BANKING AND CAPITAL MARKETS

PORTUGUESE GREEN BONDS

MACEDO VITORINO

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1. INTRODUCTION

The transition to an emission-neutral and environmentally sustainable economy is underway. The European "Green Deal", with the Portuguese PNEC, the European taxonomy, and green finance marks the beginning of a new approach to financial investments.

The environmental crisis represents one of humanity's greatest challenges today.

According to McKinsey to prevent a rise of more than 1.5°C, no more than 400 gigatons can be emitted, which means cutting present emissions levels by two-thirds over the course of the decade.

The first attempt to codify the environmental obligations of States at a global level was the Kyoto Protocol signed in 1997 and, more recently, the Paris Agreement of 2015 and the Glasgow Climate Pact of 2021.

At the European Union level, a set of sustainability policies, called the "Green New Deal", was approved in 2019, with the aim of transforming Europe's economy, and setting the following objectives:

(1) Neutral greenhouse gas emissions by 2050; and

(2) Reduction of greenhouse gas emissions by at least 55% (compared to 1990) by 2030.

The Taxonomy Regulation, approved in 2020, establishes a European Union classification system in order to determine whether an economic activity is environmentally sustainable.

Portugal has joined the European Union's and the World's efforts to promote environmental sustainability since the beginning of the millennium, with aggressive investments in renewable energy, such as wind and hydroelectric power, and, more recently, in solar energy.

On 10 July 2019, Portugal approved the National Energy and Climate Plan (**PNEC**) which sets out Portugal's agenda for the next decade in the environmental field and the country's environmental goals to be achieved by 2030, of which we highlight:

(1) To reduce greenhouse gas emissions by 45% to 55%, in comparison with 2005 emissions;

(2) To increase to 47% the value of energy from renewable sources in the gross final consumption of energy; and

(3) To reduce primary energy consumption by 35% compared to 2005.

These goals can only be achieved through the development of renewable energy projects. The investments are large; therefore, sponsors should plan and use financing strategies appropriate to the projects they develop.

The "Green New Deal" highlighted the need to act in the field of financing green projects and announced the development of a renewed strategy in this area. To this end, a new European directive is under development that will standardize the issuing and negotiation of financing instruments for sustainable projects in Europe.

The issuance of so-called "*green bonds*" has become one of the new and most important financing instruments for sustainable projects. In this briefing, we describe what green bonds are, how they work and how they may be issued.

This briefing also describes the criteria used for qualifying bonds as "green" and also the process for issuing bonds under Portuguese law.

2. LOOKING FOR "GREEN" INVESTMENTS

The case for a “green” revolution has been made in the economic press and general press since the beginning of the millennium, but “green” investments are only now beginning to make significant strides.

Global investors are beginning to demand that public and private companies and organizations make clear, precise, and measurable environmental commitments that can be verified and audited by the market. This movement extends to all types of financial assets: equities, government bonds, *exchange-traded funds* (ETFs), or *hedge funds*.

According to recent data from Bloomberg Intelligence, ETFs linked to ESG policies (an acronym for "*Environmental, Social, Governance*") cumulative assets accounted for more than $360 billion in 2021, almost 4% of global ETF assets.

Sustainable bonds accounted for 10% of overall global debt market activity, which exceeds the 6.6% of 2020 by large.

According to the *2021 Global ETF Investor Survey* by US bank Brown Brothers Harriman, 82% of global investors plan to increase investment in ETFs linked to ESG policies, and over the next five years, nearly 56% of ETF investors plan to allocate at least 11% of their investments to funds that follow sustainable policies.

By 2021, a total of USD 500 billion was invested in green bonds, issued by companies, financial institutions, and governments to finance environmentally sustainable projects, reaching a new record high.

The global value of green bonds reached $488.8 billion, almost doubling 2020 levels. In several issues, green bonds have increased by 54% compared to 2020.

Europe accounted for 54% of the sustainable bond market, compared to 22% in America and 18% in the Asia Pacific region.

In 2020, European Union was the global leader in green bonds, responsible for 48 % of global issuances and 51 % of the global volume of green bonds being issued in the European Union.

