



SUSTAINABLE FINANCE FAQ

By LuxCMA Task Force – Sustainable Finance

DECEMBER 2020

TABLE OF CONTENTS

1.	GENERAL.....	4
1.1	What is sustainable finance?	4
1.2	What is Luxembourg’s role in sustainable finance?	4
1.3	Luxembourg has set ambitious goals and initiatives to create drivers for sustainable finance and the financial industry. How can capital markets support sustainable finance?	4
2.	SUSTAINABLE BOND INSTRUMENTS	6
2.1	What are the most common types of sustainable bond instruments? .	6
2.2	How does the market for sustainable instruments generally look?	6
2.3	How do “use-of-proceeds” bonds work?	7
2.4	Which standards are applicable to green bonds?	7
2.5	Which project categories can qualify as green?	7
2.6	What is the EU Taxonomy?	8
2.7	What is the EU Green Bond Standard?	9
2.8	Are there any advantages to issuing a green bond?	9
2.9	Which standards are applicable to social bonds?	10
2.10	Which standards are applicable to sustainability bonds?	10
2.11	Which entities can issue green, social and/or sustainability bonds? ..	10
2.12	How do sustainability-linked bonds work?	11
2.13	What are transition bonds?	11
3.	DISCLOSURE AND REPORTING.....	13
3.1	Which pre-issuance disclosure should issuers of green, social and sustainability bonds provide?	13
3.2	Are there any post-issuance reporting requirements for issuers of green, social and sustainability bonds?	13
3.3	What is impact reporting and are there any common standards?	14

4.	MARKETS	15
4.1	What is the Luxembourg Green Exchange?.....	15
4.2	What are climate benchmarks?.....	15
5.	USEFUL LINKS.....	17

1. GENERAL

1.1 What is sustainable finance?

In line with the European Green Deal initiative to make the EU's economy sustainable, sustainable finance aims at channelling private investment to the transition to a climate-neutral economy.

Sustainable finance activities are geared towards improving short and long-term economic efficiency, prosperity and economic competitiveness for the lasting benefit of both clients and the society at large. Sustainable finance can be described as the process of taking environmental, social and governance (ESG) considerations into account when making financial and investment decisions. Its toolbox includes instruments such as, green bonds, social bonds, sustainability bonds, impact investing, microfinance, active ownership and credits.

1.2 What is Luxembourg's role in sustainable finance?

Luxembourg, as an international financial centre, has a key role to play in meeting the policy objectives under the European Green Deal as well as the EU's international commitments on climate and sustainability objectives such as the Paris Agreement.

Luxembourg has acknowledged the importance of sustainable finance in driving a sustainable future for the planet and thanks to a strong track record and an ever developing toolbox is already heavily engaged and invested in the topic.

1.3 Luxembourg has set ambitious goals and initiatives to create drivers for sustainable finance and the financial industry. How can capital markets support sustainable finance?

Capital markets play an indispensable part in supporting and encouraging economic growth by making it easier for investors to seek out sustainable investment opportunities and in mobilising the funds needed to finance the transition to a low-carbon economy.

Capital markets and the wide range of financing techniques, tools and structures allow companies of all sizes to finance their activities and allocate capital to projects that help create jobs, provide public services, build infrastructure and drive innovation.

2. SUSTAINABLE BOND INSTRUMENTS

2.1 What are the most common types of sustainable bond instruments?

Currently, there is no specific internationally recognised standard for sustainable bond instruments. This is a generic, but not precise, categorisation. However, well-established standards exist for [green bonds](#), [social bonds](#), [sustainability bonds](#) and [sustainability-linked bonds](#), in particular the standards issued by the International Capital Market Association (ICMA) – [cf. Question 2.4](#) below.

Most of these debt instruments (i.e. green bonds, social bonds and sustainability bonds) are use-of-proceeds instruments exclusively dedicated to financing green and/or social projects.

