue to develop green initiatives. These actions and the numbers speak for themselves. Despite all of the noise, the Climate Bonds Initiative and its supporters along with market participants in the United States show that thoughtful, voluntary action can be extremely effective in supporting green initiatives. And, the Climate Bond Initiative's January 2018 report on green bonds identifies regulation in Europe that may encourage voluntary action: the European Commission is considering "lower[ing] capital requirements for lending against energy efficient buildings and electric cars."

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[24] Sorkin, Andrew Ross, BlackRock's Message: Contribute to Society, or Risk Losing Our Support, *New York Times*, January 15, 2018 (https://www.nytimes.com/2018/01/15/business/dealbook/blackrock-laurence-fink-letter.html) (Viewed on January 15, 2018).
[25] Since inception, "ENERGY STAR and its partners have helped save American families and businesses $430 billion on their energy bills[…]." and "[…] ENERGY STAR has helped states and local governments achieve their climate goals by preventing 2.8 billion metric tons of greenhouse gas emissions[…]." https://www.energystar.gov/about (Visited January 12, 2018). Energy Star has been implemented in various respects by Canada, the European Union, the European Free Trade Association, Japan, New Zealand, Switzerland, and Taiwan. https://www.energystar.gov/index.cfm?c=partners.intl_implementation (Visited January 12, 2018).
[26] Climate Change Initiative, Green Bond Highlights 2017, January 2018 (https://www.climatebonds.net/files/reports/cbi-green-bonds-highlights-2017.pdf) (Viewed January 18, 2018).
[27] See, letter dated April 24, 2017 (http://www.ase.org/sites/ase.org/files/industry_support_letter_for_energy_star-final_5.0.pdf).