3. WHAT ARE GREEN BONDS?

As the name suggests, 'green bonds' are first and foremost bonds, i.e. financial instruments representing debt issued by a public or private entity, whose special feature, compared with other bonds, is that the bond proceeds are used exclusively for 'green' projects, i.e. projects that meet certain environmental objectives.

The first issue of green bonds was made in 2007, by the European Investment Bank, and served to finance, through loans, several projects developed by other entities. In the following years, other financial institutions, such as the World Bank, issued debt to finance environmental projects.

Since 2014, developers - usually private entities - have taken the initiative to directly issue green bonds in search of financial investors with an interest in this type of investment, and there are now numerous financial investors specializing in environmentally sustainable industries.

In general, a few types of green finance can be identified:

- Bonds with recourse to the issuer: the same credit *rating* applies as for other bonds of the issuer;
- Municipal or guaranteed bonds: the issuers' revenues arising from fees, taxes, etc. (e.g. on electricity) are pledged as collateral;
- Project bonds: the resource is limited to the project's assets and balance sheet;
- Securitised bonds: the resource is limited to a group of projects that have been pooled;
- Covered bonds: with recourse to the issuer and, if the issuer cannot repay the bonds, to the portfolio provided as collateral;
- Loans: with full recourse to the borrower(s) in the case of unsecured loans and to security interests in the case of secured loans;
- Other debt instruments: Convertible bonds, *Schuldschein,* Commercial paper, Sukuk, Debentures.

4. THE ICMA "GREEN BOND PRINCIPLES"

In the absence of specific legal rules for green bonds, the contribution of the International Capital Markets Association (**ICMA**) has been of particular importance in defining the green bond principles, which cover the following aspects:

- Use of proceeds;
- Project evaluation and selection;
- Management of proceeds; and
- Reporting.

First, the ICMA Principles state that funds should be used to finance "Green Projects" defined as projects that provide clear environmental benefits.

For ICMA, the eligible green projects categories include:

- Renewable energy, including production, transmission, appliances, and products;
- Energy efficiency, including new and renovated buildings, energy storage, district heating, smart grids, appliances, and products;
- Pollution prevention and control, including air emission reduction, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling, and energy-efficient waste;
- Environmentally sustainable management of living natural resources and land use, including environmentally sustainable agriculture; environmentally sustainable animal husbandry; climate-smart farm inputs, such as biological crop protection or drip irrigation; environmentally sustainable fisheries and aquaculture; environmentally sustainable forestry, including afforestation or reforestation, and the preservation or restoration of natural landscapes;
- Conservation of terrestrial and aquatic biodiversity (including protection of coastal, marine, and hydrographic environments);
- Clean transport, including electric, hybrid, public, rail, and multimodal transport, infrastructure for clean energy vehicles, and reduction of pollutant emissions;
- Sustainable water and wastewater management;
- Climate change adaptation, including information support systems such as climate observation and early warning systems;

- Eco-efficient and/or circular products, technologies, and adapted processes (such as development and introduction of environmentally sustainable, eco-labelled, or environmentally certified products, resource-efficient packaging, and distribution); and
- Green buildings that meet regional, national, or internationally recognized standards or certifications.

The following table lists the types of projects eligible for a green bond and relates them to the overall environmental objectives:

ENVIRONMENTAL OBJECTIVES					
Categories of green bond projects	**Mitigation of climate change**	**Adaptation to climate change**	**Biodiversity**	**Conservation of natural resources**	**Pollution prevention and control**
Renewable Energies	● Main			● Tertiary	● Tertiary
Energy efficiency	● Main				● Tertiary
Pollution control and prevention				● Tertiary	● Main
Sustainable management of living natural resources and land use	● Tertiary	● Secondary	● Main	● Main	
Conservation of terrestrial and aquatic biodiversity		● Tertiary	● Main	● Main	
Clean transport	● Main			● Tertiary	● Main
Sustainable water and wastewater management					● Main
Adaptation to climate change		● Main			
Eco-efficient and/or circular economy-friendly products, technologies, and production processes	● Secondary		● Tertiary	● Main	● Tertiary
Green buildings	● Main	● Tertiary		● Main	● Tertiary