2.2 How does the market for sustainable instruments generally look?

Green bonds, counting 6,000 bonds from some 927 issuers and worth approximately USD 600bn at the close of 2019, represent the lion's share amongst sustainable bond instruments. They are also the fastest growing instruments, with a steep year-on-year increase. According to the Climate Bond Initiative, a majority of green bonds are issued by corporates (whether financial or non-financial). Government backed entities and sovereigns follow behind. Around 80% of green bond proceeds are issued to finance three broad categories of projects: energy (renewable energy and energy efficiency), green buildings and clean transportation.

The market for social and sustainability bonds is still small compared to the market for green bonds and has been driven mainly by public issuers. However, the COVID-19 pandemic has been a turning point for the social and sustainability bond market with January-April 2020 issuances amounting to approximately USD 32bnⁱ and surpassing green bonds issuances. More corporates, mostly in the pharma sector, have joined the ranks of social bonds issuers to combat the impact of the pandemic with financings related to the healthcare services and equipment,

medical research, SME loans and projects specifically designed to prevent and/or alleviate unemployment stemming from the pandemic. Expectations are that the market will reach USD 100bn by the end of 2020ⁱⁱ.

2.3 How do “use-of-proceeds” bonds work?

“Use-of-proceeds” bonds are debt instruments in which proceeds are earmarked to ensure that they only finance and/or re-finance projects meeting certain criteria, e.g. green and/or social projects. In providing transparency and assurance to investors and enabling them to support only specific types of projects, use-of-proceeds bonds are different from common bonds usually serving “general corporate purposes”.

2.4 Which standards are applicable to green bonds?

Among the leading green bond standards worldwide are the [Green Bond Principles \(GBP\)](#) established by the ICMA in 2014. The ICMA GBP provide voluntary process guidelines for issuers of green bonds with a focus on transparency, disclosure and reporting. The proceeds of ICMA GBP-aligned green bonds shall be exclusively used to the financing or re-financing of green projects, which fall in the high-level project categories provided by the ICMA GBP. Green bonds issued in compliance with the ICMA GBP shall align with the four core components of the ICMA GBP: (i) use of proceeds, (ii) process for project evaluation and selection, (iii) management of proceeds and (iv) reporting.

Other commonly used green bond standards are, among others, the [Climate Bonds Standard](#) by the Climate Bonds Initiative and the [Green Bond Endorsed Project Catalogue](#) by the People’s Bank of China.

Furthermore, the European Commission is in the process of proposing an [EU Green Bond Standard](#) – cf. [Question 2.7](#) below.

2.5 Which project categories can qualify as green?

Green bonds support specific climate-related or environmental projects as defined by a number of international classifications, such as the ones by the Climate Bonds Initiative, the EU Taxonomy Regulation – cf. [Question 2.6](#) below – and the Green

Bond Endorsed Project Catalogue issued by the People’s Bank of China. A number of Multilateral Development Banks such as the European Investment Bank, the World Bank and the International Finance Corporation have their own criteria or definitions of eligible green projects.

Eligible green project categories generally include energy efficiency, pollution prevention, sustainable agriculture, fishery and forestry, the protection of aquatic and terrestrial ecosystems, clean transportation, clean water and sustainable water management. They also finance the cultivation of environmentally friendly technologies and the mitigation of climate change.

Historically, and still to date, most green bonds would help to finance projects in renewable energy/energy efficiency, buildings, transport and, more recently and to a lower extent, water and forestry.

2.6 What is the EU Taxonomy?

The term “EU Taxonomy” generally refers to the [Taxonomy Regulation \(EU\) 2020/852 of 18 June 2020](#), which provides for a general framework that will allow for the progressive development of an EU-wide classification system for environmentally sustainable economic activities.

Today, the Taxonomy Regulation does not yet create an exhaustive list of environmentally sustainable economic activities, but instead defines a general framework for what economic activities qualify as “environmentally sustainable”, setting out the following six environmental objectives:

- Climate change mitigation;
- Climate change adaptation;
- Sustainable use and protection of water and marine resources;
- Transition to a circular economy;
- Pollution prevention and control; and
- Protection and restoration of biodiversity and ecosystems.

Taxonomy-aligned activities shall:

- Substantially contribute to at least one of the six environmental objectives outlined above;
- Do no significant harm to the other environmental objectives;

- Meet minimum safeguards as further set out in the Taxonomy Regulation (e.g. OECD Guidelines); and
- Comply with the technical screening criteria established by the European Commission.

2.7 What is the EU Green Bond Standard?

Based on the recommendations of the Technical Expert Group (TEG) on Sustainable Finance appointed by the European Commission, the [EU Green Bond Standard \(EU GBS\)](#) is a proposed voluntary and non-legislative standard for issuers of green bonds with a use-of-proceeds approach. Projects financed by green bonds following the EU GBS shall be aligned with the EU Taxonomy. The EU GBS requires issuers to publish a Green Bond Framework before or at issuance. After issuance, the issuer is further required to provide regular allocation reporting and a final allocation and impact report. The Green Bond Framework and the final allocation report must be verified by an external expert. The TEG also recommends establishing an accreditation regime for such external experts.

Note: A targeted [public consultation](#) on the EU GBS was launched by the European Commission. Comments were due by 2 October 2020.

2.8 Are there any advantages to issuing a green bond?

From the latest [market survey](#) by the Climate Bond Initiative, the strongest and most recurrent driver for an issuer to issue under the green bond format is accessing a broader and more diversified investor base, namely to include sustainability-oriented investors.

There is also a clear branding advantage given investors' appetite and citizens' attention towards projects contributing to a more sustainable environment. By issuing under the green format, an issuer can give the market a strong signal in relation to its climate and/or environmental strategy and the investments allocated to implement it.

Subsidies, regulatory and/or fiscal incentives may also be available in certain jurisdictions. Finally, occasional pricing advantages can be associated with the green bond format but are never guaranteed up-front, depending on market supply/demand trends.

2.9 Which standards are applicable to social bonds?

Social bonds aim at promoting social objectives, e.g. social objectives defined by the Sustainable Development Goals (SDGs) of the United Nations 2030 Agenda for Sustainable Development or those mitigating the effects of the Covid-19 pandemic. In order to promote market integrity, the ICMA established the [Social Bonds Principles \(SBP\)](#). The ICMA SBP follow the four principles structure and use-of-proceeds approach already established by the ICMA GBP – [cf. Question 2.4](#) below. The main difference with the ICMA GBP is at the level of first pillar “use of proceeds”.

Social eligible categories would include, for instance, access to essential services, affordable basic infrastructure and housing, social empowerment and employment generation and are expected to be addressed to specific target populations, such as people living below the poverty line, excluded and/or marginalised populations and/or communities, people with disabilities, migrants and/or displaced persons, undereducated, aging populations and vulnerable youth. The concept of target population is an intrinsic feature within the use-of-proceeds definition.

2.10 Which standards are applicable to sustainability bonds?

Sustainability bonds aim at promoting a mix of environmental and social objectives. Sustainability bonds usually follow the [Sustainability Bond Guidelines \(SBG\)](#) established by the ICMA which refer to both ICMA Green Bond Principles (GBP) and Social Bond Principles (SBP) – [cf. Question 2.4](#).

2.11 Which entities can issue green, social and/or sustainability bonds?

All types of issuers can issue green, social or sustainability bonds provided that their projects fulfil the relevant eligibility criteria. This potentially includes issuers operating in “brown” industries. To enable a fair transition to a sustainable economy, it is essential that even issuers in non-sustainable industries participate in developing projects to make their activities (more) sustainable in the future.