I contribute to the goal:

Main ●

Secondary ●

Tertiary ●

Source: ICMA, Green Bonds Mapping, June 2019

Second, it is recommended that the green bond issuer communicates to investors:

- the goals of environmental sustainability;
- the process that led the issuer to integrate the project into the categories of eligible Green Projects;
- the related eligibility criteria, including, where applicable, exclusion criteria, or any other process applied to identify and manage potentially material environmental and social risks associated with projects, notably by providing information on the internal objectives, strategy, and processes that make the project environmentally sustainable, which can and should include, where possible, the indication of green standards and/or certifications awarded to projects and make use of audits or certification by external and independent entities.

Compliance with this principle involves the technical assessment and provision to investors of information on the environmental sustainability goals that the green project will, in the specific case, promote.

Third, bond proceeds should be credited to sub-accounts or accounts controlled by a formal internal process to ensure that the proceeds are utilized in eligible green projects and can be audited by the issuer and external auditors.

Finally, and for reasons of transparency, the ICMA Principles establish that issuers should disclose and keep available information about the allocation of the proceeds, projects, and their impact, on an annual basis or whenever there is a material change, including qualitative and, where possible, quantitative performance indicators, to allow greater investor scrutiny of the use of funding and its management.

5. THE EU TAXONOMY REGULATION

In 2020, the European Parliament approved Regulation (EU) 2020/852 ("**Taxonomy Regulation**"), which aims to promote sustainable investments and to create a secure, precise, and rigorous classification of eligible project types and the objectives of sustainable projects.

The Taxonomy Regulation defines as environmentally sustainable the economic activities that:

- Contribute substantially to one or more environmental objectives, *i.e.* (i) climate change mitigation, (ii) adaptation to climate change, (iii) sustainable use, (iv) protection of water and marine resources, (v) transition to a circular economy, (vi) prevention and control of pollution and (v) protection and restoration of biodiversity and ecosystems;
- Not significantly impair any of the environmental objectives listed in Article 17 of the Taxonomy Regulation;
- Are developed by certain minimum safeguards; and
- Satisfy the technical assessment criteria set by the Commission in Delegated Regulation (EU) 2021/2139.

The requirements set by the Taxonomy Regulation provide the basis for the concrete definition of the commitments that should be at the heart of green financing.

The Taxonomy Regulation requires projects to comply with the following requirements:

- Identify the most relevant potential contributions to the environmental objective and the minimum requirements that must be met to avoid significant harm to any relevant environmental objectives;
- Be quantifiable or, when this is not possible, use sustainability indicators;
- Be based on conclusive scientific evidence and the precautionary principle;
- Take life-cycle considerations into account by considering the environmental impact of the economic activity and the environmental impact of products and services resulting from that activity, the nature and scale of the economic activity, and the potential market impact of the transition to a more sustainable economy; and
- Covering all relevant economic activities in a specific sector and ensuring that these activities are treated equally.

6. THE FUTURE GREEN BOND REGULATION

In July 2021, the European Commission published a proposal for a Regulation on European Green Bonds (**Green Bond Regulation**).

The proposed Green Bonds Regulation foresees the creation of a standard for the issuance of European green bonds, available to all issuers, with the following features:

- ***Inclusive and voluntary***. European Green Bonds can be issued by any type of issuer, listed or unlisted, public or private, including the Member States voluntarily. The issue of green bonds complying with different standards is not prohibited, the only consequence being that such bonds may not be designated as European Green Bonds.
- ***Alignment with Taxonomy regulation***. European Green Bonds will require issuers to allocate 100% of the bond proceeds to activities that are compliant with the Taxonomy Regulation requirements.
- ***Long-termrm projects***. The proceeds of European Green Bonds can be used to fund long-term projects, up to 10 years, which involve an economic activity compliant with the Taxonomy Regulation.

Although the green bond regulation has not yet been approved it can already be used in the preparation of green bond issues.