2.12 How do sustainability-linked bonds work?

Sustainability-linked bonds (SLBs) are relatively new performance-based debt instruments where the issuer commits to future improvements in sustainability outcomes within a predefined timeline. The novelty of this instrument is that the issuer commits to reaching ambitious, science-based and measurable Sustainability Performance Targets (SPTs) and Key Performance Indicators (KPIs), having these reviewed by an external party and furthermore providing financial compensation to investors in the case SPTs are not achieved. The financial or structural characteristics of the bond can vary, the most typical one being a coupon step-up that may apply in case of failure to reach targets.

Unlike green, social and sustainability bonds, the proceeds of SLBs are not earmarked for specific projects but used to finance general corporate activities leading to the investors' scrutiny being placed at the level of the issuer. SLBs provide funding for the issuer's path towards a more sustainable operating model, and thereby represent a source of financing for issuers that set clear targets to become more sustainable. Sustainability targets can span across a number of categories as long as they provide material about the issuer's business models and are ambitious, scientifically-backed and externally verified.

SLBs have received a lot of attention after the ICMA established its [Sustainability-Linked Bond Principles](#) in June 2020.

2.13 What are transition bonds?

Transition bonds are a new asset class targeted at issuers in industries with high greenhouse gas (GHG) emissions – the so-called "brown industries" (such as mining, cement, chemicals, shipping) that cannot be expected to become green to allow them to raise capital with the goal of becoming less polluting. Transition bonds aim to help the issuer shift to greener business activities. Transition bonds are still in the process of being defined but are generally expected to take into account both the issuers' transition strategy and the nature of the activities they finance.

Issuers of transition bonds are expected to define and disclose ambitious, long-term and science-based transition strategies with clear and measurable CO₂ reduction targets and KPIs which comply with the Paris Agreement.

As of September 2020, there is no recognised standard in the market defining a framework for transition bonds. The ICMA is expected to publish a set of Principles by the end of 2020, whereas the Climate Bonds Initiative (CBI) has released, jointly with Credit Suisse, a [White Paper “Financing credible transitions”](#) proposing a framework for identifying credible transitions aligned with the Paris Agreement.

3. DISCLOSURE AND REPORTING

3.1 Which pre-issuance disclosure should issuers of green, social and sustainability bonds provide?

According to the ICMA GBP, SBP and SBG issuers of such bonds should provide detailed information about their strategy, the types of green/social projects funded by the proceeds, the management and use of the bond proceeds and the methods of reporting in a Framework. Generally, it is recommended to have the Framework verified and/or certified by a third party. Some standards, including the Climate Bonds Standard and the draft EU Green Bond Standard even require a certification by an accredited external expert.

3.2 Are there any post-issuance reporting requirements for issuers of green, social and sustainability bonds?

Issuers of green, social and sustainability bonds should make and keep readily available up-to-date information on the use of proceeds to be renewed annually until full allocation, and on a timely basis in case of material developments. The annual report should include a list of the projects to which Green Bond proceeds have been allocated, a brief description of the projects and the amounts allocated, and their expected impact. Where confidentiality agreements, competitive considerations, or a large number of underlying projects limit the amount of detail that can be made available, the GBP recommend that information is presented in generic terms or on an aggregated portfolio basis (e.g. percentage allocated to certain project categories). In addition to regular allocation reporting, it is recommended that issuers report regularly on the impact of their projects by means of suitable performance metrics.

The draft EU Green Bond Standard requires issuers to provide annual allocation reports and at least one impact report, either at maturity or upon full allocation of the bond proceeds. The final allocation report shall be verified by an accredited external expert.

3.3 What is impact reporting and are there any common standards?

Impact reporting is one of the recommended components of the ICMA GBP, SBP, SBG and a mandatory pillar of the draft EU GBS. The GBP recommend the use of qualitative performance indicators and, where feasible, quantitative performance measures (e.g. energy capacity, electricity generation, greenhouse gas emissions reduced/avoided, number of people provided with access to clean power, decrease in water use, reduction in the number of cars required, etc.) and disclosure of the key underlying methodology and/or assumptions used in the quantitative determination. Issuers with the ability to monitor achieved impacts are encouraged to include those in their regular reporting. Different voluntary guidelines have been published in an attempt to standardise impact reporting including for example the [ICMA Harmonized Framework for Impact Reporting](#) or the [Position paper on Green Bonds Impact Reporting](#) prepared by Nordic public sector issuers. Those documents aim at a harmonised framework for impact reporting for energy efficiency, renewable energy, water and wastewater projects, and waste management projects (see Guidance document). The guidelines include templates for the format of impact reporting at project and at portfolio level that issuers can adapt to their own circumstances.