The proposed Green Bond Regulation sets out the following requirements for the classification of bonds as "European Green Bond":

- The proceeds of the bonds should be applied in activities that comply with the Taxonomy Regulation (Regulation (EU) 2020/852)
- Before issuing, issuers must complete a factsheet following the model attached to the Regulation, obtain external certification, and publish both documents;
- Issuers must prepare an annual report on the allocation of the proceeds until they are fully used and a report on the environmental impact of the use of the proceeds at least once during the lifetime of the bonds; and
- Issuers should obtain a post-issuance verification of the report regarding the allocation of bond proceeds by an external entity.

7. ADVANTAGES OF GREEN BONDS

7.1. *SIGNALING*

An advantage associated with the use of this type of instrument is the information transmitted to the market and investors.

In general, all investors today seek to understand whether the companies in which they invest are committed to pursuing environmental and social responsibility goals. Understanding these matters is now socially and economically very relevant because the future of the planet depends on them and the "environmental emergency" is now an unavoidable reality.

For this reason, it is now standard practice for listed companies to inform investors and other *stakeholders of* their environmental and social responsibility commitments.
By issuing green bonds, companies give a clear and credible signal to the market of their environmental responsibility.

7.2. ACCESS TO THE "GREEN MONEY" MARKET

Related to environmental responsibility is also access to the "green money" market, i.e., to a growing range of investors specialized in sustainable projects.

In practice, this means that companies committed to environmental goals will have access to investors that other companies do not have.

The actual size of the "green money" market is not yet exactly quantified, but it is already clear that a growing number of investors are fully committed to, or at least seeking to allocate a significant portion of their investments to, environmentally sustainable projects and companies.

This justifies the exponential growth of green bond issues, as well as the guarantee of origin certificates for renewable energy production.

It is estimated that green or socially relevant projects have attracted investment to the tune of €30 billion, particularly in Europe, where half of that amount has been concentrated.

7.3. MORE FAVORABLE FINANCING CONDITIONS

Finally, there is a general perception that investors are willing to pay a premium when it comes to green products.

There are some studies to this effect. However, it seems too early to say with certainty that the same is true for bonds, i.e. that compared to other types of bonds, green bond issuers benefit from more favourable financial conditions.

The reasons for our uncertainty are that not enough green bonds have been issued to date.

8. THE ISSUANCE OF GREEN BONDS

8.1. GENERAL FRAMEWORK FOR THE ISSUE OF BONDS

As stated above, bonds are designated green bonds because they are issued to finance projects or entities that comply with a set of environmental responsibility rules. For everything else, green bonds follow the general bond regime outlined in the Portuguese Companies Code.

It should be noted that bonds can only be issued by companies registered for more than one year, unless, in the case of private companies, they are the result of the merger or division of companies of which at least one has been registered for more than one year or the bonds are guaranteed by a credit institution, the State or a similar public entity.

The law also requires that investors are provided with financial information on the issuer, reported to a date not exceeding three months before the issue, audited by an independent auditor registered with the Portuguese Securities Market Commission (CMVM), and prepared by the applicable accounting standards.

8.2. LIMITS ON ISSUANCE

The issuance of bonds depends on the issuer showing, after the issue, a financial autonomy ratio equal to or greater than 35%.

Compliance with the financial autonomy ratio must be confirmed by the opinion of the supervisory board, the sole supervisor, or the statutory auditor.

This limit will not apply to companies whose shares have been admitted to trading on a regulated market or companies with a rating assigned by a rating company registered with the CMVM.

This limit will not apply either to (i) bonds secured by special security interests in favour of bondholders, (ii) bonds with a unit par value of EUR 100,000 or more, or where subscription is carried out exclusively in minimum lots of EUR 100,000 or more, and (iii) bonds fully subscribed by qualified investors within the meaning of the Portuguese Securities Code, provided that the bonds issued are not subsequently placed, directly or indirectly, with non-qualified investors.

8.3. APPROVAL AND REGISTRATION OF THE ISSUE

The issue of bonds must be approved by the shareholders unless the articles of association authorize it to be approved by the board of directors, and no resolution to issue bonds may be taken until a previous issue has been subscribed to and carried out.

Shareholders may authorize a bond issue approved by them to be made in series, to be specified by them, or by the board of directors.