The GBP encourage further initiatives, to help establish additional references for impact reporting that others can adopt and/or adapt to their needs. Guidelines for additional sectors are under development and suggest specific impact metrics and units for each category of projects (e.g. Annual GHG emissions reduced/avoided, in tons of CO₂-equivalent for projects falling under the renewable energy category). They also provide some recommendations for issuers on the structure of their impact reporting. Some key recommendations include: reporting based on annual impact, reporting bond-by-bond or on bond-program basis, reporting at different levels of granularity (by project, by category of project, by country, or at a global aggregated level), reporting based on the share financed.

4. MARKETS

4.1 What is the Luxembourg Green Exchange?

The [Luxembourg Stock Exchange](#) established the [Luxembourg Green Exchange](#) (LGX) in 2016 as a contribution to the Paris Agreement and the United Nations Sustainable Development Goals. LGX is the world's leading platform entirely dedicated to sustainable securities entirely built upon criteria of enhanced transparency and reporting aligned to the market's highest standards. It started with green bonds in 2016 and the scope has since been expanded to also include social and sustainability bonds as well as SRI funds.

LGX's overarching objective is to promote the sustainable finance agenda by facilitating sustainable investment and help reorient capital flows towards green and sustainable development. LGX has a truly global footprint and as of 31 August 2020 displays around 800 sustainable securities totalling EUR 300 bn, from 135 issuers in more than 30 countries.

In 2020, LuxSE established the [LGX Academy](#) to strengthen sustainable finance knowledge in the market. It also launched the [LGX DataHub](#), which provides investors and asset managers with structured and granular data on sustainable securities, allowing them to build and/or assess responsible investment portfolios, to report on investments and to compare across different securities.

4.2 What are climate benchmarks?

The term climate benchmarks refers to two categories of benchmarks created by the [Regulation \(EU\) 2019/2089 of the European Parliament and Council of 27 November 2019](#).

The first category encompasses the so-called "Climate Transition Benchmark" where the underlying assets are selected, weighted or excluded in such a manner that the resulting benchmark portfolio is on a decarbonisation trajectory.

The "EU Paris-aligned Benchmark" constitutes the second category and is composed of underlying assets selected in such a manner that the resulting benchmark portfolio's greenhouse gas emissions are aligned with the long-term warming target of the Paris Agreement.

Specific requirements will be set by Delegated Acts for each category and only benchmark administrators that comply with such requirements are eligible to use the labels when marketing in the European Union.

5. USEFUL LINKS

- 🔗 Climate Bonds Initiative, Climate Bonds Taxonomy
<https://www.climatebonds.net/standard/taxonomy>
- 🔗 Climate Bonds Initiative, Chinese Green Bond Endorsed Project Catalogue
<https://www.climatebonds.net/china/catalogue-2020>
- 🔗 Climate Bonds Initiative, *Transition Finance*
<https://www.climatebonds.net/resources/reports/financing-credible-transitions-white-paper>,
<https://www.climatebonds.net/resources/reports/financing-credible-transitions-summary-note>
- 🔗 Climate Bonds Initiative, Green Bond Treasurer Survey 2020
<https://www.climatebonds.net/resources/reports/green-bond-treasurer-survey-2020>
- 🔗 ICMA, Green Bond Principles
<https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Green-Bonds-Principles-June-2018-270520.pdf>
- 🔗 EIB, *MDBs Climate Finance Methodology*
<https://www.eib.org/attachments/press/1257-joint-report-on-mdbs-climate-finance-2019.pdf>
- 🔗 European Commission, *EU Taxonomy*
https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en
- 🔗 European Commission, *EU Green Bond Standard*
https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf
- 🔗 European Commission, *Benchmarks Regulation*
<https://eur-lex.europa.eu/legal->