The issuance of bonds and the issue of each of its series, when made through a private offering, are subject to commercial registration, except if their admission to trading on a regulated market has occurred within the time limit for requesting registration.

8.4. PLACEMENT OF BONDS

Bond issues may be placed through:

- a public offer; or
- a private offer.

The offer is considered a public offer when it is preceded by the disclosure of a prospectus or another document required under EU law.

Under Regulation (EU) 2017/1129 (the "**Prospectus Regulation**"), as a rule, a prospectus is required when the securities are offered to the public or admitted to trading on a regulated market. However, the Prospectus Regulation exempts certain offers from this requirement, such as:

- Offers addressed solely to qualified investors;
- Offers addressed to fewer than 150 natural or legal persons per Member State, other than qualified investors;
- Offers of securities whose denomination per unit amounts to at least EUR 100,000; and
- Offers addressed to investors who acquire securities for a total consideration of at least EUR 100,000 per investor, for each separate offer.

In case of offers where a prospectus is required, the steps are as follows:

(1) Submission of prospectus approval request to the CMVM;

(2) Approval by the CMVM of the draft prospectus within 10 business days of submission (or 20 business days when the issuer does not have any securities admitted to trading on a regulated market and has not previously offered securities to the public); and

(3) Publication of the prospectus.

As of 2022, public offers where a prospectus is required have the right (but not the obligation) to engage a financial intermediary to provide assistance and placement services.

In private offers, a prospectus is not required and the issuer will enter into a subscription agreement with the investor(s) to regulate the terms and conditions of the subscription of the bonds.

8.5. RIGHTS OF BONDHOLDERS

8.5.1. REMUNERATION OF BONDS

The subscription of bonds gives their holders a claim on the issuer.

Bonds may confer bondholders the right to (i) a fixed interest rate, additional interest, or a redemption premium, either fixed or dependent on the profits made by the company, (ii) a variable and dependent interest and redemption plan based on profits, to be convertible into shares, whether ordinary or preferred, with or without voting rights, or into other securities, or (iii) subscribe for one or more shares, whether ordinary or preferred, with or without voting rights.

The supplementary interest or repayment premium referred to above may be established as a fixed percentage of the profit of each financial year, regardless of the amount of the latter and of any fluctuations during the life of the loan, or as from a certain minimum limit to be established in the issue.

The additional interest or redemption premium may also be established based on a variable percentage based on the volume of profits produced each year or on profits to be considered more than the minimum threshold stipulated in the issue.

There may also be an allocation of profits to shareholders and bondholders in proportion to the nominal value of existing securities.

Where the terms of the issue provide for the distribution of supplementary interest or redemption premiums in the year of the issue, the amount thereof is calculated using the criteria established in the issue.

They may also be subordinated, that is to say, they may be reimbursable after the satisfaction of the common creditors, provided that this is expressly stated in the terms of issue and the documents, registers, and entries relating thereto, or they may offer special security over certain assets or income belonging to the issuer or a third party, provided that such special security is expressly stated in the terms of issue and the documents, registers, and entries relating thereto.

8.5.2. BONDHOLDERS' MEETING

The bondholders may meet in a bondholders' meeting, convened by the common representative of the bondholders or, while he/she is not elected or while he/she refuses to convene it, by the chairman of the board of the general meeting of shareholders, or judicially when they refuse, provided that bondholders holding at least 5% of the nominal value of the bonds so request.

The bondholders' meeting deliberates on all matters assigned to it by law or that are of common interest to the bondholders, and in particular on:

- appointment, remuneration, and removal of the common representative of the bondholders;
- modification of the conditions of the bondholders' claims;
- proposals for rescue or insolvency plans;
- claims by bondholders in enforcement actions, except in cases of urgency;
- establishment of a fund for the expenditure necessary to protect the common interests and the rendering of the respective accounts;
- authorization of the common representative to bring legal proceedings.

The resolutions passed by the meeting are binding on absent or dissenting bondholders, which is particularly relevant when the meeting approves company recovery or insolvency plans that may result in a reduction in the value of the credits held by the bonds.

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