[content/EN/TXT/?uri=uriserv:OJ.L_.2016.171.01.0001.01.ENG&toc=OJ:L:2016:171:TOC](https://eur-lex.europa.eu/content/EN/TXT/?uri=uriserv:OJ.L_.2016.171.01.0001.01.ENG&toc=OJ:L:2016:171:TOC)

- 🔗 ICMA, Social Bond Principles
<https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Social-Bond-PrinciplesJune-2020-090620.pdf>
- 🔗 ICMA, Sustainability Bond Guidelines
<https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Sustainability-Bonds-Guidelines-June-2018-270520.pdf>
- 🔗 ICMA, Sustainability-Linked Bond Principles
<https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Sustainability-Linked-Bond-PrinciplesJune-2020-100620.pdf>
- 🔗 ICMA, Impact Reporting
<https://www.icmagroup.org/green-social-and-sustainability-bonds/impact-reporting/>
- 🔗 Luxembourg Stock Exchange, Official Website
<https://www.bourse.lu>
- 🔗 Luxembourg Green Exchange (LGX)
<https://www.bourse.lu/lgx>
- 🔗 LGX Academy
<https://lgxhub.bourse.lu/en/academy>
- 🔗 LGX DataHub
<https://lgxhub.bourse.lu/en/datahub>
- 🔗 FAQ LGX bonds
<https://www.bourse.lu/faq-on-lgx>
- 🔗 Natixis, EU Taxonomy “Skydiving” kit
<https://gsh.cib.natixis.com/eu-taxonomy>

-
- i <https://www.spglobal.com/ratings/en/research/articles/200622-a-pandemic-driven-surge-in-social-bond-issuance-shows-the-sustainable-debt-market-is-evolving-11539807#:~:text=Social%20Bond%20Issuance%20Has%20Reached%20Record%20Levels,-ICMA%20defines%20social&text=Of%20the%20%24400%20billion%20in,%25%20>
 - ii <https://www.livemint.com/news/india/covid-19-spurs-global-social-bond-issuance-to-all-time-highs-says-moody-11588672257232.html>

Legal disclaimer: This document as well as the information contained herein (collectively the “**Publication**”) was prepared by the Luxembourg Capital Markets Association (LuxCMA).

This Publication has been prepared solely for information purposes. Although the LuxCMA has made reasonable efforts to ensure that the Publication is accurate and not misleading, the LuxCMA does not accept any responsibility or liability of any kind whether for the accuracy, reliability or completeness of the Publication or for any action refrained or taken or results obtained from the use of this Publication. This Publication does not constitute and is not construed as any advice, recommendation, undertaking or commitment from or on behalf of the LuxCMA. This Publication shall not be substitute for the readers’ own researches, investigations, verifications or consultation for professional or legal advice.



About the LuxCMA – Luxembourg Capital Markets Association

Created on 1 March 2019, the LuxCMA is a not-for-profit association (a.s.b.l.), registered at the RCSL (F12205), whose registered office is 6 rue Jean Monnet, L-2180 Luxembourg. The LuxCMA today represents memberships detailed on LuxCMA's website (www.luxcma.com), which is composed by banks, law firms and services providers, amongst others.

Task Force – Sustainable Finance

The main purpose of the Sustainable Finance Task Force is to identify and promote sustainable finance from a capital markets perspective, supporting the development and growth of sustainable finance in Luxembourg and abroad.

For more information, please contact info@luxcma.lu

LuxCMA – Luxembourg Capital Markets Association

6 rue Jean Monnet | L-2180 Luxembourg

info@luxcma.lu | www.luxcma.com | Follow us on LinkedIn and Youtube